R3, the Association of Business Recovery Professionals | **www.r3.org.uk/recovery** **Summer 2011**

RECOVERY

Public sector cuts

Major cuts in public sector spending will challenge many companies

Death by a thousand cuts
What the public spending cuts mean for charities

TPR's approach to the Nortel/Lehman judgment
The Pensions Regulator appreciates the need to have an effective rescue culture

Interview with Adrian Bailey, MP
The work of the BIS Select Committee

Re Capitol Films
Administrators must carefully consider which group of creditors' interests they are serving

Pre-packs: a legitimate means to phoenix an insolvent company
Comparison between UK, US and other jurisdictions

Plus:
Legal update; Holding Rescue to Ransom campaign

R3's Smaller Practices Group
New, regular page

Editorial

There are some first class articles for you in this edition of *Recovery*, not least Mark Andrew's valedictory Opinion column on page 4 and Frances Coulson's inaugural presidential address on page 5.

For a different perspective on the pre-pack debate we visit Australia on pages 32–33 to find the welcome conclusion that we should invite legislative reform to embrace pre-packs!

The Pensions Regulator, at pages 24–25, appreciates the rescue culture and will act reasonably in relation to financial support directions and contribution notices in insolvencies. Unfortunately that perspective completely misses the point that it must be wrong in principle and anathema to the rescue culture for the Pensions Regulator to impose a contribution notice as an administration expense on the creditors of an insolvent company.

Our cover theme is public sector cuts and we focus on care homes, charities and small businesses. My own recent experience of one of the slightly obscure legal entities referred to in Ian Oakley-Smith's charities article on pages 18–19 is that public authorities can be constructive in their approach to distressed not-for-profit providers. In that case, an insolvent £10–12 million turnover care sector charity with a non-executive board and part-time CEO and CFO needed (among other things) a little more stakeholder management expertise to persuade its public sector customers to enhance their support, despite financial constraints. This facilitated a distressed M&A disposal. The driver for the solution here was that everyone, including the public sector customers, wanted to avoid disruption to the end users – the vulnerable people being cared for – for a variety of practical, financial and compassionate reasons. As we are used to seeing in the private sector, pragmatism and commerciality can overcome financial difficulties. Public sector cuts clearly offer opportunities to restructuring and insolvency professionals.

And finally, I know you would not want me to forgo the opportunity of drawing to your attention Insol Europe's conference in Venice on 22–25 September. As I said in my interview in last quarter's *Recovery*, it offers real opportunities to UK restructuring and insolvency professionals to network with like-minded foreigners who may need help here or be able to offer it 'over there'.

Chris Laughton is editor of *Recovery* and a partner at Mercer & Hole

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“The BIS Select Committee is also considering looking into debt management companies for one or two sessions, and I imagine R3 would have a lot to say on that topic.”

Adrian Bailey is Labour and Co-operative MP for West Bromwich West

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RECOVERY

Editor
Chris Laughton, Mercer & Hole

Publishing manager Sarah Houghton
Tel: 01491 828939, sarah.houghton@groupgti.com

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

Art editor Thomas Gray

Administration Eva Faberova

Printed by Stephens & George

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www.r3.org.uk/recovery

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

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The winds of change

Mark Andrews offers a view from the bridge of proposed legislative and regulatory changes that could fetter the functioning of an administration, reducing the likelihood of corporate rescue and potential returns for creditors.

Insolvency practitioners operate in a climate of constant change. Judges make frequent adjustments to the way we do things and the last decade has seen intense legislative change, including the wholesale re-working of the Insolvency Rules.

Straws in the wind

The indication from The Insolvency Service has, for some time, been that corporate insolvency reform is a low priority for this government and that there is no early slot available in the legislative timetable. Given the experience since the turn of the millennium, that suggestion is counter-intuitive. All the evidence points the other way. The Service has consulted recently upon a potential new procedure – the short-term, free-standing, court-based stay on creditor action. The consultation has just ended on the regulation of the profession (the government's response to last year's study of the profession by the OFT). The government has just announced its intention to impose restrictions on certain types of pre-packaged transactions. From the other direction, R3 is campaigning for an extension of the stay in administration to preclude contract termination by suppliers. Finally, it is a fact universally acknowledged that something must be done urgently to reverse the judicial extension of the liabilities, which must be treated (and accorded priority) as administration expenses.

The changes currently in the air fall into two categories – those perceived by the profession as conducive to the effective conduct of corporate insolvency business and those seen as an unwelcome obstruction to that noble aim.

Pre-packs

Heading the queue of unwelcome measures to be thrust upon us is the newly declared determination to legislate by 2013 to restrict the power of administrators to complete pre-packaged business sales to connected parties. The government is minded to impose a requirement that three days' prior notice be given to all creditors before a pre-pack sale is consummated. That proposal wilfully ignores the conventional wisdom that it is the very absence of notice to any one at all that is fundamental to the benefits acknowledged to be derived from pre-packing. There is an unanswered question whether 'connected parties' will be given the conventional corporate meaning (which will be bad enough) or whether, in a secured creditor-driven transaction, a purchaser controlled by the secured creditor will also be treated as 'connected'.

> "The central proposal for an independent complaints authority with a remit to include after-the-event complaints about fees will inevitably increase the difficulty and expense of transacting insolvency business."

Regulation of the profession

Coming a close second among the unwelcome measures is the reform package foreshadowed by the newly closed consultation on regulation of the profession. While it leaves the fundamental notion of self-regulation intact, the central proposal for an independent complaints authority with a remit to include after-the-event complaints about fees will inevitably increase the difficulty and expense of transacting insolvency business. It is an ill-favoured initiative, driven by an OFT finding of 'market harm' focusing only upon fees, which has no proper place in a developed statutory regime providing a full set of checks and balances for the quantification of fees. The real issue, namely how creditors can be prevailed upon to participate actively in the processes already provided by law, is not addressed in any substantial or coherent way by the consultation.

Business rescue

In neutral colours comes the proposed new procedure whereby a free-standing moratorium can be put in place at the request of the company, with its management remaining in control for a limited time to enable a restructuring solution to be agreed and implemented. The idea of a short, automatic moratorium was widely welcomed when first consulted upon. However, our British obsession with the primacy of creditor rights has produced a less attractive proposal hedged around with safeguards. The procedure, if it makes it through the legislative process, will be court-dominated, contentious and uncomfortably heavy on professional fees (with the consequence that it will only be invoked by large companies).

Paradoxically, given all the energy being channelled into reform options, very little traction is yet being gained for the reforms advocated by the profession itself with a view to making administration effective as a business rescue tool. R3 is campaigning for an extension of the statutory stay to prevent contract termination by ransom suppliers (an initiative that should swiftly be extended to customer contracts). This is the feature we most need to borrow from Chapter 11, to which most credit must be given for that regime's reputation for efficient business preservation. If businesses are to survive the insolvency process, the moratorium must hold contracts in place with both suppliers and customers provided that, post-filing, the company complies with its ongoing contractual commitments. It is to be hoped that, sooner or later, good sense will prevail and this important initiative will be adopted by the Service.

The other essential reform demanded by the profession is the reversal of the line of authority whereby taxes, rates, rent and, now, obligations imposed by the Pension Regulator have gained priority as administration expenses. Unless and until that trend is reversed by legislation, our administration procedure cannot function properly as a rehabilitation process for trading businesses.

Ironically, the government could best achieve its objective of diminishing the much-criticised ubiquity of pre-packaged sales, not by setting shackles upon that valuable option, but by adopting and endorsing the reforms advocated by the profession to make administration more value-protective and, therefore, pre-packs less necessary. We shall see!

Mark Andrews is a consultant at SNR Denton UK LLP.

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

President's column

Frances Coulson outlines some of the hurdles of her presidency, and resolves to stay the course and speak up on behalf of the members.

Some of you may be aware of my love of horses and it does feel as though I start my presidency of R3 by joining a horse race that is already well underway. Of course, I have been following insolvency events from the rails over a number of years and I take over the reins from Steven Law, who has done a fantastic job over the last 12 months. So what hurdles and ditches lie ahead of me? Will the going be good? Perhaps being an R3 president is like being a jockey – trying to impose an element of steering and restraint while at a full gallop and clearing some hurdles along the way. However, I still think we can influence the odds in our favour.

Two consultations

I suspect out of all the fences to clear, The Insolvency Service's consultation on regulation is perhaps the hardest. The Service will be making decisions about the profession that will impact on us for years. My predecessor has already worked hard on this, rounding up several different points of view and using all of R3's policy capabilities to formulate a robust response that challenges some of the assumptions made by the consultation. We anticipate that some change is on the cards, but it must not be change for change's sake. The underlying principle should be that creditors engage during the insolvency process, not just complain about it afterwards.

> "The underlying principle should be that creditors engage during the insolvency process, not just complain about it afterwards."

The establishment of a fee review body, while intending to bring greater transparency, risks reducing returns for the body of creditors as a whole and would render the existing statutory fee-setting processes futile, and actively discourage creditor participation. R3 is endeavouring to influence the eventual outcome to one that works for the profession and promotes the continuance of self-regulation. We believe it is vital that those with knowledge of the profession are involved in its regulation.

Another race out of the stalls already is the Consumer Credit and Personal Insolvency Review, to which R3 has submitted a response on behalf of the profession. This review considers a huge range of potential changes and The Insolvency Service is due to respond in mid-May, with a potential consultation on the insolvency elements of its response to follow. Some of our proposals include: creditor moratorium lasting four weeks; encouraging repayment where possible; raising the minimum amount of debt a creditor can petition for bankruptcy for and better regulation in the DMP market.

Expenses in administration

The current uncertainty over administration expenses is one of the most significant issues facing the profession. We will continue to highlight the creeping tendency of adding further 'expenses in administration' that threatens the rescue culture and lending following the *Nortel* and *Lehman* judgments in December: as Mr Justice Briggs conceded then, there is a clash between insolvency and pension law. In his own words, 'it may be that parliament might wish to consider a suitable amendment [to the law]'. After calling for evidence from the profession, it is now time for The Insolvency Service to take appropriate action.

There is an undeniable cost in the widening of administration expenses to: the ability of IPs to rescue businesses; the lending climate; and returns for the body of creditors as a whole, including unsecured creditors. R3 will be forcing a solution on which items of expenditure should be payable as expenses and which should not. We cannot underestimate just how urgently clarity is required.

Jackson proposals, personal insolvency and R3's campaign

I am also keen to pursue R3's public affairs work on the Jackson recommendations, which, as a litigator, is an issue close to my heart. R3 is calling for insolvency litigation to be exempt from the Jackson proposals to ensure that the existing arrangements for the recovery of success fees and ATE premiums are retained in insolvency cases. What is true for personal injury no win, no fee claims does not necessarily work in insolvency and, in fact, could have completely the reverse public policy effect. In my view, it would enable the wrong-doers to benefit to the detriment of creditors.

All insolvency practitioners see cases where directors have literally taken all the money with them, either through fraud or gross mismanagement, leaving the creditors high and dry. I am keen to ensure that directors who do not fulfil their responsibilities are brought to task and ensure that the deterrent effect is strong and respect for the courts and the law is maintained.

I strongly believe that our personal insolvency regime should be fit for purpose, especially given the explosion in numbers over the last decade. The current system can appear complex with a number of debt solutions to suit varying circumstances – choosing the right option can be difficult in a pressurised situation. A breathing space from creditor action for 28 days, in which time individuals are required to seek advice from a qualified, independent adviser who do not have an interest in pushing a particular debt solution would go some way to address 'mis-selling'. Individuals using a search engine to find a debt adviser have no guarantee that the organisation they find is qualified and regulated and it may be an 'ambulance chaser'. I believe that the debt advice sector should be regulated to the same standard as IPs to deter bad practice in the industry.

Finally, I am keen to continue Steven Law's work on R3's first ever campaign, Holding Rescue to Ransom. Every year over 2,000 potentially viable businesses are forced to close due to the opportunistic actions of suppliers as a business goes into insolvency. I will now seek to bring this issue to the attention of ministers.

During my term, R3 will continue to communicate the experience, skill and education needed to be an IP to MPs, journalists and the public at large. Emphasising the jobs and businesses saved by skilled practitioner work, R3 will continue to promote an accurate and positive image of the profession. Let's hope we can all stay the course that lies ahead.

Frances Coulson is head of Insolvency & Business Recovery and managing partner at Moon Beever Solicitors.

News update

Retailers at risk of insolvency rises

There has been an alarming rise in the number of retail firms at high risk of insolvency, according to a report released by RSM Tenon.

With the exception of April last year, the report showed that the number of retailers at serious risk had fallen month on month. However, in both February and March of this year, the report revealed an increase of four per cent of retailers in serious difficulty. This announcement further compounds the gloom for the sector, following on from an announcement by the British Retail Consortium in which it announced a 1.9 per cent drop in sales in March compared with the same period last year.

Unsecured creditors could lose out

R3 has warned that plans to introduce a three-day notice period for pre-pack sales to connected parties could mean unsecured creditors lose out, as more businesses are liquidated instead.

An unintended consequence of the changes could be that the value of a business depreciates and that delay could jeopardise corporate rescue. The business may also be at risk of losing key staff and customers.

Steven Law, former president of R3, said, 'When faced with this option, directors may simply decide that liquidation is a better route, and this would reduce returns to both secured and unsecured creditors and result in considerably fewer jobs being saved than under a pre-pack.'

The announcement coincided with the annual government report on IP compliance with (SIP 16) reporting on pre-packs. In 2010 only 1.7 per cent of cases were referred to the recognised professional body for disciplinary procedures and general compliance increased to 75 per cent.

R3 highlighted that the government's monitoring report also indicates that there is 'no reliable evidence to suggest that misconduct by directors is any more prevalent in pre-pack cases than in conventional administrations'. Mr Law added, 'It would be better for the business rescue culture if the government looked at ensuring suppliers are bound in the event of a formal insolvency or were prevented from making ransom payments. We have put these ideas to government as part of our Holding Rescue to Ransom campaign. If the proposals are to be taken forward we advocate that our ideas are also brought into statute to help businesses stay held together during the three day period.'

Insolvency practitioners estimate the change in legislation R3 is calling for will reduce the number of pre-packs by more than a fifth.

North West reeling under public sector cuts

Begbies Traynor's Red Flag report has showed that the number of companies within the North West with critical problems has leaped 15.6 per cent year on year. The construction industry in Liverpool, which has relied on public sector projects during the recession has taken a major blow with construction businesses accounting for almost a third of companies facing critical problems. However, the local travel operators got good trade transporting protesters to London in April to take part in the march against public sector cuts.


Lee Manning

New R3 vice-president

Lee Manning, a partner at Deloitte, is now R3 vice-president and will become president in April 2012.

Insolvencies rise for squeezed middle

Recent figures from Experian have shown that, of the 157,741 personal insolvencies across England, Wales, Scotland and Northern Ireland in 2010, the middle classes accounted for the largest increase in new cases, although the number of personal insolvencies in 2010 fell by one per cent on the previous year.

Experian found that the biggest increase in new cases occurred among mostly married, middle-class and skilled working-class people of middle age who live with their children – a demographic that makes up 13.2 per cent of UK adults. Young, single professionals and middle-income earners had the second highest concentration of insolvencies last year.

Ring-fencing for Britain's major banks

Sir John Vickers' interim report of the Independent Commission on Banking (ICB) has proposed that retail banking in Britain's major banks should be ring-fenced. The report also recommends that banks should provide more consumer choice and make it easier and simpler for them to switch accounts.

The ICB suggests that the ring-fenced retail banks should be forced to hold more capital: ten per cent rather than the seven per cent demanded by international regulators for the entire bank. But it also sets out the case that ten per cent should become the 'international standard' for systemically important banks.

The ICB recommendations come in advance of its final report, which will be published in September. In the meantime the Commission will consider views and responses to the proposals.

HMRC rejects more TTP arrangements

Business insolvencies in the UK have increased in the Q1 2011 as HMRC tightens its approach to its Time To Pay rules.

The statistics for the Business Payment Support Service recently released by HMRC indicate that there is an ever increasing level of applications being refused. During 2009, approximately 240,000 applications were received of which only 2.7 per cent were declined. In 2010 the figures were 139,000 and 6.0 per cent respectively, while the figures for the three months to March 2011 were 3,000 and 10.1 per cent.

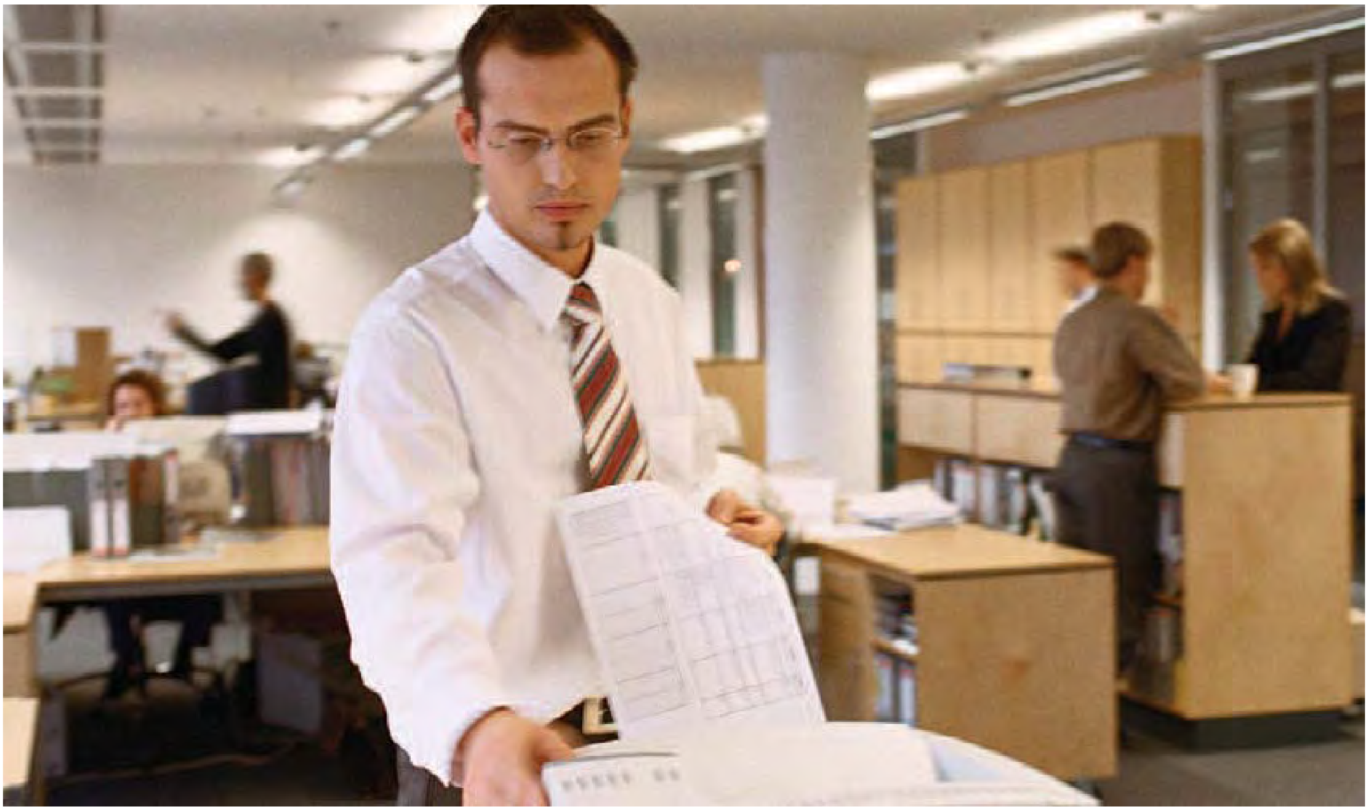
The Pension Protection Levy – A New Framework: Policy Statement

On 16 May, the Pension Protection Fund published its Policy Statement, following its October 2010 consultation document. The Policy Statement sets out the final design of the pension protection levy that will be effective from 2012/13.

The document confirms the board's intention to implement changes that will support greater stability and predictability in levies. New rules include a pledge to fix guidance for three years and the introduction of averaging for funding levels to prevent excessive volatility.

A draft Determination, including the levy parameters that will apply from 2012/13, will be published for consultation in autumn 2011 – **www.pensionprotectionfund.org.uk**

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



Legal update: *OTG Limited* v. *Barke & Others*: TUPE or not TUPE?

Tom Withyman discusses the recent *OTG* v. *Barke* case and its effects on the rights of staff employed by companies that are sold by administrators.

In the recent judgment of *OTG Limited* v. *Barke & Others* (UKEAT 0320/09/RN) *(OTG)*, the Employment Appeal Tribunal (EAT) considered whether the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) applied to the sale of businesses in administration proceedings under schedule B1 to the Insolvency Act 1986 (IA 1986). In *OTG* the EAT declined to follow its earlier decision in *Oakland* v. *Wellswood (Yorkshire) Ltd* (UKEAT/0395/08) (*Oakland*), concluding that administrations cannot be 'bankruptcy or analogous insolvency proceedings instituted with a view to the liquidation of the transferor's assets' within the meaning of regulation 8(7) of TUPE. Therefore, in a sale of a business by an administrator, regulation 8(6) applies and the employees of a company in administration will automatically transfer to the buyer under regulation 4 of TUPE. This decision is to be welcomed as removing much of the uncertainty created by *Oakland* on this issue.

Background

TUPE was introduced to give effect to Council Directive 2001/23/EC, the Acquired Rights Directive (the Directive), to provide protection for employees' rights in the event of an involuntary change of employer as the result of a transfer of the undertaking in which they are employed.

> "TUPE established new provisions that are designed to encourage a rescue culture by making failing businesses more attractive to potential buyers."

In addition, TUPE established new provisions that are designed to encourage a rescue culture by making failing businesses more attractive to potential buyers.

Regulations 8(6) and 8(7) of TUPE are based on article 5 of the Directive, and apply where a business is subject to either 'terminal' or 'non-terminal' insolvency proceedings under the supervision of an insolvency practitioner. Regulation 8(6) of TUPE gives effect to article 5.2 of the Directive and applies to non-terminal proceedings, where the business is the subject of 'relevant insolvency proceedings' that have been instigated 'not with a view to the liquidation of the assets of the transferor'. In such circumstances, the employees will transfer to the buyer under regulation 4 of TUPE and they also receive the protection from unfair dismissal afforded under regulation 7.

Terminal proceedings (under article 5.1 of the Directive) are regarded under regulation 8(7) of TUPE as 'bankruptcy proceedings or any analogous insolvency proceedings that have been instituted with a view to the liquidation of the assets of the transferor'. In this situation, employees do not automatically transfer to the buyer of the company, as assets and dismissals resulting from the transfer will not automatically be deemed unfair.

The distinction made in the Directive, and transposed into TUPE, between liquidation proceedings and other kinds of insolvency proceedings originated from the European Court of Justice (ECJ) case *Abels v. Bedrijfsvereniging voor de Metallindustrie en de Electrotechnische Industrie* [1985] ECR 469 (*Abels*). The reasoning in *Abels* made a clear distinction between two kinds of insolvency proceedings: the approximate Dutch equivalent of liquidation proceedings and administration proceedings. The ECJ regarded the object of liquidation as to dispose of all the assets of the business, and concluded that employees did not benefit from the protections of the Directive and thus did not automatically transfer to the buyer of the company. In contrast, the ECJ considered that Dutch administration proceedings have an entirely different purpose, which is to continue the business, as far as possible, in the same hands. Such proceedings would provide employees with the protection of the Directive and thus the employees would automatically transfer to the buyer.

Prior to the EAT decision in *Oakland*, this same distinction was adopted in practice in the UK and it was assumed that administrations fell within the definition of 'relevant insolvency proceedings' under regulation 8(6) and liquidations came under the phrase 'bankruptcy proceedings or any analogous insolvency proceedings' under regulation 8(7). In *Oakland*, however, the EAT held that where administrators are not able to trade a business with a view to its sale as a going concern it could be regarded that the administrator had been appointed with the intention to liquidate the company.

The primary objective of the appeal in *OTG* was to ascertain whether administration proceedings under schedule B1 of the IA 1986 can ever constitute 'bankruptcy or analogous proceedings ... instituted with a view to the liquidation of the assets of the transferor' in the light of the fluid three-tier purpose of administration.

The government guidance

In July 2007, the Department for Trade and Industry (DTI) published guidance that suggested that administrations did not fall within regulation 8(7) (see The Transfer of Undertakings (Protection of Employment) Regulations 2006 – Redundancy and Insolvency Payments (URN 06/1368), **www.bis.gov.uk/files/file30031.pdf**). Here the DTI considered that the correct approach was to 'look at the main or sole purpose of the procedure, rather than its outcome in a specific instance'. The DTI went on to state that the main purpose of bankruptcy proceedings is to 'realise the free assets of an insolvent debtor and share the proceeds after deduction of costs and expenses among all the debtor's creditors. This is not the main purpose of administration'. As a result, the DTI concluded that regulation 8(7) of TUPE will not apply to administrations.

The Department for Business Innovation and Skills (BIS), formerly the DTI, issued additional guidance in June 2009 on regulation 8(7) (see Employment Rights on the Transfer of an Undertaking – a guide to the 2006 TUPE Regulations for employees, employers and representatives, **www.berr.gov.uk/files/file20761.pdf**). In relation to regulation 8(7), it stated that 'relevant insolvency proceedings' means 'any collective insolvency proceedings in which the whole or part of the business or undertaking is transferred to another entity as a going concern' and that the definition covers 'an insolvency proceeding in which all creditors of the debtor may participate, and in relation to which the insolvency office-holder owes a duty to all creditors'. In other words, the BIS guidance suggested the position was far less clear than in the earlier DTI publication.

The guidance issued by the DTI and by BIS is, of course, not binding on companies and only provides the Secretary of State's opinion. The guidance was widely criticised, particularly in relation to situations where an administrator takes the view that the company in question cannot be rescued but its business can, and an administration later turns into a liquidation – without fresh court proceedings being initiated. In situations such as this, where proceedings are initially opened 'not with a view to the liquidation of the assets of the transferor' but are subsequently continued with a view to liquidation, it was unclear whether regulation 8(6) or 8(7) will apply.

The decision in *Oakland*

The EAT held in *Oakland* in December 2008 that whether administration (or any other type of insolvency proceedings) fell within regulations 8(6) or regulation 8(7) was a matter of fact in each case.

Oakland concerned a transfer as part of a pre-pack administration, where the claimant had subsequently been made redundant. The EAT followed a 'fact-based approach' and concluded that the company had been subject to 'bankruptcy proceedings or any analogous insolvency proceedings ... instituted with a view to the liquidation of the assets'. As a result, regulation 8(7) of TUPE applied and the employees did not automatically transfer to the buyer under the pre-pack sale. The EAT considered that where administrators are not able to rescue the company as a going concern, their appointment should instead be regarded as having been instituted with a view to liquidation of the company's assets, pursuant to paragraph 3(1)(b) IA 1986.

Oakland was later appealed, although on a different point, and the Court of Appeal did not rule on whether a company in administration fell within regulation 8(7). However, in providing his judgment Lord Justice Moses made it clear that there were strong grounds to consider that the EAT's approach had been wrong (see pp 905 G–H and 907 B–C) and that an appeal on the TUPE point was 'strongly arguable'.

> "Contrary to its earlier decision in *Oakland*, the EAT ruled that, in a business sale by a company in administration, employees will automatically transfer to the buyer under regulation 8(6) of TUPE."

The *Oakland* decision attracted a significant amount of criticism among commentators, not least for going against the government guidance. In addition, it created commercial uncertainty for insolvency practitioners and potential purchasers as to whether employee liabilities would transfer to the buyer upon the transfer of a business in administration (under regulation 8(6)), or whether these would remain with the insolvent seller (under regulation 8(7)). Instead, it was a question of fact to be decided in each case.

The *OTG* judgment

Contrary to its earlier decision in *Oakland*, the EAT ruled that, in a business sale by a company in administration, employees will automatically transfer to the buyer under regulation 8(6) of TUPE. In *OTG* the EAT drew a clear distinction between liquidation and administration, holding that the latter can never fall within regulation 8(7) of TUPE, even in the case of a pre-pack administration. Therefore, in the sale of an undertaking via administration, the relevant employees will transfer to the buyer under regulation 4 of TUPE and be protected from any transfer-related dismissal under regulation 7.

In *OTG*, the EAT favoured the 'absolute approach' to the 'fact-based approach' adopted in *Oakland*. The absolute approach takes the view, that due to their very nature, administration proceedings can never constitute insolvency proceedings under regulation »

8(7) and therefore TUPE would always apply. The EAT gave five reasons for favouring the absolute approach over the fact-based approach:

- The EAT considered that the Directive's legislator intended the distinction in article 5 between different types of insolvency proceedings to depend on the legal character of those proceedings. The EAT held that legal certainty would be provided by focusing on the object of the proceedings as opposed to the object of the individuals operating it;
- The EAT regarded article 5 of the Directive as being explicitly concerned with the object of the proceedings when they are instituted. The EAT understood from paragraph 3 of schedule B1 IA 1986 that when an administrator's appointment takes effect he or she is obliged to consider whether the primary objective of rescuing the company as a going concern is overridden by the other considerations set out at paragraph 3(3). The EAT recognised that in some cases it may be immediately clear that the primary objective is overridden, but stated that the question must still be asked. In this respect, it cannot be said that at the moment administration proceedings are instituted the administrator's object is to liquidate the company's assets;
- The EAT acknowledged that there is no requirement for an administrator to state at the beginning of an administration which of the objectives under paragraph 3 of Schedule B1 IA 1986 he or she is pursuing. The argument follows that if the fact-based approach of *Oakland* was applied, there is no authoritative way in which anyone affected by a transfer could establish whether regulation 8(7) of TUPE applies or not;
- The EAT raised concerns that the fact-based approach would increase the likelihood of disputes over who is liable for the transferor's obligations, which would generate costs, delay and uncertainty. The panel considered that a 'bright-line' rule adopted through the absolute approach would have clear advantages and;
- Finally, the EAT recognised that the purpose of the Directive is to protect employees in the event of a transfer and to ensure that their rights are safeguarded. In this sense, the absolute approach achieves this purpose as it results in regulations 4 and 7 of TUPE taking effect where there is a relevant transfer by an insolvent company, whereas a fact-based approach would result in many employees being left without protection.

> "The *OTG* decision will increase the liabilities that a purchaser takes on when considering buying a business in administration."

The effect of the decision

It is clear that *OTG* is likely to have a marked effect on the sales of businesses by administrators and have significant consequences for those parties associated with the administration process.

Employees

Employees are likely to benefit most from the *OTG* decision. Where regulation 8(6) applies, employees' rights are safeguarded and they are afforded the protections of regulation 4 and their employment will automatically transfer to the buyer. If the employees are subsequently made redundant for a reason associated with the transfer, they will have the prospect of bringing a claim for unfair dismissal against their new employer. However, there is also the possibility that fewer businesses in administration will be able to find buyers because of the level of TUPE-related liabilities.

Administrators

As a result of *OTG*, administrators may find it harder to find a buyer for a business in administration, particularly given that any potential buyer will reflect any redundancy-related TUPE costs in its offer. However, *OTG* has provided administrators with an absolute approach to follow, as opposed to the fact-based approach in *Oakland*, which should prevent future disputes on the application of TUPE to the sale of businesses in administration.

Purchasers

The *OTG* decision will increase the liabilities that a purchaser takes on when considering buying a business in administration. Those advising purchasers should make their clients aware of the potential liability to pay unfair dismissal compensation awards to employees who have been dismissed because of the sale of a business in administration. The current statutory cap is £68,400 per employee, which could have a significant impact on (a) whether a business in administration will attract any buyers; and (b) the price a purchaser is willing to pay in respect of that business.

Purchasers also potentially face liability for protective awards as a result of the company or its administrators failing properly to consult with employees ahead of any redundancies in connection with the transfer.

The case also raises the question of whether purchasers who have bought businesses from administrators over the last two years since *Oakland* will now, following *OTG*, be faced with some employee claims that they were hoping to avoid. In practice, given the criticism of *Oakland*, it is unlikely that purchasers will not have been advised of the prospect and that such claims will not have been provided for. In any event, the three-month time limit from termination of employment or from transfer for an employee to bring a claim to the EAT means there is a relatively small window for such claims against purchasers.

Creditors

A prospective buyer of a business may seek to reflect TUPE-related costs in its offer price and this clearly has the potential to stifle sales of small to medium-sized businesses and the proceeds realisable for creditors.

Comment

Following the decision in *Oakland*, insolvency practitioners and potential purchasers have faced uncertainty as to whether employee liabilities would transfer to the buyer upon completion of a business sale by a company in administration, or whether these would remain with the seller. Such parties were faced with a decision that contradicted the government's BIS guidance and was criticised by the Court of Appeal. The *OTG* decision has provided clarity and commercial certainty for insolvency practitioners as to how administrations are to be categorised.

The EAT considered five appeals within the *OTG* hearing, each raising the same issue. However, the differing rulings in *Oakland* and *OTG* have resulted in two conflicting judgments by the EAT on the same point. It appears that a Court of Appeal decision is now required to clarify the position finally. In the meantime, it seems likely that future tribunals will adopt the *OTG* decision, not least since the hearing panel included the EAT president, Mr Justice Underhill.

Until a decision by a higher court is sought, insolvency practitioners should be aware of the EAT's current approach to the situation and apply TUPE accordingly in relation to the transfer of businesses in administration and be alert to the fact that reliance upon the *Oakland* decision is no longer advised. □

Tom Withyman is a partner at Lawrence Graham LLP.

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

Recent case summaries

Corporate and personal insolvency update from Carly Sandbach.

Corporate insolvency

***Folgate London Market Ltd* v. *Chaucer Insurance PLC* [2011] EWCA Civ 328**

Facts: A company, M, was successfully sued for personal injury. M was insured, but its insurer declined to cover M, relying upon an exception in the policy. M alleged negligence against its broker in arranging the policy.

M and its broker entered into a settlement agreement under which the broker indemnified M for sums payable in respect of the personal injury claim. The contract provided for the said obligation to indemnify to cease if M entered administration.

The issue before the first instance judge was whether a clause in a settlement agreement, which relieved the paying party from its obligation to make payment to the receiving party in the event of the latter's insolvency, infringed the so-called anti-deprivation principle. This prevents the making of a valid contract by which a man's property is to remain his until bankruptcy but is, on such event, to pass to someone else and so be taken away from his creditors.

The first instance judge held that the relevant clause infringed the principle and made an order accordingly.

> "The relevant clause was found to be a collateral device to avoid the consequences of the insolvency legislation."

Held: Before the Court of Appeal reliance was placed upon *Lomas and Others* v. *JFB Firth Rixson, Inc and Others* [2010] EWHC 3372 Ch. The broker argued that the terms of the agreement entitled it to take over the defence of the personal injury claim from M, and that there was a 'commercial link' between M's obligation under the contract to provide assistance to the broker in defending the claim, and the release of the broker's payment obligation, since, it was argued, in such an insolvency situation, the said assistance was likely to evaporate.

In *Lomas*, Briggs J had drawn a distinction between (i) situations where the relevant asset of the insolvent company was a chose in action representing the *quid pro quo* for something already done before the onset of insolvency; and (ii) situations where the right in question consists of the *quid pro quo* (in whole or in part) for services yet to be rendered or something still to be supplied by the company in an ongoing contract. In the latter case, the court would more readily permit the insertion, *ab initio*

of a flaw in that asset triggered by the insolvency process.

On the present facts, the Court of Appeal had no hesitation in finding that the relevant clause fell in the former category, and that the attempt to categorise the said 'commercial link' as something moving this clause into the latter category was, 'fanciful'. The relevant clause was found to be a collateral device to avoid the consequences of the insolvency legislation.

Personal insolvency

***Eric John Stonham (Trustee in Bankruptcy of Sebastian Satyanard Ramrattan)* v. *(1) Sebastian Satyanard Ramrattan (2) Anna Bortolussi* [2011] EWCA Civ 119**

Facts: R had purchased a property in 1987 that was registered in his name. In 1990, R transferred the property into the sole name of his wife, B, by way of a gift. In 1995 R was declared bankrupt. In 2007, R's trustee in bankruptcy, issued proceedings seeking a declaration that the transfer to B was a transaction at an undervalue and that B had no beneficial interest in the property.

Held: At first instance Mr Registrar Simmons found that R had forged the signatures to the 1990 transfer and that it was a sham document. Alternatively, he held that if he were wrong, it was a gift to B and therefore was a transfer at undervalue. He declined, however, to grant relief due to the delay in bringing proceedings by the trustee in bankruptcy.

The decision was appealed to Mr Justice Mann. The judge expressed the view that, as a forgery, the 1990 transfer was simply devoid of any legal effect. Accordingly, B had always held the property on trust for R and, as such, the same had vested in his trustee in bankruptcy; alternatively, the transfer was a transfer at undervalue pursuant to s339 IA86. He further expressed the view that the judge had erred in the subsequent refusal to grant relief.

Permission was granted for a further appeal to the Court of Appeal on the issue of the application of s283A IA86, the so-called 'use it or lose it' provision, to the present facts.

Section 283A provides for a limited period of three years within which a trustee must take steps to realise the bankrupt's interest in the family home, failing which such interest would revert to the bankrupt.

It was argued that property recovered under s339 for the benefit of the estate, is treated as belonging to or having been vested in the bankrupt at the commencement of the bankruptcy, and that accordingly the provisions of s283A applied, and the trustee was out of time in his claim.

The court held that the entire section was concerned with, and only with, an interest in the relevant home which not only was at the date of the bankruptcy the sole or principal residence of a relevant person, but where the interest itself was at that date vested in the bankrupt and accordingly became part of the estate by virtue of the direct operation of s283(1)(a).

Accordingly, s283A is not engaged by claims under s339.

Notably, however, the court did conclude, that the legislative policy behind s283A was something that would be legitimately borne in mind in dealing with the discretion under s342. Also, although *obiter*, the view was expressed that the limitation period for a claim under s339 was 12 years and ran from the appointment of an IP or the OR as trustee.

Carly Sandbach is a barrister at Exchange Chambers.

Technical update

The GTC update on extending administrations, the Jackson Review and the EU Bank Resolution Regime.

Extending administrations

Back in the mists of time (2002) it was decided that administrations should last for twelve months and not a second longer. A slight over-simplification; administrations can be extended by consent for up to six months or for longer by order of the court. If no action is taken by the administrator, however, the administration simply comes to an end. The reasons for this time limit are obscure. Initially when the Enterprise Act was subject to consultation it was proposed that administrations should only last for three months; after some argument one year was settled upon. We suspect that most of our readers find twelve months inadequate in many cases and would now regard the original proposal with incredulity. And the reason for the time limit? We think that creditors and government thought that cases took too long but insufficient weight was given to the reasons why; so much for the history.

The consequence of the time limit is that there are many applications to court to extend the duration of administrations. We do not have any statistics but the courts are reported to have complained about the number of 'late' applications and become so exasperated that they have awarded costs against the office-holder. At the time of writing it is understood that an application to extend must be made no later than four weeks prior to the anniversary of the appointment unless there is good reason for the delay. Otherwise an adverse costs' order may result. There are rumours that this time limit may now be six or even eight weeks!

> "The future of recoverability is now in doubt as a result of the recommendations made by Lord Justice Jackson following his review of litigation costs."

This all represents a terrible waste of time and money and is a further burden on the courts.

Now comes the exciting bit: why not extend the statutory limit or remove it altogether? What harm would be forthcoming? Case progression might be seen as an issue but failures of this sort can be dealt with by regulatory action by the RPBs. Alternatively if case progression remains a matter of concern for stakeholders the time limit might be extended to two years.

It might also be argued that secured creditors should not be prevented from exercising their rights over their security for more than twelve months. We are inclined to discount this argument as such creditors are likely to have the resources to tackle any perceived abuse by the office-holders. It is hard to think of other negatives, let alone attribute much weight to those identified.

Conditional fee arrangements – the Jackson Review

It is not uncommon for insolvent estates to have claims in damages or against property or former directors but for there to be insufficient funds in the estate to pay for proceedings.

Once upon a time, informal arrangements used to exist between insolvency practitioners (IPs) and solicitors whereby, in order to make allowance for the paucity of assets in certain cases, fees would only be charged where actions were successful. Then, in April 1991, The Insolvency Service issued Dear IP 17, which suggested that such arrangements were unlawful and unenforceable. The Dear IP article said: '*… although section 58 of the Courts and Legal Services Act 1990 … contemplates the legitimisation of certain contingency [sic] fee arrangements, it is not anticipated that any orders made thereunder will extend to insolvency legislation.*' This statement effectively put an end to such arrangements, and the inability to enter into enforceable conditional fee arrangements thus became an obstacle to the effective recovery of assets for the benefit of the estate. As a consequence, SPI (as it then was) made submissions to the Lord Chancellor's Department recommending that conditional fees should be made available for actions by IPs.

As a result of these representations, actions by IPs were among the first types of proceedings for which conditional fee arrangements became available when the first Conditional Fee Agreements Order was made in 1995 (the others were personal injury claims and proceedings before the European Commission of Human Rights and the European Court of Human Rights). Since that time, conditional fee arrangements have been of invaluable assistance in enabling insolvency office-holders to recover funds for the benefit of creditors.

Under the provisions of the Access to Justice Act 1999 various changes were made to the conditional fee regime, among which were the extension of conditional fees to all civil cases and the recoverability of success fees (the uplift) and after-the-event insurance premiums from the losing party. Recoverability has been particularly helpful in insolvency cases for two reasons. First, because it maximises the assets available for distribution. If the costs were instead to be borne by the insolvent estate, it would substantially reduce the amount available for the creditors. Secondly, because the prospect of an adverse costs' order provides a strong incentive for defendants to settle at an early stage, and avoid the costs of litigation altogether.

However, the future of recoverability is now in doubt as a result of the recommendations made by Lord Justice Jackson following his review of litigation costs. The review is wide-ranging, but in the section dealing with conditional fee arrangements Lord Justice Jackson identifies various flaws in the current recoverability regime. In particular, he notes excessive costs burdens being placed on the NHS and local authorities (and therefore indirectly on taxpayers) in medical negligence and personal injury cases, with the result that there is an incentive on claimants to bring unmeritorious claims in the hope that the defendant will settle rather than face the risk of adverse costs.

Jackson's recommendation is to abolish recoverability in all cases (but there is no suggestion of abolishing conditional fee arrangements altogether). It is notable that in the section of the report dealing with the flaws in the present system there is hardly any mention of insolvency proceedings, yet because the recommendation makes no distinction between different types of cases it would apply to insolvency cases as well.

In November, the Ministry of Justice issued a consultation paper on the Jackson Review's recommendations. R3 responded, arguing that in the interests of creditors, and the wider public interest, existing arrangements for the recoverability of success fees and after-the-event insurance should be retained in insolvency cases. The flaws in the present system identified by the review do not apply in insolvency cases. The burden of adverse costs does not fall on the public purse – indeed, HM Revenue and Customs is frequently a major beneficiary of recoveries made by IPs using conditional fee arrangements. And office-holders must avoid bringing unmeritorious claims by virtue of their position as officers of the court.

The Ministry of Justice has now published its paper *Reforming Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson's Recommendations*. Sadly there is no exemption for insolvency cases in the paper, but lobbying continues.

EU Bank Resolution Regime

Members will be aware that, in the wake of the banking crisis, the UK introduced a new special resolution regime for ailing banks. What they may not be aware of, however, is that the European Commission has begun consultation on a possible EU-wide bank resolution regime.

In January, DG Internal Markets and Services issued a working document entitled *Technical details of a possible EU framework for bank recovery and resolution*. This was the subject of an article by Ambrose Evans-Pritchard (AEP) in the *Daily Telegraph* of 6 January, under the rather more attention-grabbing headline, 'Europe unveils sweeping plans to govern reckless banks'.

According to the working document, the first stage in the process will involve establishing a common set of resolution tools and the reinforcement of co-operation between national authorities in order to improve the effectiveness of the arrangements for dealing with the failure of cross-border banks. The proposals set out in the document fall under the broad heads of supervision and prevention, early intervention, resolution tools and powers, group resolution, and financing arrangements.

The proposed resolution tools include the familiar ones of sale of the business and transfer to a bridge bank, including provisions for continued support from the transferor, protection for counterparties in cases of partial transfer, and a valuation mechanism to ensure that creditors will be no worse off under a resolution regime than they would be in an insolvency. Much of this mirrors the existing UK bank resolution regime, and perhaps this is no surprise. AEP notes, *'Mr Barnier [the commissioner for internal markets and services], a former French foreign minister and Savoyard ski enthusiast, has worked closely with the authorities in the UK, where similar plans are already under way.'* The document also seeks views on an additional power of compulsory debt write-down exercisable by the resolution authorities.

One unsatisfactory feature of the proposals is the suggestion that the same regime should apply to both banks and investment firms. However, the issues raised by the failure of these two types of institution are completely different, and their respective resolution regimes should have correspondingly different objectives.

Of course, getting the resolution mechanisms to work in cross-border situations will be the most challenging problem, and that means dealing with countries outside the EU, as well as the various EU member states. The Commission's ultimate aim is an integrated resolution regime, possibly based on a single European Resolution Authority, by 2014.

AEP remarks: *'Much grief might have been avoided if the EU had created this machinery long ago, before launching monetary union.'*

The consultation on the working document closed in March, and the GTC has responded. The Commission's plan is to adopt a legislative proposal for a harmonised EU regime for crisis prevention and resolution by the summer of 2011, and it is possible that more detailed proposals will have been published by the time this edition of *RECOVERY* appears. ◻

> "The Commission's ultimate aim is an integrated resolution regime, possibly based on a single European Resolution Authority, by 2014."

Technical Bulletins

Technical Bulletin 94 was issued in February.
Its contents included:

- Financial support direction held to be administration expense
- Prescribed part – participation by second charge-holder
- Prescribed part – Scottish case
- Entitlement to vote – unliquidated or unascertained debts
- Administration extension applications – new deadline
- 'Use it or lose it' provisions do not apply to transactions at an undervalue
- Changes to OR policy on income payments arrangements and the bankrupt's family home
- Transfers of undertakings – no exemption for administrations
- New depositor protection arrangements
- Environment Agency – new civil sanctions power
- Employment Rights Act – increases in limits

Technical Bulletin 95 was issued in April.
Its contents included:

- Court of Appeal clarifies balance sheet insolvency test
- Practice Statement on Approval of Remuneration – Court of Appeal guidance
- IVA – assignment of debt was a material irregularity
- English courts' powers to assist foreign courts
- Power to appoint receiver in Scotland
- Change in bankruptcy jurisdiction
- Debt Relief Orders and Rights Under Approved Pension Schemes
- New court fees
- Increases in deposits
- New Statements of Insolvency Practice

New Statements of Insolvency Practice

Following a review by the Joint Insolvency Committee, the RPBs have issued the following new Statements of Insolvency Practice, which come into effect on 2 May 2011:

- SIP 1 – Introduction to Statements of Insolvency Practice
- SIP 2 – Investigations by Office Holders in Administrations and Insolvent Liquidations
- SIP 7 – Presentation of Financial Information in Insolvency Proceedings
- The new SIP 1 is an introductory statement of overriding principles, which apply to all SIPs. The old SIP 1 has been re-numbered SIP 17 and re-issued accordingly

Giles Frampton (left) is a partner at Richard J Smith & Co and John Francis (right) is the technical director at R3.

Legal voice

Are you an R3 member? Could you write the Legal Q&A column? If you have advice you could usefully share with your fellow professionals please contact **Sarah Houghton** at GTI (**sarah.houghton@groupgti.com**).

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

Legal Q&A

Cathryn Williams answers your insolvency queries.

I have been asked to be nominee of a company voluntary arrangement (CVA) for a company with several retail premises where rents fall due imminently that the company cannot pay. There is an outstanding winding up petition against the company. The directors want to propose a CVA but want to avoid the costs of applying for a CVA moratorium or an administration if the proposal is going to be acceptable to the creditors. If the CVA is not approved, an administration will be necessary to avoid compulsory winding up. Can the company obtain protection from creditor action while the CVA is considered and can the proposal compromise the lease liabilities?

Where a winding up petition has already been issued, the company can apply to court within those proceedings to stay further creditor action pending the hearing of that petition. As long as the creditors' meeting can be held, on 14 days' notice, before the winding up petition is heard, such a stay will protect the company until the CVA meetings take place.

If no winding up petition has been presented, the question would depend on whether there is a qualifying floating charge-holder (QFCH) who supports the re-organisation. If so, the directors could file a notice of intention to appoint an administrator. This would provide a moratorium for ten business days. Upon expiry, the directors could file further notices (without it being an abuse of process) until after the CVA meetings were held.

If there is no winding up petition and no QFCH, the directors could issue an administration application with a hearing date after the creditors' meeting. The administration application could be withdrawn if the CVA is approved or, if rejected, the administration order could be made. In the meantime, the issue of the administration application would stay proceedings.

Recent years have seen a marked increase in the use of CVAs by retailers in an attempt to reduce their lease liabilities and release onerous parent company guarantees. Some such CVAs have received cautious support from landlords, but real concern arises concerning the practice of 'guarantee stripping'. Landlords can challenge a CVA on the basis that they are unfairly prejudiced by the majority decision. There is no single test that can be

applied to determine whether a proposal is unfair. There are, however, a number of approaches that can be used to assess the impact of a proposal on a creditor's position, including (1) the vertical approach, an established principle that a CVA ought to place the creditor in a better position than in a liquidation and (2) the horizontal approach, which involves comparing the position of the creditor against that of other creditors or classes of creditors who are also subject to the CVA. Different treatment of creditors will need to be justifiable on an objective basis for the CVA to be fair.

It is incumbent on the nominee proposing the CVA to maintain independence and to act in good faith when proposing a CVA. You must act at all times in the best interests of all the creditors. You must not allow your judgment to become clouded by the commercial considerations of any parent company that may be providing the ultimate funding for the CVA if you want to avoid a challenge to approval of the CVA and investigation by your professional body.

As administrator of a major clothing retailer, I am looking into the validity of several all-monies retention of title (ROT) clauses from wholesale suppliers seeking return of the goods they supplied. Some goods could have been supplied by more than one of the suppliers. I am not intending to trade without their agreement but how should I approach their claims?

Even if they have all-monies ROT clauses incorporated into their contracts and have identified the goods still in the possession of the company, the ROT clauses may be ineffective if their operation is inconsistent with the overall trading relationship between the parties. For example, an all-monies ROT clause is unlikely to be effective in the context of a revolving stock agreement to supply goods for immediate resale.

Where more than one supplier might have supplied the goods and they are prepared to work together, the administrator will not be able to argue that they cannot adequately identify their goods when it is known that one of the group must have been the supplier. The goods will have to be handed back to them jointly so they can agree the issue between themselves. Where they are branded goods manufactured for the company, you can require the labels to be removed before they are resold.

> "An all-monies ROT clause is unlikely to be effective in the context of a revolving stock agreement to supply goods for immediate resale."

A question that often arises when a ROT clause fails to retain title in the stock, is whether it works as a charge (either over the stock or the proceeds of sale): any such charge would be floating not fixed where the goods comprise stock. A ROT clause that operates as a floating charge over sale proceeds will not generally fall within the scope of the Financial Collateral (No. 2) Regulations 2003 because the financial collateral is required to be in the possession of or under the control of the chargee. Therefore, to be enforceable against administrators, the charge would have to be registered at Companies House.

Cathryn Williams is a partner at Squire Sanders Hammonds.

Public sector cuts

Care homes: an industry in need of acute care?

Restructuring professionals are likely to become increasingly involved in the care home sector following reductions in local authority funding through the Comprehensive Spending Review, and also changes to the structure of the NHS caused by forthcoming legislation.

Background and macro funding considerations

When considering the impact of the Comprehensive Spending Review (CSR) and current reform on the care home sector (elderly and specialist care provision such as learning disability/mental health), we must be conscious that the majority of UK healthcare is funded through the public purse:

- NHS – for specialist nursing and acute psychiatric care: low levels of real growth in NHS spending (0.1 per cent pa under the CSR) will be the lowest since the 1940s and, given the ageing UK population, significant productivity gains (about £20bn) will be required simply to maintain existing care levels.
- Local authorities (LAs) – for social care (longer term mental illness/elderly care): LAs are facing real term budget cuts of 26 per cent over the next four years.

Anticipated structural changes in the NHS, driven by the Health & Social Care Bill (HSCB), will bring the NHS and LAs together in commissioning care and should result in a greater focus on cost, thus increasing pressure on operators. It is clear therefore that the industry is under funding pressure, even before key operational considerations are taken into account.

Key micro issues facing the sector

Margins are under pressure:

Revenue:

- Occupancy (both elderly residential and specialist) is at a low ebb, driven by the increasing use of lower cost models (increasing care in the home) by the government. Care homes are highly operationally geared and therefore small changes in occupancy quickly impact on profitability/liquidity;
- Average weekly fees are being squeezed in real terms by the commissioners of services; and
- In July, the Dilnot Commission will opine on the age-old problem of who will meet the increasing burden of long-term care. The conclusion is likely to shift the burden to a co-payment model, which would lead to more sophisticated buying decisions by increasingly empowered consumers/their relatives. Branding and quality will become more important and the consumer will not settle for the traditional norm.

Cost:

- Wages are the largest single cost for any home. Wage inflation is currently 2 per cent and expected to rise to 3.8 per cent in 2013 (OBR figures);
- Increasing regulation will happen through a new regulator, the Care Quality Commission (CQC);
- Significant leverage accumulated to fund buy and build strategies/site acquisitions pre-credit crunch will need to be serviced; and
- Rents will rise, exacerbated under sale and leaseback structures with upward-only rent reviews.

While the casual observer may conclude that the market should prosper given the ageing UK demographic and increasing levels of dementia requiring specialist care, it is clear that operational restructuring and indeed a fundamental shift in focus will be required across the sector to restore medium-term viability. In the event that owners/operators are subject to excessive levels of leverage, balance sheet restructurings will also be required. With a precedent shift to more care at home, one could argue that the residential care sector has overcapacity.

What the future has in store

Fundamental change seems inevitable in the care home sector as the traditional residential care home model is outdated. To react to the increasing application of co-payment, the focus for operators going forward will be an increasingly branded offering and specialist care.

Care will increasingly need to be funded by the individual/family and we therefore envisage the evolution of more insurance products to cover care in our old age; the argument that we already pay for this through our monthly deductions is idealistic at best!

Conclusions

The sector is hamstrung by expensive residential facilities (and over-leverage) at a time of unprecedented change. Financial stakeholders will need to move quickly to preserve the value of their investment/security.

In insolvency scenarios, there are certain key challenges to realising value in today's market, including: (1) the changing care model impacting on occupancy and, as such, funding; (2) the potential drying-up of ongoing referrals given the uncertainty; and (3) the likely absence of a significant buyer pool for traditional homes. This is before we even consider the potential criminal liability for the IP in the event of non-compliance with CQC regulation! It is critical therefore to develop a proactive strategy for assets in this sector at an early stage.

At the restructuring stage, it is key to fully understand the market issues and, importantly, future direction together with local specifics, particularly relating to capacity. Our natural reticence as restructuring professionals when considering further financial investment in stressed/distressed assets will need to be carefully balanced with the specifics of this sector – in this industry, an absence of liquidity will soon manifest itself in reduced capital expenditure, leading to further occupancy decline and potential brand impact and reputational damage, which may be irreversible.

In summary, action is needed at an early stage, before the problems facing this industry become life threatening!

Rob Harding (far left) is an appointment-taking director and David Jones (left) is a partner and the head of the Corporate Finance Healthcare Practice at Deloitte.

Charities: death by a thousand cuts?

Ian Oakley-Smith **explores what the public sector spending cuts could mean for charities.**

What the next few years hold

By common consent, the public sector spending cuts will impact on charities for the next few years and possibly for some time after that. A substantial number of charities rely, to a large extent, upon statutory sources of income and are anxious as to the scale of the impact of the cuts. Such anxiety is also impacted on by the very significant planned changes to many of the sub-sectors in which these charities operate, for example, health, welfare and childcare. In addition, demand for many of the services provided by charities is also likely to increase.

For some charities, reduced statutory income will inevitably lead to a reduction in services; for others, it may threaten their very existence, either because they cannot afford to administer a basic level of support, or because trustees consider that they are no longer providing an effective service.

In any event, charities should already be looking at what can be done to make more of their available money. Once they exhaust the possibility for internal efficiency savings, they should look at other organisations – many of which will be in a similar position – in order to consider how their collective position might be enhanced by working together more closely or by merging.

Such collaborations or mergers have been advocated by many sector commentators for some time. However, while some charities have embraced this opportunity to think broadly about how to thrive in the current environment, many charities are, in reality, not doing much more that talking about the possibility of collaborations or mergers. The risk is that this apparent inaction will result in some charities being ill-prepared to respond to reductions in income, which in turn will result, for some, in more desperate solutions or even failure.

There is a real need for proactive independent advice to charities struggling to cope with the responses to the current environment. For some, that advice will also need to come from insolvency professionals as they find the funding environment increasingly damaging to their financial position.

> “Charities should already be looking at what can be done to make more of their available money.”

What is the scale of the issue?

As of 31 December 2010, there were slightly over 162,000 registered charities in England and Wales according to the Charity Commission. While the Commission indicates that many of these charities are very small indeed and are therefore unlikely to be impacted on greatly by the cuts, there were some 27,000 charities with income in excess of £100,000, many of which rely upon statutory income to a greater or lesser extent.

According to the *National Council for Voluntary Organisations (NCVO) Civil Society Almanac 2010*, statutory income accounts for some 36 per cent of total income received by voluntary organisations. This is a very large percentage and reflects the increased role the charity sector has played in supporting the public sector over the last few decades.

It is clear, therefore, that significant cuts to public sector spending will impact on many charities. It is for this reason that charities are anxious and having to consider very carefully how they respond. The government has taken some action to ameliorate the immediate impact, for example, creating a ‘transition fund’ of £100 million to support charities having to transition to a lower income. However, charities are not inherently well structured to address significant changes and rely upon strong boards of trustees and senior management teams to ensure that the necessary planning and implementation is properly considered and acted upon promptly if they are to make the most of the environment.

For some, however, the current environment represents a real opportunity. Those charities that are well managed and have a robust financial position should be thinking carefully about the opportunities that present themselves to enhance what they do for their beneficiaries.

Charities as legal entities

Most charities other than the very smallest are incorporated as companies limited by guarantee. This means that, while they operate with trustees as the group of people charged with running the charity, the people are almost invariably also directors of the limited company. In these cases, the law and practice in relation to ‘normal’

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corporate insolvency remains appropriate.

However, there are various other legal entity types, often slightly obscure and sometimes with unclear legal options in relation to insolvency. In addition, there remain many unincorporated charitable trusts or associations. In these cases, there is no limited liability and the trustees will be liable, jointly and severally, for the debts if the trust or association becomes insolvent.

with professional or business backgrounds neither always available nor willing to apply their experience fully.

Individuals, either at trustee level or on the senior management team, sometimes consider that their charity has to survive in its current form in order to deliver what its beneficiaries need. This can lead to a lack of open consideration of other, possibly more effective, solutions.

> We had the unhappy duty to explain to seven trustees of an unincorporated trust that was winding down its affairs that, in order to exit its two multi-employer pension schemes, it would need to find some £1 million more than the charity had by way of net assets.

By way of example, we had the unhappy duty to explain to seven trustees of an unincorporated trust that was winding down its affairs that, in order to exit its two multi-employer pension schemes, it would need to find some £1 million more than the charity had by way of net assets. This came as a shock to the trustees who were understandably confused and angry that they may be personally liable in this way when they were only doing their bit for charity.

This may sound harsh and is not meant to be overly critical. It is, however, a reality in some cases and all trustees need to be challenged on this issue.

One common problem for smaller charities is that they can seem like 'families' to the people who work there, particularly given the close nature of working together for a common cause. This can make decisions very hard to take when they involve the likelihood that some employees will lose their jobs as a result.

What are charities doing now?

There is some evidence that charities are cutting back on resources in anticipation of spending cuts, while others are investing further in fundraising activities in order to diversify away from a reliance upon statutory income.

There is also evidence that more discussions are taking place in relation to mergers and collaboration. For example, we have worked with leading charities that have been spending significant time working with others in their sub-sectors, and thereby seeking sector-wide solutions to streamline the work they all perform for their beneficiaries.

Many in the sector consider that, to the detriment of beneficiaries, there are more charities than strictly necessary and that collaboration or merger is one of the most obvious responses that charities should be considering if they are in danger of becoming insolvent as a result of spending cuts (or decreases in other sources of income). That way, many of the existing services they perform for their beneficiaries can continue.

What stops charities considering collaboration or merger as a solution?

In our experience, some charities are reluctant to progress open discussions, even to the extent of simply establishing what options might exist. Many of the factors, which inhibit such discussions, result from a failure to think strategically or to ask the difficult questions. This problem is sometimes made worse by those trustees

> Trustees may in some cases find it helpful to utilise the experience of independent third parties in order to 'de-personalise' the challenge process and to provide a robust assessment of the available options.

Trustees must ensure that they remain focused on what is the right thing to do for their beneficiaries, even if this causes difficulties for some employees. This can be a particularly difficult area, but one where trustees will need to remain strong. This can involve trustees challenging recommendations of their senior management team where personal interests could have clouded those recommendations.

A common response from trustees to the consideration of collaboration or merger is, 'what are the compelling reasons why we should consider such action?'. In our view, trustees should explore this question from the other side: 'what are the compelling reasons why we should remain a stand-alone charity?'. We believe that trustees will have discharged their responsibilities to beneficiaries only when this question can be answered with conviction and can be clearly explained to stakeholders.

As will be seen from the above, this may involve trustees having to challenge received wisdom and to challenge their senior management team. They may feel the need to speak to trustees of other charities personally in order to satisfy themselves that all reasonable options are at least being considered. None of this is easy, and it is often not what trustees thought they were signing up for; however, we find ourselves in unprecedented times and it is the needs of the beneficiaries – not the trustees or staff – which should be the primary motivation.

The role of a turnaround adviser

In our experience, trustees may in some cases find it helpful to utilise the experience of independent third parties in order to 'de-personalise' the challenge process and to provide a robust assessment of the available options. This independent challenge may come from a respected individual or organisation, in whom the trustees can have confidence to find a solution that prioritises the needs of beneficiaries and is achievable. While the solution may not be to everyone's liking, at least trustees can be satisfied that a robust and defensible process was undertaken and that they can be satisfied that they have appropriately discharged their obligations.

Over the coming few years, there are likely to be more charities that find themselves having to consider their options against an increasing likelihood that they will become insolvent. As a result, turnaround and restructuring advice will be needed. This restructuring may need to use formal insolvency processes: for example, we have worked with a small number of cases recently where the activities of a charity have been transferred in a manner consistent with a pre-pack, particularly where there are, for example, pension-related liabilities, which rendered the charity unable to continue.

In that context, IPs will want to be familiar with the issues that will need to be taken into account; for example, how to deal with the Charity Commission and how to address the existence of so-called 'restricted funds', where monies have been donated for a specific purpose. Finally, and perhaps more important than the technical considerations, are the behaviours and drivers of individuals within the sector, which can lead to surprising results and would be the subject of an article all by itself!

Ian Oakley-Smith is a director at PwC.

The effect of public sector cuts on the Northern Ireland economy

Northern Ireland's position within the UK and its reliance upon the public sector creates both challenges and opportunities for the region. Brian Murphy reports.

Northern Ireland is a small place: it is marginally larger in size than Yorkshire, with a population of 1.7 million (only slightly more than the West Yorkshire urban area). The region shares much in common with other areas of the UK, but there are also major differences which impact upon the structure and performance of its economy.

In recent years, perhaps the most pertinent of these is the fact that, uniquely within the UK, Northern Ireland has a land border with another economy. The economic woes of the Republic of Ireland have thus had an inevitable knock-on effect in Northern Ireland and have contributed to a more challenging economic climate than in other regions within the UK. Against this background, the large public sector base in Northern Ireland has had a stabilising impact on the economy.

The public sector in Northern Ireland

Historically, the Northern Ireland economy has relied heavily upon public sector spending. It is still the case that almost 30 per cent of total employment resides within the public sector and public sector expenditure accounts for some 63 per cent of the region's GVA.

During the last two and a half years, the existence of a large public sector base in Northern Ireland has helped insulate the local economy from the worst of the recessionary effects. While the downturn in the property market has led to wide scale redundancies within the construction industry, employment and salary levels within the public sector have, to date, remained relatively stable. This stability has gone some way to restore consumer confidence.

However, the proposed cuts in government expenditure will have far reaching effects on the Northern Ireland economy and, in that context, there are likely to be difficult years ahead. In fact, many economists believe that the region will suffer disproportionately because of its heavy reliance on public expenditure.

The release of the Comprehensive Spending Review late last year and the announcement that public sector cuts were in the pipeline attracted a great deal of media attention. Speculation varied widely within the media and headlines referring to up to 36,000 redundancies were a common feature of the daily news reports. To put this figure in perspective, this level of job losses would amount to 5.2 per cent of the total jobs in the region, the highest percentage toll of all the UK regions.

Inevitably, the announcement has had a negative impact on consumer confidence, as many public sector employees who had considered their jobs secure, now find themselves facing an uncertain future. This uncertainty has been further increased by delays within the local Executive in detailing how the necessary savings will actually be achieved and which government departments will face the worst of the anticipated cutbacks.

> "A reduction in corporation tax in Northern Ireland, to approach parity with the rate in the Republic of Ireland, would likely stimulate a significant increase in inward investment."

Further impact

In addition to redundancies, there are other areas that will be impacted on by the cuts:

- Capital investment for roads, hospitals and public projects will be cut by 40 per cent by 2014/15;
- A two-year pay freeze will be implemented for civil servants earning above £21,000 a year (some 12,000 people);
- A 15p plastic bag levy will be introduced;
- Government owned car parks and other buildings will be put to the market;
- The Belfast Harbour Commissioners will be levied for £25 million;
- Housing Associations will have to surrender £80 million of assets; and
- Rates are to rise in line with the CPI.

Nine out of ten surveyors in Northern Ireland have reported that the property market has already suffered as a result of the announcement of the above measures.

What does the future hold?

There is no doubt that the recession will continue to impact upon the Northern Ireland economy for some time to come and further rationalisation in the public and private sectors is both necessary and unavoidable.

It is widely recognised that economic growth and wealth creation must come from the private sector. It is therefore imperative that the private sector responds positively to the challenges it faces by reinvigorating its efforts to demonstrate innovation and its entrepreneurial spirit.

While it is not realistic to expect growth in the private sector alone to compensate for the cuts, there are strong performing sectors that will help to bridge the gap. In particular, the manufacturing sector in Northern Ireland, largely driven by agri-food, continues to expand, while the tourism sector continues to show year-on-year growth. Government investment has also succeeded in establishing a flourishing local film industry, with US film companies investing significantly in the region. The professional services sector has also seen growth, with large legal firms being attracted to Northern Ireland for its pool of skilled employees, available at wage costs that compare favourably to the rest of the UK.

In addition, the current debate on corporation tax rates here is crucial. A reduction in corporation tax in Northern Ireland, to approach parity with the rate in the Republic of Ireland, would likely stimulate a significant increase in inward investment. It is private sector growth on this scale that is needed to truly drive the region's economy forward.

Northern Ireland faces many challenges, but a strong private sector, appropriately supported by both the banking system and the government, can work its way towards a positive recovery.

Brian Murphy is a partner at BDO Northern Ireland.

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

Public sector cuts: R3 research into the knock-on effects on small businesses

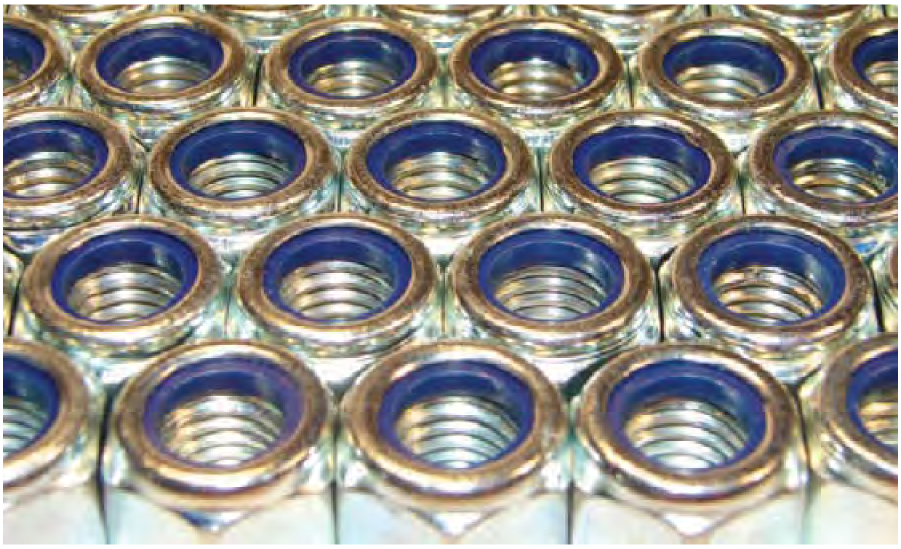
The heavy reliance of small businesses on public sector contracts could put many companies in jeopardy.

When the chancellor described the 2011 Budget he referred to it as 'the growth' budget that would benefit businesses and it is true that, since it was announced that corporation tax was being cut, many businesses including WPP have announced that they would move their tax base back to the UK. However, the continued reduction in capital spending is likely to have a negative effect on those businesses with government contracts.

Late last year, R3 commissioned a piece of research examining the impact the public sector cuts will have on small businesses. Chief in our findings was that nearly one third of small businesses describe themselves as reliant on public sector contracts. In fact, almost ten per cent (or 148,000) of small businesses fear they could be pushed into insolvency if they lose their public sector contracts. This shows that a considerable amount of businesses would be at risk if their contracts were terminated. To put this figure into context, consider that in 2010 there were fewer than 25,000 corporate insolvencies.

> "Chief in our findings was that nearly one third of small businesses describe themselves as reliant on public sector contracts."

As former R3 president Steven Law noted, we do not expect that these will all happen at once: 'It is highly unlikely that all public sector contracts will be withdrawn and the figure of 150,000 business failures represents the worst case scenario. However, we have already seen businesses fail due to the cutting of public sector contracts, with the Connaught collapse blamed on local authorities deferring spending on contracts. Businesses need to be aware of the risks and seek professional advice before a reliance on public sector work threatens their survival.'



R3's research also showed:

- 24 per cent of small businesses say that their profits will reduce should their public sector contracts cease.
- 14 per cent of small businesses say they would consider job losses if their public sector contracts were stopped.
- 11 per cent or the equivalent of 173,000 small businesses say they would be in serious financial trouble should their public sector contracts cease.
- Businesses in the North and the Midlands are more reliant on public sector contracts than the South. Small businesses in the North say they are more likely than those in other regions to collapse should their public sector contracts cease.
- Businesses that started in the 1990s and 2000s are more reliant on public sector contracts than those started in the 1980s and before. This suggests a shift towards increased reliance on the public sector in recent decades.

Steven Law commented: 'Over recent years there has been a shift towards greater reliance on the public sector. Consequently this has had a knock-on effect on the private sector, with both small and large enterprises bringing in a significant amount of revenue from public sector contracts. As the government's austerity measures begin to take their toll and public sector contracts across the UK begin to cease it is likely to have a detrimental effect on small businesses. The loss of a public sector contract would lead to a reduction in a business's income and, in the cases where this short-fall can not be offset, this may push the business into insolvency.'

> "The loss of a public sector contract would lead to a reduction in a business's income and, in the cases where this short-fall can not be offset, this may push the business into insolvency.' Stephen Law."

Will Black is the communications manager at R3.

YOUR DECISIONS ARE IN THE DETAIL

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Practical H&S risk management

Paul O'Connor offers a 'Day 1' checklist to help IPs get to grips with H&S issues on appointment.

The first conviction[1] under the Corporate Manslaughter and Corporate Homicide Act 2007 on 15 February 2011 provides a timely reminder of the potential consequences of heath and safety risk management failures.

Alex Wright, a 27-year-old geologist, died in a work-related accident on 5 September 2008. At the time of the accident, he was employed by Cotswold Geotechnical Holdings, and was investigating soil conditions in a deep trench on a development plot in Stroud when it collapsed and killed him. The prosecution's case centred on the charge that Mr Wright's employer had failed to take all reasonably practicable steps to protect him from the risks involved in the task. Cotswold Geotechnical was found guilty and fined £385,000.

To avoid establishing an equally unwelcome precedent, insolvency practitioners acting in the role of management while trading administrations need to take proactive action to satisfy themselves that the H&S risks associated with accepting an administration role are well understood, and that appropriate risk controls are established on appointment.

Failure to manage H&S risk and compliance on appointments could open up personal risks for the IP (in terms of civil or criminal penalties), as well as impacting negatively on the reputation of the insolvency firm involved.

Impact of insolvency on H&S performance

Businesses in distress are typically associated with poor H&S performance. The chart illustrates the impact of distressed trading conditions on H&S performance at a printing company. A series of restructuring exercises resulted in headcount reductions and the subsequent impact on health and safety performance in terms of increased numbers of accidents is apparent in the May and June safety performance statistics. Root causes of the increase were reshuffling of remaining staff to unfamiliar machine operation roles and a decrease in motivation to follow established safety procedures following the headcount reduction.

The H&S performance situation illustrated here is one that is commonly encountered in distressed trading conditions, and can attract attention from the H&S regulatory agencies. As well as increasing the risk of formal regulatory measures (including those that may impact on the IP personally), extended interaction with the regulatory agencies typically drains the insolvency management team's resources and may deflect focus from delivering the insolvency appointment strategy.

H&S risk and legal compliance remediation in distressed businesses – where to start?

Best practice is to make proactive efforts to understand H&S risks *before* an insolvency appointment is accepted. In the vast majority of cases, effective mitigation measures can be put in place to manage risk issues, allowing the appointment strategy to be realised.

The full extent of historical H&S risk and legal compliance shortcomings often starts to reveal itself on Day 1 of an appointment. This can be a particularly difficult time for the insolvency management team as they focus on the appropriate prioritisation of H&S risk issues amidst all the other challenges typically presenting themselves. The reality of the situation is often that H&S shortcomings in distressed businesses have an extended history, and issues cannot realistically be resolved immediately. It is important therefore for the insolvency team to have access to the right specialist advice to enable them to identify any critical H&S risks, which could imminently result in fatalities or serious injuries. Once these risks are addressed, the next step is to put in place a prioritised programme of remedial measures to address key legislative requirements.

An example list of potential 'Day 1' questions for insolvency management teams is set out in the box.

Experience to date suggests that time spent considering H&S risks pre-appointment together with due effort on appointment to introduce the basic measures necessary to achieve a satisfactory level of legal compliance and risk mitigation is invaluable in protecting employees of companies in administration. This can reduce the IP's personal risk and maintain the reputation of the insolvency firm involved.

Getting to grips with H&S – Day 1 checklist

- Who is currently responsible for H&S management within the company? Could the person(s) responsible be affected by planned insolvency-related processes (eg headcount reduction)?
- Does the company have a clear understanding of its legal obligations relating to H&S and is management able to clearly articulate the H&S risks relevant to its operations?
- What management controls have been established to address H&S risks and legal compliance obligations (eg H&S management systems)? What assurances have management sought that the controls established are operating effectively (eg internal/external audits, site inspection programmes, management tours)?
- Can management provide documented evidence that legal compliance obligations have/are being met (eg risk assessments, gas safety certificates, electrical inspection reports, fire risk assessments, asbestos)?
- Are H&S performance metrics available (eg data on numbers of accidents/incidents occurring)? Have any serious accidents or incidents occurred?
- Is there any evidence of enforcement action or tensions with the H&S regulators (eg official correspondence noting improvement requirements etc.)?

Reference

[1] www.cps.gov.uk/new/press_releases/107_11

Paul O'Connor is assistant director, sustainability and climate change, at PwC.

The Pensions Regulator's approach to the Nortel/Lehman judgment

Stephen Soper explains that it is not TPR's intention to frustrate the administration and restructuring process, and appreciates the need to have an effective rescue culture.

Many readers of *RECOVERY* will have taken a great interest in the outcome of the Nortel/Lehman High Court case at the end of last year. The judgment was regarded as one of the most important of recent years within the spheres of insolvency and pensions law.

The key issues to be decided were whether a Financial Support Direction (FSD) imposed any obligation when issued against a 'target' company following an insolvency event and, if so, the status of the FSD in the insolvency order of priority.

The judge, Mr Justice Briggs, concluded that an FSD did impose a legal obligation in such circumstances and that the costs of complying with it would rank as an expense of the administration or liquidation. In law, the expense must therefore be paid before any distributions to preferred creditors, floating charges and unsecured creditors.

In the aftermath of the judgment, some insolvency practitioners warned that the judgment represented a serious set-back to the UK's rescue culture and would make banks more reluctant to lend if they did not have priority over an occupational pension scheme in an insolvency.

In fact, it is not the intention of The Pensions Regulator to frustrate the administration and restructuring process. We have recently had positive meetings with some of the top insolvency firms to help them understand our approach. We believe that there are substantial reasons why, in practice, these fears are unlikely to be realised. These include:

- The regulator is required by legislation to act reasonably.
- It is also required to take account of the interests of parties directly affected by its regulatory actions.
- Parties can challenge the proposed regulatory action by making a reference to the upper tribunal (and, on a point of law, to the Court of Appeal).
- In practice the FSD regime requires parties subject to regulatory action to bring forward proposals for reasonable financial support for the occupational pension scheme. The form of support is not prescribed and allows significant flexibility.
- Administrators may, if appropriate, apply to the court for a prospective order to vary the order of priority that the FSD liabilities hold vis-à-vis other expenses.

I will talk about these points further, but first I would like to explain a little about The Pensions Regulator's role and recap on the events that culminated in last year's High Court case.

The pension protection framework and the regulator's powers

The Pensions Regulator is the regulator of work-based pensions. Our statutory objectives include protecting members' benefits and reducing the risk of situations that could lead to the Pension Protection Fund (PPF) paying compensation for loss of retirement savings.

The regulator and the PPF were established under the Pensions Act 2004. It's important to remember that this followed a series of corporate insolvencies that had seen around 150,000 people lose all or part of their pensions towards the beginning of the last decade. The regulator and PPF were set up to try to prevent detriment on this scale being repeated in the future.

In pursuit of its objectives, the regulator uses a range of approaches including discussion and negotiation. We have a number of powers, including Financial Support Directions (FSDs) and Contribution Notices (CNs), sometimes known as our moral hazard powers. Issuing an FSD imposes an obligation upon a 'target' company, or companies, to provide reasonable financial support to an under-funded occupational pension scheme. The form of financial support is not prescribed. However, non-compliance with the FSD can result in issuance of a CN, requiring a specified sum to be paid to the scheme.

The regulatory action

Unsurprisingly, the recent global economic turbulence required our intervention to protect pensions. Companies in the Lehman Brothers banking group became insolvent in September 2008, leaving the 1,300-members UK pension scheme with a 'buy-out' deficit of around £148 million. The Nortel Networks UK pension plan had a £2.1 billion pension deficit when the global telecoms group collapsed in January 2009. There are 42,000 members in this scheme.

In separate cases, the regulator's Determinations Panel (DP) decided that it would be reasonable to issue FSDs to six US and UK 'target' companies in the Lehman group and a total of 25 Nortel group companies in Canada, the US and Europe. The DP is a committee of the regulator that decides whether certain types of regulatory action should be taken. The DP received evidence about how both groups had conducted their affairs while solvent. In particular, the companies concerned had benefited from the provision of services and employees by the sponsoring employers of the respective UK pension schemes.

In response to the regulator's actions, the administrators for a total of 20 companies in the Lehman and Nortel groups jointly launched a legal challenge to their pension schemes' ability to recover money as a result of an FSD against an insolvent company, and they were supported by the American parent of the Lehman group and one of its UK subsidiaries. The trustees of the Nortel and Lehman schemes, and the regulator, opposed the challenge.

The judgment

Mr Justice Briggs carried out an in-depth examination of the Insolvency Rules and case law to ascertain the status of an FSD in an insolvency. In the judge's words, the critical issue was deciding *'whether the cost of complying with an FSD, or the monetary obligation imposed by a CN, ranks in the administration or liquidation of the target as a provable debt, or as an expense, or neither of those, so that it is recoverable only in the very unlikely event that there is a surplus otherwise available for distribution to members after all creditors have been paid in full.'* A finding that the FSD was neither a provable debt nor an expense would have, in effect, consigned the FSD to fall down a black hole, and this would have had serious implications in terms of the regulator's ability to protect members' benefits and to limit calls on PPF funding in the future.

> "A finding that the FSD was neither a provable debt nor an expense would have, in effect, consigned the FSD to fall down a 'black hole', and this would have had serious implications in terms of the regulator's ability to protect members' benefits and to limit calls on PPF funding in the future."

Mr Justice Briggs' conclusion that issuance of an FSD created an expense in an administration or liquidation was met by grave concerns from some insolvency specialists – who predicted that providing 'super creditor' status to occupational pension schemes threatened to stifle the rescue culture.

Use of FSDs in practice

In practice, we believe that there are several factors that can provide substantial reassurance to the insolvency community. The Pensions Regulator is required by legislation to act reasonably and have regard to the interests of directly affected parties when using our powers. Parties are also able to challenge the regulator's determinations by way of a reference to the upper tribunal, part of the Tribunal Service.

A vital consideration is how the regulator uses an FSD in practice. Where it is deemed reasonable to issue an FSD, parties are required to come back to us with proposals for reasonable support for the scheme. Mr Justice Briggs summarised what this means in practice: *'The issue of an FSD does not, in itself, create any immediate financial obligation. It imposes a legal obligation on the target company, to be performed at the direction of the administrators, to secure that reasonable financial support for the pension scheme is put in place within the period specified in the FSD, either by the target acting alone or by the target acting in cooperation with one or more of the other targets of the FSD. For that purpose the administrators may need to consult with stakeholders, negotiate with administrators of other insolvency targets, and the management of any solvent targets, and no doubt communicate with the regulator with a view to ascertaining what it might regard as reasonable in the circumstances.'*

There is also great flexibility as to what may be proposed as financial support. In the first FSD case of *Sea Containers*, the regulator approved an arrangement whereby shares in a company were deemed reasonable financial support for the scheme. The arrangement was also approved by the Delaware insolvency court in 2008.

Administration expenses

One concern that arose in light of the judgment was that the super creditor ranking of FSD regime could prevent the administrator getting paid, precluding administrators accepting office in cases where a substantial pensions deficit is concerned. Mr Justice Briggs acknowledged such fears and was able to give additional comfort. Parties may apply to the court for a variation in the order of priority to ensure that the administrators' fees are paid. In the judge's words: *'Administrators may well wish, if the facts justify it, to seek a prospective priority order, so as to ensure that the uncertainties created by the ranking of any FSD financial obligations as an expense do not undermine the beneficial outcome of the present administrations.'*

Furthermore, administrators can and have in the past approached the regulator early in the insolvency process to discuss any likely action against the insolvent companies. The process of clearance is frequently used by insolvency practitioners seeking comfort from the use of the regulator's moral hazard powers.

> "Parties may apply to the court for a variation in the order of priority to ensure that the administrators' fees are paid."

Conclusion

The Pensions Regulator has acted in accordance with its statutory objectives throughout the legal process. Our involvement in the High Court case was necessary in order to defend a legal challenge to our powers which, if successful, risked undermining our ability to protect pension scheme members and the PPF, and it was not an indication that we intend to behave in a way that would frustrate the normal insolvency process. We fully appreciate the need to have an effective rescue culture and will continue to take a reasonable approach, as we are required by legislation to do. □

Stephen Soper is the interim executive director for defined benefit (DB) funding at The Pensions Regulator.

Interview with Adrian Bailey MP

The Business Innovation and Skills Select Committee is a powerful backbench Parliamentary committee. Its remit is to examine the work of the government's business department. Esme Harwood interviews the chair of the committee.

A former librarian and Co- operative Party organiser, Adrian Bailey entered parliament as Labour and Co-operative MP for West Bromwich West in 2000. He was elected chair of the Business, Innovation and Skills Committee at the beginning of the 2010 parliament, making him one of the most influential backbenchers in the Commons. The cross-party committee's role is to check and report on policy areas under the auspices of the Business Innovation and Skills department.

What are your priorities as chair of the Business Innovation and Skills Select Committee?

One of my key priorities is removing bureaucratic obstacles to the effective operation of businesses. I also want to 'bang the drum' for British business. I don't see the role of a Select Committee to be negative. It's important to recognise when the government gets it right, but to point it out when they get it wrong.

> "There is great apprehension that public sector contracts will fall substantially."

How effective do you think the government has been in reducing bureaucracy for businesses?

The jury's still out. I have always felt that the 'one in one out' slogan was a catchphrase not a realistic way of addressing the issue. What we need is good regulation in and bad regulation out. At the moment, there is no evidence that the government is cutting bureaucracy but they must be given time. After a while, we will see whether it is a meaningful policy or a PR exercise.

If you could bring in a policy tomorrow to support businesses, what would it be?

We must get the banks to lend or set up alternative finance mechanisms to ensure businesses have access to credit and investment. Venture capitalists could play a

Adrian Bailey is Labour and Co-operative MP for West Bromwich West

role or the government itself could set up schemes. To give them credit, the government has extended the Enterprise Finance Guarantee Scheme; but the overall picture is that the banks are still not lending, venture capitalists are nervous about moving in and there has been a real diminution of state support. Removing Regional Development Agencies for example has stripped away a key resource for SMEs.

Would you give the government a thumbs up or down for their efforts to drive growth so far?

Thumbs down. The figures speak for themselves. Their priority has been cutting the deficit rather than growing the economy out of recession. There are some positive signs, but these are mainly due to the weaker pound and lower interest rates – not products of government policy.

As you say, the government's priority has been to tackle the deficit. What impact do you think public sector cuts will have on the private sector?

In certain key areas, such as construction, there is great apprehension that public sector contracts will fall substantially. Many of the contracts put in place prior to the election are still coming through, but they are starting to dry up. There is also a risk that, if public sector jobs are lost, demand for private sector products will diminish. Many redundancies in the public sector haven't happened yet and there will be a lag effect, but the impact is likely to start to kick in within the next six months.

Thinking about the recession and early recovery, why do you think the 'insolvency lag' that typically follows a recession has not materialised this time round?

The previous government put in a number of measures that had a very positive impact on the levels of insolvencies – such as the VAT reduction that sustained consumer spending or the scrappage scheme that saved a lot of businesses in the motor retail sector. What businesses tell me though, is that the crunch often comes when they try to expand after a recession so there may still be many insolvencies to come. I don't think things will be as bad as they were in 2008 and 2009, but our economic growth will bump along and a lot of firms that have been hanging on in anticipation of an upturn will fail.

Often companies in trouble leave it too late to seek help. How can we encourage them to come forward at an earlier stage?

It would help if banks were more involved in the running of small businesses. It is also important to change the perception that as soon as a business talks to an insolvency practitioner (IP), it is doomed to fail. IPs have specialist knowledge that cannot be found elsewhere so companies need to understand that they can talk to them without losing the confidence of customers and creditors.

Is there anything we can learn from the US's more forgiving attitude towards business failure or is the balance right in the UK?

On a trip to the US in 2009 with the Business Committee, I was struck by the cultural attitude that it's acceptable to have four or five failures before starting a business that is successful. The legislative framework of Chapter 11 also seems far more helpful to struggling companies.

If R3 can suggest improvements to the insolvency regime in the UK that could reduce business failures or mitigate against the consequences of them, politicians would respond. It would be a great service to the business community and wider economy.

Actually, R3 is campaigning for a legislative change that would transplant one element of Chapter 11 to the UK to bolster the rescue culture. How should R3 get its message across to the minister?

This may be something my committee could examine. By exploring the issue and putting recommendations to ministers, the government would be forced to respond – we may go some way to moving the

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ministerial agenda in this direction. But I must warn you that the number of suggestions for enquires we have is huge and we only have a limited amount of time. For us to look at an issue, we must be convinced that the problem is of sufficient scale, the government must have the capacity to fix it through legislation, and it must be wholly relevant to economic policy. There is a case to be made.

What's coming up for the BIS Select Committee?

We're just finishing a higher education study, we have lots of pre-legislative scrutiny to do and we'll be looking into the impact of pub companies on tenant landlords, which is an incredibly contentious issue. We are also considering looking into debt management companies for one or two sessions, and I imagine R3 would have a lot to say on that topic.

How do you feel about the Alternative Vote (AV)?

I'm against AV. I don't think it will result in a profound change in voting behaviour or the distribution of seats. Claims that AV will equalise the political parties are dubious. When I ask voters which party would receive their second preference, an amazingly high proportion simply don't have one. So it seems we're looking to introduce a system that the public is not interested in. Having seen different forms of proportional representation (PR) in operation in other parts of the country, I haven't seen any significant change in people's faith in democracy, so I don't believe claims that increased PR will enhance democratic participation.

> "Many redundancies in the public sector haven't happened yet and there will be a lag effect, but the impact is likely to start to kick in within the next six months."

Why do you think democratic participation is currently so low?

In the past, people voted according to their class identity. When I started my political career, I would go onto a council estate and know that I would get 80 per cent of the vote; when I went onto a private estate, I knew I'd be lucky to get 20 per cent. Partly as a result of the Thatcher revolution, there is much less class allegiance in voting. People have adopted a far more consumerist approach to party choice and political participation. A large proportion of the electorate does not feel committed to a particular party or don't vote consistently.

Educational factors have played a role in diminishing democratic participation as well. One of the appalling features of the Thatcher era was the removal of civic education from schools. We have a generation of people who don't seem to understand even the basics of politics and government, often relying on the media for their understanding.

Media coverage has also become very negative towards politicians. Of course we shouldn't have an overly deferential system, but I do feel it has gone to the other extreme. There is a sustained campaign to distort the job of an MP and to misrepresent their commitment to their job, which is hugely disappointing. ◻

Esme Harwood is policy manager at R3.

Re Capitol Films: a cautionary tale

Henry Phillips warns of the perils of administrators not carefully considering which group of creditors' interests are they are serving.

The decision of Richard Snowden QC, sitting as deputy judge of the High Court, in *Re Capitol Films Limited* [2010] EHC 3223 (ch) is a cautionary tale for administrators considering whether to make an application under paragraph 71(3) schedule B1 Insolvency Act 1986. The facts of the case were relatively extreme but the message, tolerably clear: administrators need, at all times, to be mindful of which group of creditors' interests they are serving and to be sure to behave reasonably and rationally in promoting those interests. The dogged pursuit of an application in the face of opposition from such creditors may be undertaken at the administrator's peril. The failure of the paragraph 71(3) application in *Re Capitol Films* resulted not only in an order for indemnity costs against the administrators personally but also, and more significantly for the administrators, an order that they be prevented from recovering any of those costs as an expense of the administration.

> "The failure of the paragraph 71(3) application in *Re Capitol Films* resulted… in an order for indemnity costs against the administrators personally… an order that they be prevented from recovering any of those costs as an expense of the administration."

The facts

Capitol Films Limited (the company) was one of a number of companies owned by a prominent figure in the American film industry, Mr Bergstein. The company was involved in the business of producing and distributing motion pictures and, as such, owned the rights to 125 films, some of which were covered by fixed charges to a number of creditors.

Shortly before the company was placed into administration, it agreed to assign its rights in 81 films (the disputed films) to another company connected with Mr Bergstein, Pangea (the Pangea assignment). Mr Bergstein then resigned as a director of the company, which was placed into administration by the new directors. Upon their appointment, the

administrators sought to sell the company's film rights.

At an early stage in the administration, the company's secured creditors emphasised the need to investigate the validity of the Pangea assignment, as this would be critical to assessing the value of the company's assets. As various offers were made and considered by the administrators, the concerns of the secured creditors became a familiar refrain. Nevertheless, and despite intimations in correspondence to the contrary, the administrators failed to give proper scrutiny to the circumstances surrounding the Pangea assignment.

By the time the administrators had found a suitable purchaser for the assets and business of the company, it had become clear that there would be no distribution to unsecured creditors and a shortfall in the security of the secured creditors. In short, the administration was being run for the purposes of achieving a better realisation for secured creditors.

The purchaser of the company's assets was Exodus Films Company (Exodus), yet another business connected to the erstwhile director of the company. The terms of the sale meant that Exodus would have received all the company's film rights as well as any rights that the company may have had against Pangea.

In order to give effect to the sale, the administrators made an application pursuant to paragraph 71 schedule B1 IA 1986 to overreach the rights of the secured creditors. For the purpose of this application, the court was asked to proceed on the basis that the Pangea assignment had been effective to pass title to the disputed films. Once again, the secured creditors objected to the application, which came before Richard Snowden QC.

The decision

In the first reported decision, Mr Snowden QC refused the application made by the administrators under paragraph 71 schedule B1 IA 1986 for permission to sell the fixed charge assets. The administrators' evidence in support of the application was palpably incomplete. It gave no indication as to their view of the value of the company's rights in the disputed films and contained no evidence of the details of or background to the Pangea assignment. Absent such evidence, the court could not and would not say whether the sale contract would be effective to transfer the disputed films. The case was then adjourned to hear arguments on costs.

At the second hearing, the administrators sought to resist a costs order on the basis that the application under paragraph 71 schedule B1 IA 1986 was *'essentially a commercial decision taken to realise the assets of the company in the administration'*[1] and that, by reference to *Unidare plc* v. *Cohen* [2006] BCC 26, the court should not challenge the commercial decision making of an office-holder provided he behaved rationally. This argument was rejected. An administrator applying under paragraph 71 will usually be seeking to advance the interests of unsecured creditors,

> "Paragraph 71 application represents a significant interference with the rights of the holders of fixed charges to realise their security at a time and in a manner of their choosing."

preferential creditors or the holder of a floating charge above those of fixed charge-holders. If fixed charge-holders succeed in opposing the application, they should not be required to bear their own costs simply because the administrator has behaved rationally in advancing the interests of other creditors.

Mr Snowden QC went on to hold that, in any event, the administrators' behaviour was neither reasonable nor rational and that, as a consequence, costs should be awarded on the indemnity basis. The unsecured creditors were out of the money and there was a shortfall in the security – *'the administration was, in essence, a substitute for each of the holders of fixed security conducting their own sales of the charged assets'*[2]. In these circumstances, the administrators ought to have engaged with the secured creditors constructively, instead of launching, without prior consultation, an application in the face of steadfast resistance. Moreover, a paragraph 71 application represents a significant interference with the rights of the holders of fixed charges to realise their security at a time and in a manner of their choosing. Such interference in the face of opposition by secured creditors might be justified where the proposed sale could lead to greater realisations for unsecured creditors. Where, however, the administrators take the view that assets covered by fixed charges will not be paid in full, they have no material constituency to serve other than the secured creditors, *'their approach to any sale proposals leading to an application under paragraph 71 ought to ... reflect ... that fact'*.[3]

In addition, the administrators had failed to investigate the Pangea assignment properly and could not provide any satisfactory reasons for failing to do so. Their pleas of impecuniosity were given short shrift; administrators are expected to act with a 'robustness of purpose'[4] and could well have afforded to have questioned Mr Bergstein closely about the circumstances of the Pangea assignment and have obtained legal advice, which could provide a basis for negotiating the provision of further funds from the company's creditors.

Having decided that indemnity costs should be awarded against the administrators, Mr Snowden QC then ordered that they should not be able to be recovered as an administration expense. The fact that application was 'irrational and misconceived'[5] was itself sufficient to preclude the administrators from claiming the costs as an administration expense and, in any event, it would have been unjust if the administrators were entitled to recoup themselves ahead of the claims of floating charge-holders and unsecured creditors as there was no evidence that such parties stood to benefit from the proceeds of the proposed sale to Exodus.

Comment: The orders made in *Re Capitol Films Limited* [2010] EHC 3223 (ch) were inevitable in light of the extreme facts of the case. The administrators had, inexplicably, fixed themselves upon a course of action, which put them in direct conflict with the wishes of the secured creditors whose interests they were supposed to be serving and had, inexplicably, failed to investigate matters that plainly required investigation. The administrators tumbled into such obvious pitfalls that they scarcely require comment. Nevertheless, the case does contain some noteworthy observations as to the circumstances in which an administrator will be denied the rights to recoup costs as an administration expense. The court held, by analogy with cases on liquidation expenses, that it plainly has the discretion to deny the right of recoupment in circumstances where the administrator has been guilty of misconduct, where he has made a 'blunder' or serious mistake or where it would be unjust for other reasons to permit such recoupment.

The case also has some significance in relation to the costs of paragraph 71 applications in more ordinary circumstances. As costs follow the event, administrators should take care when making an application to ensure that it can be clearly shown to be in the best interests of unsecured creditors or the holders of a floating charge, and to ensure that there will be sufficient funds to cover their liability for the costs of the fixed charge-holder if the application fails. In practical terms, consulting the largest creditors and obtaining their approval is likely to be a prudent step in all cases where there is sufficient time to do so.

1 At paragraph 83
2 At paragraph 88
3 At paragraph 37
4 At paragraph 93
5 At paragraph 102

Henry Phillips is a barrister at 3–4 South Square.

Heading towards a more secure Australia

Michael Ryan discusses some implications for insolvency practitioners of Australia's proposed Personal Property Securities Act.

In less than six months, new legislation dealing with taking and enforcing security in Australia is expected to be enacted. The new legislation will be called the Personal Property Securities Act 2009 (Cth) (PPSA or Act). The legislation is based on similar legislation in New Zealand and Canada, and draws on concepts found in article 9 of the US Commercial Code. Even though a two-year transition period will apply, certain aspects of the legislation will apply from day one. Some have described the legislation as the most fundamental change in commercial law in Australia since the voluntary administration regime was introduced in 1993.[1]

This article focuses on four elements of the PPSA that are of particular relevance to insolvency practitioners (IP):

1) the effect on retention of title suppliers;
2) application to receivables financing arrangements;
3) risks for equipment lessors and hirers; and
4) additional enforcement duties and powers.

The new legislation in 100 words

Under the Act, a security interest is widely defined and captures traditional securities (such as charges and mortgages) as well as leases, retention of title and consignment arrangements. Personal property is also widely defined to include all property other than land and certain statutory licences[2]. Central to the legislation is an online register. Failure to register a security interest could result in a loss of priority vis-à-vis other security holders or a subsequent purchaser of the secured property[3]. New enforcement procedures will provide some additional flexibility to security holders. The Act will replace numerous federal and state laws and online and manual registers.

Retention of title

Supplier arrangements under the current law

Currently, suppliers of inventory who want to ensure payment for their goods will insert what are commonly known as 'retention of title' clauses into credit application forms, terms of trade and supply invoices. These clauses have the effect of securing the payment of the goods as the supplier retains title to the inventory until payment is made by the customer.

These arrangements are not currently recognised as registrable securities and therefore are not revealed on a search of the companies register or any other register. It is therefore difficult, if not impossible, for an outsider to ascertain what goods are subject to retention of title arrangements and on what terms.

Supplier arrangements under the PPSA

The PPSA aims to create a far simpler and more transparent method of dealing with these arrangements.

> "Under the Act, suppliers will be required to register a security interest on the register to notify the world of their ongoing interest in the relevant assets."

Under the Act, suppliers will be required to register a security interest on the register to notify the world of their ongoing interest in the relevant assets. It will be possible to register one security interest at the beginning of a trading relationship in respect of all present and future assets that will be traded on retention of title terms.

The proceeds from the sale of such goods will also be protected by the registration provided that they can be identified.

It will also be simpler for suppliers to retain a security interest over goods that become included in, or become part of, other property. For both goods that remain identifiable (such as tyres on a car) and goods that are no longer identifiable (such as yeast in beer) the supplier's security interest will continue in the goods. This is likely to result in lower realisations for secured creditors holding charges over substantially all the assets and undertakings of manufacturing or assembly businesses than is currently the case. There will be different rules in relation to enforcement of those security interests. Where the supplier's interest in these goods has not been registered, then title will be lost if the property in which the goods have been included is sold or given as security.

Practical considerations

From a practical point of view, the ability to search one, all-encompassing register that records traditional securities (equivalent to charges and mortgages) and also title-based securities (such as title retention arrangements) will ensure a more accurate understanding of a company's assets and liabilities. It should also assist with the resolution of disputes as between various 'secured' parties. However, until the new legislation is understood by the wider business community, and subject to the transitional provisions, there may be some 'windfall' outcomes for secured creditors holding charges over substantially all the assets and undertakings, as retention of title suppliers discover their existing securities are ineffective unless registered.

Retention of title suppliers will no longer be able to rely on their ownership of the goods as under current law. They may still be able to seize the supplied goods on a default, but they will no longer be entitled to simply retain and sell the goods unless they follow the retention and sale procedures in the new legislation. To some extent these provisions can be contracted out of but again, until the wider community becomes familiar with the legislation, there may be some unexpected outcomes.

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Receivables financing

The legislation applies to most types of receivables financing. Receivables financing secured by a fixed and floating charge[4] should be registered in order to 'perfect'[5] the security interest.

> From a practical point of view, the ability to search one, all-encompassing register that records traditional securities… and also title-based securities… will ensure a more accurate understanding of a company's assets and liabilities.

Where receivables are transferred on a non-disclosed basis and therefore do not achieve a transfer of the legal interest in the receivable, a security interest should also be registered. An arrangement for the transfer of receivables on a disclosed basis will generally also create a registrable security interest.

The only type of receivables financing that does not give rise to a registrable security interest is where the receivables are transferred on a disclosed and non-recourse basis.

Lessors and hirers

The legislation contains two concepts relevant to lessors and hirers: a PPS Lease and a Purchase Money Security Interest (PMSI).

The PPS Lease is an agreement to lease goods for more than a year or for an indefinite period or renewable annually. Further, the period is reduced to 90 days where the goods subject to the lease are identifiable by a serial number. A PPS Lease is deemed to be a security interest under the legislation. One potentially very significant consequence is that if a PPS Lease is not perfected by registration, it is possible the owner of the goods will not be entitled to enforce its rights as against the holder of a general security interest over all the assets and undertakings of the lessee.

A PMSI is a security interest taken over secured property that is purchased in part or in full with the funds provided by the secured party. A PPS Lease and a sale of inventory that includes a retention of title clause in the sale agreement would be a PMSI under the new Act.

A PMSI, if perfected, will enjoy priority over a prior general security interest over all of a company's assets and undertakings, which will give PMSIs a so called 'super priority'.

Enforcement

The legislation introduces a new regime for enforcement of a security interest. Many of the concepts are similar to current procedures; however, there are some relevant new rights and obligations.

Application to receiverships

Section 116 states that the chapter dealing with enforcement: '*…does not apply in relation to property while a person is a receiver, a receiver and manager, or a controller of the property.*'

This means that receivers will not be bound by the additional obligations imposed under the PPSA and will not be able to take advantage of the additional rights and remedies provided by the PPSA. Rather, they will be subject to the statutory and common law rights and obligations that currently apply. The exclusion of receivers may change secured creditors' approach to the enforcement of their securities. Although presumably, if a secured party wished, they could appoint a receiver and manager who could then be retired (and replaced by an agent for the mortgagee or the mortgagee itself) immediately before the secured party wished to avail itself of the right.

> Receivers will not be bound by the additional obligations imposed under the PPSA and will not be able to take advantage of the additional rights and remedies provided by the PPSA.

Exercising rights

Section 111 states that: '*All rights, duties and obligations that arise under this chapter must be exercised or discharged:*
a. honestly; and
b. in a commercially reasonable manner.'

Section 131 requires the secured creditor to take all reasonable care when disposing of the secured property and:
'*a. if the collateral has a market value at the time of disposal – to obtain at least market value; or*
b. otherwise – to obtain the best price that is reasonably obtainable at the time of disposal, having regard to the circumstances existing at the time.'

It will be interesting how these sections are interpreted by the courts in comparison to the obligations that currently exist under the Corporations Act 2001 (Cwth)[6] and the common law and whether these sections will influence secured parties' decisions as to whether to:

- contract out of the legislation to the extent allowed; and
- appoint a receiver or enforce via a mortgagee in possession or agent for the mortgagee.

A simpler method of foreclosure

The legislation provides two ways for a secured creditor to effectively foreclose on the secured property. The first way is the provision of a statutory right to dispose of the collateral by the secured party purchasing it. The second way is by providing a secured creditor the right to retain the collateral in exchange for extinguishment of its debt.

Both methods require ten days' notice[7] to be given to the grantor (usually this will be the debtor) and other secured creditors. These parties may object, in which case the secured property must be disposed of by private or public sale.

Conclusion

From an IP's point of view, the proposed PPSA legislation should eventually make life easier when conducting investigating accountant's assignments. The availability of a central register should make determination of the financial position of a company clearer from an asset and liability perspective. However, additional complexity will be added to the IP's role given secured creditors may contract out of certain provisions of the legislation from time to time. It will be important to understand the effect of such action in providing strategic restructuring advice. Finally, dealing with retention of title arrangements will need a fresh approach given the fundamental nature of the changes involved.

References

1 Note the new laws also apply to household property; however, this article is written from a commercial property perspective
2 And other limited exceptions such as mining leases
3 Except where the secured property is subject to the possession or control of the secured party
4 The terms 'fixed and floating' will be replaced by the terms 'non circulating' and 'circulating'. Fixed and floating charges will be replaced by general security agreements having a similar effect
5 Perfection is a key concept in the new legislation and is achieved when certain steps necessary to render the security interest enforceable against third parties are taken. Those steps may be registration of the security interest on the PPS register or the secured party taking possession or control of the secured property
6 Section 420A and sections 180–184
7 This notice period can be extended by application to the court

Michael Ryan is the managing partner of Taylor Woodings, Australia.

Pre-packs: a legitimate means to phoenix an insolvent company

Using pre-packs to resurrect insolvent businesses is far from being illegal and may offer significant advantages.

A pre-pack sale is co-ordinated by the insolvent company's existing management. Typically, the assets or business are sold for market value to a related company, which we will call New Co. New Co re-employs the existing staff and produces the same goods and services from the same premises. While you may think 'that is a phoenix and is illegal', we would like to challenge that view.

The USA

The United States of America has used the pre-pack model of selling assets since 1978. In 2009, approximately 12,000 companies used the framework in an attempt to restructure and save their businesses.

In late 2009 General Motors Inc (GM), the largest automobile manufacturer in the US, was sold as a pre-pack for $50 billion. The sale was finalised only 40 days after initiating the protection of Chapter 11 of the United States Bankruptcy Code. Some 225,000 staff were re-employed by New GM Inc after it purchased the $85 billion-worth of assets from Old GM. The purchase was funded and approved by the United States Government. GM was the fourth largest corporate failure in history and is the biggest pre-pack to date.[1]

Another of the largest corporate failures in the US to date is Lehman Brothers. The day after it entered Chapter 11 protection, Barclays Bank announced its agreement to purchase its investment-banking assets. A week later that agreement was approved by the courts. This sale was not a pre-pack but it was a sale of $600 billion in assets made within 24 hours of the regulator's rubber stamp.[2] It certainly demonstrates a quick sale can be a good sale.

The entire structure of Chapter 11 is designed to provide existing management with time to sell an insolvent business into a new entity. However, in our view the US system is cumbersome and expensive because the process is controlled by the courts.

The United Kingdom

The UK Insolvency Act 1986 was revamped by the Enterprise Act 2002, which permitted a company to appoint an administrator without judicial scrutiny. The UK Act was modelled on Australia's Voluntary Administration laws but it has some twists.[3]

The most significant difference between the Australian voluntary administration procedure and the UK version is that the UK administrator gets involved early and assists management in undertaking the pre-pack sale of assets prior to their formal appointment. After the terms of the sale have been agreed, the UK administrator is formally appointed. The administrator will then immediately sign the contract for sale.[4]

> "The UK Insolvency Act 1986 was revamped by the Enterprise Act 2002… it was… modelled on Australia's Voluntary Administration laws but it has some twists."

This point must be emphasised: the UK administrator will typically sign off on the pre-pack sale on the day of their appointment. In the UK, there are around 100 pre-pack sales per month.[5]

Some examples of recent pre-pack sales include:

- Officers Club, the men's retail clothing chain sold to the existing management by PwC immediately after their appointment as administrator. This business had 120 retail stores and more than 1000 staff.
- Whittard of Chelsea (the tea and coffee retailer) sold to private equity by Ernst & Young immediately after their appointment as administrator. This business had 130 retail stores and more than 1000 staff.

The Insolvency Service (the UK's equivalent of ITSA and ASIC) has stated: *'a pre-pack may offer the best chance for a business to be rescued, preserve goodwill and employment, maximise realisations and generally speed up the insolvency process'*.[6]

The UK's insolvency regulatory bodies have in fact sanctioned pre-pack sales and issued a guidance note to accountants and lawyers to assist them to undertake pre-packs. The 'Statement of Insolvency Practice 16' (SIP 16) sets out the basic principles and essential procedures that are to be followed.

It has been adopted by each of the United Kingdom's regulatory bodies, including the Insolvency Practitioners Association (UK), the Institutes of

Particulars	Pre-pack sale (%)	Insolvency sale (%)
All employees transferred to new company	92	65
Secured creditor return	42	28
Average return (unsecured creditors)	1	3
Sale of assets to related party	59	52

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Chartered Accountants in England and Wales, Ireland and Scotland, and the relevant Law Societies.[7]

SIP 16 is not a definitive statement of law, but insolvency practitioners are liable for disciplinary action by their respective regulatory trade body if they fail to comply with its guidelines.

The website of the UK Attorney General states:

'It is perfectly legal to form a new company from the remains of a failed company. Any director of a failed company can become a director of a new company'.[8]

During the eight years pre-packs have been used in the UK, some research into the process has been undertaken which is summarised in the table opposite.[9]

The key statistic from this table is 52 per cent of all insolvency sales by a liquidator in the UK involve a sale of some assets to a related party.

Reform of pre-packs

It is our view that the UK model for pre-packs is a commendable first attempt to get the process right; however, it could be refined and improved if the following modifications were adopted.

In the UK, the business is not openly advertised for sale. Instead, it is commonplace for the business to be sold in secret. We feel this approach is a mistake. A justification for this approach is that almost all companies have exhausted their lines of credit and cash reserves before they approach a liquidator seeking advice. An administrator will only trade an insolvent company if the cash flow during the trade-on period is positive, there is certainty as to the value of the assets that are to be sold, or there is an indemnity for trading losses.

Any liquidator will say that when an administration commences:

- customers stop paying their debts and suppliers withdraw credit and supply; and
- employees undoubtedly want to and do leave, which can be a particularly bad scenario when a company has a high dependency upon a small group of skilled employees.

We suspect it is for these reasons that the UK approach has sought to avoid the sale of assets by a publicly advertised process. The UK approach ensures that the business will continue to trade up until the date of its sale. It is clear that a sale, by way of limited marketing exposure, offers the following benefits, in that it:

- preserves the goodwill of customers and suppliers;
- retains staff;
- avoids the personal exposure of a voluntary administrator, including occupational health and safety obligations, which can cause liquidators significant concern;
- avoids funding a trade-on administration, which is always difficult and therefore avoids significant liquidator/voluntary administrator fees; and
- eliminates the costs of an auction/formal liquidation sale, which are significant.

"A material defect of the UK pre-pack system is that the administrator works with management to organise the sale… The problem here is the administrator who put together the deal also has the responsibility for checking to see if the sale has realised market value on behalf of creditors."

The UK legislation has considered these pros and cons and seemingly formed the view that a secret sale is better than no sale at all. Creditors have criticised this aspect of the process, suggesting that asset realisations may be improved through wider marketing.

Second, we contend that a further material defect of the UK pre-pack system is that the administrator works with management to organise the sale. Thereby, the administrator in waiting will help management with:

- valuations of the business;
- discussions with prospective buyers;
- obtaining the support of secured creditors and suppliers;
- setting the sale price and terms of the contract for sale.

When all the details are agreed and a sale agreement is ready to be executed, the formal appointment of the administrator is then attended to. The problem here is the administrator who put together the deal also has the responsibility for checking to see if the sale has realised market value on behalf of creditors.

This means that there is an inherent conflict of interest in the two roles. There can be no doubt that management will enjoy the expertise of an administrator or pre-pack expert. Selling an insolvent company is a specialist role and only a few have knowledge and experience to do the job well. However, fundamentally, a liquidator should only sit on one side of the fence, and ideally, the administrator should be appointed by creditors to preserve and protect their position and specifically prosecute the directors and advisers who fail to realise market value from a sale.

Other jurisdictions

In Spain, the Insolvency Act was amended by Royal Decree 3/2009, which created a pre-insolvency negotiation period to enable a pre-pack plan to be developed.[10]

In New Zealand, which has largely adopted Australia's voluntary administration regime, the Companies Act 1993 was recently amended to accommodate phoenix arrangements. The explanatory material suggests that many phoenix situations are legitimate and operate to promote the interests of creditors of the insolvent entity through lower transactions costs and higher sale price as the business is sold as a going concern.[11]

The advantages of pre-packs

We need to re-think the idea that a sale of an insolvent company's assets to the existing management is always unconscionable. We should invite legislative reform to embrace pre-packs. Pre-packs offer a means to increase the survival rate of insolvent companies.

For small business, pre-packs offer by far the best chance for existing management to save their business. Pre-packs are a common, everyday occurrence for our trading partners but in Australia, they remain a developing process that should only be attempted by a professional to ensure creditors' interests are preserved. ◻

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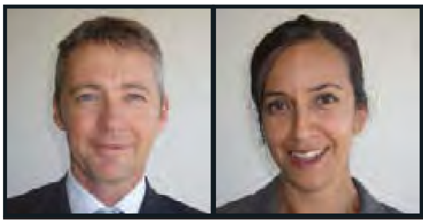

Nicholas Crouch and Shabnam Amirbeaggi are partners in Crouch Amirbeaggi.

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Requirements for FSA consent before appointment of administrators

Alan Gar explores whether permission from the Financial Services Authority is required before the appointment of an administrator for firms listed on their register.

We have found a range of opinions among insolvency practitioners on whether the consent of the Financial Services Authority (FSA) is required prior to the appointment of an administrator for companies/partnerships who are listed on the FSA register. The answer depends on who is appointing the administrator (ie the company, its directors or a qualifying floating charge-holder (QFCH)).

Types of FSA registration

The FSA register can be checked online using the name of the firm and/or its postcode: **www.fsa.gov.uk/register/firmSearchForm.do**

There are three types of FSA registration:

1. An authorised person

An authorised person is someone who is FSA-registered and is permitted to carry out one or more regulated activities (ie advising on investments or arranging deals) under the Financial Services and Markets Act 2000 (FSMA). This authorisation is given under s31 FSMA and can apply to a company/partnership that has been specifically authorised by the FSA, an EEA or Treaty firm qualifying for authorisation, or a firm authorised by a provision of FSMA itself.

2. An appointed representative

An appointed representative is a company/partnership that will be on the FSA register but is not authorised by the FSA to carry out regulated activities. However, by virtue of s39 FSMA these firms can carry out certain regulated activities because an authorised person has accepted responsibility for them when carrying out such activities. It is the responsibility of the authorised firm to ensure that its appointed representative is fit and proper to deal with clients on their behalf.

3. An introducer-appointed representative

An introducer-appointed representative is a company/partnership, which will be listed on the FSA register but is not authorised to carry out regulated activities either in its own right or through its relationship with an authorised person. An introducer-appointed representative is appointed by a firm; its scope of appointment is limited to affecting introductions and distributing non real-time financial promotions.

Participation

Under s362 FSMA, the FSA is entitled to participate in the administration proceedings of a company or partnership that is (or has been) one of three types of registered entity, or has carried on a regulated activity in contravention of the general prohibition. This section applies both to appointments under paragraph 14 and paragraph 22 of schedule B1 of the Insolvency Act 1986, that is, appointments by a QFCH, the directors or the company itself.

'Participation' means that the FSA is entitled to be heard at the hearing of the administration application or petition, or at any other court hearing, and any notice or document that is required to be sent to a creditor of the company or partnership must also be sent to the FSA. This section does not require the consent of the FSA before the company/partnership can be placed in administration.

	Paragraph 22 (Company/Directors)		Paragraph 14 (QFCH – Bank)	
	Participate in administration	Consent required	Participate in administration	Consent required
Authorised person	✔	✔	✔	✘
Appointed representative	✔	✔	✔	✘
Introducer-appointed representatives	✔	✔	✔	✘

FSA consent

Under section 362A FSMA, which was introduced by the Enterprise Act 2002, FSA consent is required before a company or partnership can be placed into administration under paragraph 14 of schedule B1:

'An administrator of the company may not be appointed under paragraph 22 of schedule B1 to the 1986 Act without the consent of the Authority.'

This section also requires that the consent be filed at court with the notice of intention to appoint an administrator (paragraph 27 of schedule B1 of the Insolvency Act 1986) or, if notice of intention to appoint is not required because there is no QFCH, attached to the notice of appointment. The reason that there is confusion among insolvency practitioners as to whether FSA consent is required for an appointment by a QFCH, is that section 362A of FSMA refers only to directors' appointments under paragraph 14. However, section 362 (discussed above) of FSMA (as amended) refers to appointments under paragraph 14 of schedule B1 (QFCH appointments) as well as paragraph 22 of schedule B1 (appointments by the directors/company).

> "The reason that there is confusion among IPs as to whether FSA consent is required for an appointment by a QFCH, is that s362A of FSMA refers only to directors' appointments under paragraph 14. However, s362 of FSMA… refers to appointments under paragraph 14 of schedule B1… as well as paragraph 22 of schedule B1."

As section 362A of FSMA does not mention QFCH appointments, it therefore does not appear to be a requirement that the QFCH obtains consent prior to appointment. We have asked the FSA for their view in advance of the publication of this article, but we have yet to hear back from them.

Under section 362A of FSMA, any appointments under paragraph 22 or notices of an intention to appoint under paragraph 27 for a company/partnership that is one of three types of registered entity, must have prior consent from the FSA. This consent must be in writing and needs to be filed at court with any notice of intention to appoint or, if no such notice is required, it must accompany the notice of appointment filed. QFCH appointments over either authorised persons or appointed representatives (including an introducer-appointed representative), do not appear to require the consent of the FSA.

Many practitioners have decided to adopt the prudent approach of requesting the FSA's consent, whether the appointment is to be made by directors/company or by the QFCH (although this may result in a slight delay to the appointment).

Alan Gar is a partner at Simmons & Simmons LLP.

A question of priorities: do charge-holders' or prosecutors' rights reign supreme in POCA cases?

Lucy Edwards investigates whose rights prevail when a restraint order is made against assets subject to a floating charge.

Gone are the days when serious criminals only dealt in used fivers. They are now more sophisticated operators who will go to great lengths to hide their criminal activity behind a facade of legitimacy and to conduct large-scale fraud they may use one or more companies to achieve their goal, particularly if that is large-scale VAT or duty evasion, whether by means of MTIC/carousel fraud or otherwise. The really clever criminal who is intent upon secreting away ill-gotten gains well beyond the reach of the enforcement authorities, who will pursue the criminal under the Proceeds of Crime Act 2002 (POCA), may be bold enough to run the business empire with the support of bank borrowing secured by a debenture. An interesting question of priorities then arises when a restraint order is made against the defendant that covers personal assets, the shares in the company and the assets of the company.

The prosecutor can ask the court to make a restraint order that covers the defendant's assets and the company's assets in reliance upon the provisions of POCA and case law. Under section 41 of POCA, the Crown Court may make a restraint order prohibiting the defendant from dealing with any realisable property held by the defendant if a criminal investigation has been started or proceedings have been commenced, and there is reasonable cause to believe that the defendant has benefited from criminal conduct. Section 83 of POCA defines 'realisable property' as 'any free property held by the defendant'. Property is defined by section 84 of POCA and provides that 'property is held by a person if he holds an interest in it'. For the company's assets to be restrained without charging the company itself with an offence, which would add an additional layer of complexity by introducing the concept of corporate mind and will,[1] the court must be asked to lift the corporate veil in order to treat the assets of the company as the assets of the defendant.

> "The prosecutor can ask the court to make a restraint order that covers the defendant's assets and the company's assets in reliance upon the provisions of POCA."

When will the court lift the corporate veil?

It is established law that a duly formed and registered company is a separate legal entity from its shareholders, with its own rights and liabilities.[2] It is also established law that 'the court will lift the corporate veil where a defendant by the device of a corporate structure attempts to evade (i) limitations imposed on his conduct by law'.[3]

In the cases of *R* v. *Seager* and *R* v. *Blatch*[4] (heard together) the Court of Appeal summarised the three situations identified by the courts in criminal cases when the corporate veil can be lifted:

1) *'if an offender attempts to shelter behind a corporate facade, or veil, to hide his crime and benefits from it'.*[5]
2) *'Where an offender does acts in the name of a company, which (with the necessary* mens rea*) constitute a criminal offence, which leads to the offender's conviction, then "the veil of incorporation is not so much pierced as rudely torn away"'.*[6]
3) *'Where the transaction or business structures constitute a 'device', 'cloak' or 'sham', ie an attempt to disguise the true nature of the transaction or structure so as to deceive third parties or the court'.*[7]

Each of these three circumstances when the corporate veil can be lifted or pierced involve impropriety and dishonesty.

Once the corporate veil has been lifted, the property of the company is to be regarded as the property of the defendant who controls it and is, therefore, restrained. The company may have granted charges to the lender over its assets but the Crown Court has declared that the assets are in fact the defendant's.

Whose rights prevail: the prosecutor's or the charge-holder's?

Fixed charge-holders are protected because restraint orders specifically declare that any financial institution is not prevented from enforcing an existing charge over property so secured.

Pre-crystallisation, however, the floating charge does not attach to any particular property, so a management receiver appointed under section 48 of POCA, in respect of the realisable property to which the restraint order applies, will be able to deal with the floating charge assets in the ordinary course of business. Who has priority if there is an event of default thereby crystallising the floating charge? Depending on the drafting of the debenture, the appointment of the management receiver itself could trigger crystallisation.

The general principle under POCA is that the first in time gets the assets. Property subject to a restraint order made before a winding-up order, a resolution for the voluntary winding up of the company or an order appointing a provisional liquidator is excluded from the liquidation.[8] These provisions accord with the legislature's approach to POCA, which is to ensure that the defendant's assets are available to satisfy a confiscation order that may be made following the defendant's conviction. Indeed, section 69 of POCA, which has become known as 'the legislative steer', requires the court itself and a receiver appointed to manage the assets pre-confiscation or to enforce the confiscation order post-conviction, to exercise their powers to this end.

What is surprising is the omission from POCA of any reference to an administrator, whether appointed by a qualified floating charge-holder (QFCH) or by the court. Section 430 of POCA entitled 'floating charges' provides that the functions of a receiver appointed by or on the application of the holder of a floating charge are not exercisable in relation to property, which is subject to a restraint order made under section 41 of POCA before the appointment of the receiver. The term 'receiver' must be an 'administrative receiver' as only an administrative receiver can be appointed under a floating charge. The drafting is odd, however, because it refers to a receiver being appointed 'on the application', presumably to the court, of the floating charge-holder but the court does not have the power to appoint an administrative receiver.[9] In all likelihood the omission of 'administrator' from section 430 was a drafting error. This view is supported by *Hunter and Kerr on Receivers and Administrators*, which says that those drafting and enacting POCA had always intended to include administrators.[10]

What power does an administrator have over restrained assets?

The appointment post restraint order of an administrative receiver under an old floating charge, which is possible notwithstanding the prohibition in section 72(A) of the Insolvency Act 1986, would not assist the lender because of the provisions of section 430 of POCA. As there are no prohibitions in POCA against the appointment of an administrator under paragraph 14 of schedule B1 or under paragraph 35 of schedule B1, on an application to the court, it may still be possible for a QFCH to enforce its rights, notwithstanding a prior restraint order. The management receiver (appointed under section 48 of POCA) can assist the court, whether on the receiver's own application for directions if an administrator has been appointed out of court, or at the hearing of the QFCH's application under paragraph 35, by arguing the supremacy of the confiscation order enshrined by the legislative steer and by relying upon the decision of Rimer J in *Ice Media International Limited and Blue Point Media Limited (both in liquidation)* v. *Q3 Media Limited*.[11]

While section 69(2) of POCA provides that the court and the receiver must exercise their powers to preserve the value of realisable property and ensure there is no diminution in its value without taking account of any obligation of the defendant that conflicts with these obligations, the powers must also be 'exercised with a view to allowing a person other than the defendant or a recipient of a tainted gift to retain or recover the value of any interest held by him'.[12] This is intended to protect parties with a proprietary interest in restrained assets. Pre-crystallisation, the QFCH has an equitable interest in the charged assets. The effect of the restraint order that pierces the corporate veil is to recognise the defendant's beneficial interest in assets held by the company. But which equitable interest would prevail? It could be argued by the management receiver/prosecutor that the floating charge assets of the company always belonged to the defendant who used the company as a vehicle for criminal activity. It could be argued by the QFCH that the floating charge predated the restraint order and the defendant only became the beneficial owner when the restraint order was made.

> "Until these issues are aired in court, there must be uncertainty as to who will prevail: the floating charge-holder or the prosecutor."

In reliance upon the decision in *Q3 Media*, the receiver could also argue that the purposes of administration cannot be achieved because it is not clear whether there are any assets available for creditors because of the existence of the restraint order and the requirements of section 69 of POCA.

In *Q3 Media*, the judge declined to make an administration order on a creditor's petition because an interim receiver had been appointed over the assets of Q3 under section 246 of POCA (Civil Recovery) to investigate whether the property of Q3 appeared to be recoverable or associated property having been obtained through unlawful conduct. The judge was satisfied that there was a good arguable case that Q3's creditors could have no interest in the realisation of Q3's business because the proceeds would not be available to meet their debts if the assets of Q3 were found to be recoverable property. He declined to make an administration order until the interim receiver had reported to the court.

Until these issues are aired in court, there must be uncertainty as to who will prevail: the floating charge-holder or the prosecutor; and it is unlikely that the omission of administrator from POCA will be remedied before this question is litigated. Whether or not it was the legislature's intention, the rights of lenders are likely to prevail for the time being. ◻

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Lucy Edwards is a senior solicitor in the Insolvency & Business Recovery Team at Blake Lapthorn.

R3 Smaller Practices Group

Smaller practices form the backbone of the profession and play an important part in supporting businesses. Liz Pywowarczuk launches a new, regular page aimed at providing R3's SPG members with updates tailored to their needs.

Welcome to the first page in *RECOVERY* dedicated to smaller practice matters. Using this new page, we aim to keep R3's smaller practice members informed about the work of the SPG Committee, its role in providing a voice for the SPG community and provide members with updates on 'hot topics' relevant to smaller practices.

The SPG Committee currently comprises six smaller practice IPs, two lawyers and one compliance expert drawn from across the R3 regions. It meets each quarter to discuss and progress issues that impact upon R3's smaller practice members and to ensure that the SPG community maintains a strong voice on key issues, both within R3 and externally with government and stakeholders. The committee chair, Liz Pywowarczuk, is herself a sole practitioner and currently sits on the IVA Standing Committee as the smaller practitioner representative.

Within R3, the Smaller Practices Group is headed up by Emma Lovell, R3's SPG Committee support executive, who is a dedicated resource to address SPG members' needs. Both Emma and the SPG Committee would like to continue to hear from you, R3's smaller practitioner members, about what issues are important to you, what your priorities and concerns are for 2011 and the future, and how the committee can continue to improve its support for the SPG constituency. So please, get in touch and let us know! **email: emma.lovell@r3.org.uk**

At the SPG Committee meeting.

Current committee work

The SPG Committee meeting on 26 January focused on several important issues that impact on smaller practices, including the recent BIS Call for Evidence in support of the Consumer Credit and Personal Insolvency Review. SPG Committee members worked closely in liaison with R3's policy team, as well as the General Technical Committee and the Policy Group, in order to provide input for R3's final response to the Call for Evidence and will continue to provide input for future developments arising from the review.

The committee also discussed the differing needs of smaller practitioners working in both personal and corporate insolvency. In line with its commitment to address issues affecting SPG members in the corporate and personal insolvency markets, the committee will be surveying R3's SPG members later this year for their views on what issues, related to corporate or personal insolvency, are important to them for follow-up work or support from the committee. Input from smaller practitioners for the survey would be greatly appreciated in order that we can comprehensively assess your needs and concerns.

Liaison with The Insolvency Service and the committee's OR Watch initiative are longstanding agenda items and there were detailed discussions regarding The Insolvency Service's introduction of new policies relating to IPAs/IPOs and the bankrupt's family home during the meeting. SPG Committee members are actively involved in the ongoing liaison meetings between R3 and The Insolvency Service's regional directors and will continue to voice SPG views relating to the OR rotas and IP appointments arising from the rotas during such meetings.

The committee also discussed ways further to improve the dialogue between the committee and the SPG community. This dedicated SPG page in *RECOVERY* is one step towards ensuring that the committee's work is communicated to smaller practice members. R3 is also aiming to launch dedicated SPG web pages as a means of further demonstrating the work that the Smaller Practices Group undertakes on behalf of members and to strengthen the contact between the SPG community and the committee. Discussion during the committee meeting on 20 April centred around issues such as The Insolvency Service consultation on reform to the regulation of IPs, preparations for the SPG Forum in November this year and SPG members' needs in terms of courses and training. A full update on this meeting will be provided in the next edition.

Hot topics

R3 courses

In line with the SPG Committee's commitment to address the training needs of SPG members, R3 has recently launched a new IVA Masterclass workshop, aimed at smaller practitioners who do not undertake a great deal of IVA Protocol based work, to bring them up to speed on recent developments. The course is also a refresher for those practitioners with experience of working with IVAs and will provide valuable practical input on the setting up and running of protocol compliant agreements.

The new course was launched in London on 4 May and it is hoped that it will also be run in other UK venues in due course.

Insolvency Service changes to OR policy

As reported in R3's February Technical Bulletin, The Insolvency Service has announced policy changes to the way in which official receivers deal with income payment agreements, income payment orders and the bankrupt's family home. The changes in policy will undoubtedly impact upon the advice which smaller practitioners may need to give to debtors regarding the implications of the bankruptcy process. Smaller practitioners are therefore advised to familiarise themselves with the new policies, for which further information can be found at section 94.7 of R3 Technical Bulletin Issue No. 94.

Liz Pywowarczuk is the director of Liberta Financial Ltd.

Holding Rescue to Ransom

Launched in Westminster on 1 March, R3's first ever campaign 'Holding Rescue to Ransom' received unanimous support from cross-party MPs. Neville Kahn explains the thinking behind the campaign and sets out the change in law that would be required.

For many of us, traditional administrations have become fewer and further between, as changing conditions have reduced our ability to trade a business and served to increase the appeal of the swift pre-pack. A key consideration when deciding whether to trade is the actions of suppliers. Will they continue to supply; and if so, will they do so at a reasonable price? R3's campaign, Holding Rescue to Ransom, centres on the pivotal role suppliers play in determining the outcome of insolvency cases. It calls for a change in legislation to introduce a wider stay, obliging suppliers to continue to supply on insolvency to the benefit of the business rescue culture and creditor community.

Anne-Marie Morris MP, with (on her left) Mark Andrews, chair of R3's Policy Group.

Altering supplier behaviour

R3's campaign, recently launched at a round table event in parliament with cross-party support, calls for an amendment to section 233 of the Insolvency Act 1986. It seeks to prevent suppliers demanding ransom payments, dramatically increasing tariffs, or withdrawing supply altogether on insolvency by compelling suppliers to continue to supply at a reasonable price (providing they are paid for doing so) on insolvency. In doing so, the campaign calls for the UK legislation to learn from the automatic stay provisions in the US Chapter 11.

By effectively reducing the risks of trading, a wider stay would surely enhance our profession's ability to trade a business, generally resulting in greater returns for creditors and/or a full or partial rescue of the business. R3's research indicates that ensuring continuity of supply would result in more than 2,000 extra business rescues a year through diminished liquidations. The increased attractiveness of trading would also have the impact of reducing the comparative appeal of pre-packs. According to R3's research, a wider stay would result in a 22 per cent decline in this much-misunderstood procedure, which explains the campaign's appeal among certain elements of the unsecured creditor community.

Ensuring suppliers are protected

But what of the counter-arguments? The first question asked by MPs and business organisations is whether a change in legislation would put suppliers in a more vulnerable position. This is easily defused by explaining the protection suppliers gain, given that they are paid as an administration expense. Seemingly counter intuitively, continuing to supply actually puts suppliers in a less risky position than they were in before the insolvency.

It also helps to explain that the campaign does not call for special treatment to businesses entering insolvency; rather, it aims to prevent suppliers taking advantage of an insolvency. This prompts the question – is there anything wrong with suppliers extracting a commercial advantage? Of course, there is nothing in the law to prevent suppliers using insolvency to their own commercial advantage by extracting ransom payments or charging a higher price for their services. I would argue, though, doing so has a hugely negative impact on the body of creditors as a whole. One creditor is effectively able to tip the balance in their own favour and against the interest of other creditors. For the greater good it would seem reasonable that public policy – and consequently, insolvency legislation – prioritises the interest of the body of creditors as a whole above the narrow interests of individual suppliers.

> "For the greater good it would seem reasonable that public policy – and consequently, insolvency legislation – prioritises the interest of the body of creditors as a whole above the narrow interests of individual suppliers."

Freedom of contract

Another challenging issue in this debate is how forced continuity of supply would impact on freedom of contract. Again, I think this is a question of priorities. There are certain laws already in place that supersede contracts between parties because they serve a greater public interest. Extortionate credit transactions and unfair contract terms both override the terms of individual contracts, for example. In fact, insolvency legislation itself already interferes with contractual and legal rights where parliament believes it is appropriate to do so – the 1986 Act, for example, introduced a requirement for utilities to continue supply on insolvency. Continuity of supply and the prevention of the enforcement of so-called '*ipso facto*' clauses is simply an extension of this existing policy. What matters is whether a legal change of this nature would be in the public interest. A bolstered business rescue culture, which sees a revival of more traditional administrations and increased returns to creditors, is, in my view, adequate justification for this kind of intervention.

R3's campaign is gathering momentum as preparations begin for the next step – convincing ministers and policy makers at The Insolvency Service of the need for change. As we make this case, it is a refreshing by-product to be able to focus these influential audiences on the important role our profession plays in rescuing businesses, saving jobs and maximising returns to the business community.

Neville Khan is the global head of reorganisation services at Deloitte.

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

R3 events, courses and conferences

Date	Event title	Venue
June		
3	Yorkshire Women's Group Ladies Lunch	Alea Casino, Leeds
6	North West Regional Meeting	Hilton Deansgate, Manchester
7	Debt Restructuring	Renaissance Hotel, Manchester
9	Golf Day	Scarcroft Golf Club, Leeds
9	South West and Wales Women's Group Black Tie Dinner	The Bristol Hotel, Bristol
14	Introductory Programme – Rescue 2	Deloitte LLP, Birmingham
14	Introductory Programme – Rescue 2	etc venues, London
14	Introductory Programme – Rescue 2	Irwin Mitchell LLP, Leeds
16	Partnership Insolvency	Hyatt Regency Hotel, Birmingham
16	Property Insolvency	Hyatt Regency Hotel, Birmingham
17	International Restructuring	Radisson Blu Portman Hotel, London
17	North West Ladies Charity Lunch	Lowry Hotel, Manchester
21	Insolvency for New Professionals	Radisson Blu Portman Hotel, London
23	Yorkshire Regional Meeting	Crowne Plaza, Leeds
27	Breakfast Briefing – Hotels	PricewaterhouseCoopers, Bristol
28	Partnership Insolvency	Grange City Hotel, London
28	Property Insolvency	Grange City Hotel, London
July		
1	Breakfast Briefing – Hotels	PricewaterhouseCoopers, Leeds
5	Breakfast Briefing – Hotels	PricewaterhouseCoopers, London
5	Introductory Programme – Rescue 3	Deloitte LLP, Birmingham
5	Introductory Programme – Rescue 3	etc venues, London
5	Introductory Programme – Rescue 3	Irwin Mitchell LLP, Leeds
7	Partnership Insolvency	Cedar Court Hotel, Huddersfield
7	Property Insolvency	Cedar Court Hotel, Huddersfield
11	Eastern Regional Meeting	
12	Debt restructuring	Marriott Bristol City Centre Hotel
14	Breakfast Briefing – Hotels	PricewaterhouseCoopers, Manchester
21	Breakfast Briefing – Hotels	PricewaterhouseCoopers, Birmingham
28	Midlands New Professionals Summer BBQ	

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2011 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

regional events **R3 events**

R3 contacts

Staff R3, 8th Floor, 120 Aldersgate Street, London EC1A 4JQ
Tel: 020 7566 4200 **Fax:** 020 7566 4224 **Website:** www.r3.org.uk

President ....Frances Coulson *e-mail:* fcoulson@moonbeever.com
Vice-president ....Lee Manning *e-mail:* leemanning@deloitte.co.uk

Administration

Chief Executive Officer ....Graham Rumney *e-mail:* grumney@r3.org.uk
Executive Assistant ....Gabriella Pizzichemi *e-mail:* gpizzichemi@r3.org.uk
HR and Office Manager ....Alan Roberts *e-mail:* aroberts@r3.org.uk
Assistant Office Manager ....Tasneem Choudhury *e-mail:* tchoudhury@r3.org.uk

Finance

Finance Manager ....Ryan Porter *e-mail:* rporter@r3.org.uk
Assistant Finance Manager ....Alex Coles *e-mail:* acoles@r3.org.uk
Accounts Administrator ....Chris Shann *e-mail:* cshann@r3.org.uk

Membership & Marketing

Head of Marketing & Member Services ..Cynthia Matthews *e-mail:* cmatthews@r3.org.uk
Marketing Executive ....Helena Douglas *e-mail:* hdouglas@r3.org.uk
Membership Marketing Assistant ....Katherine Bassett *e-mail:* kbassett@r3.org.uk
Regional Administrator ....Sara Calvert *e-mail:* scalvert@r3.org.uk
Database & IT Administrator ....Samit Vadgama *e-mail:* svadgama@r3.org.uk

Communications, Public Affairs and Policy

Director of Communications & Public Affairs ....Victoria Johnson *e-mail:* vjohnson@r3.org.uk
Communications Manager ....Will Black *e-mail:* wblack@r3.org.uk
Policy Manager ....Esme Harwood *e-mail:* eharwood@r3.org.uk
Communications Officer ....Addy Frederick *e-mail:* afrederick@r3.org.uk
External Communications Officer ....Charlotte Towerton *e-mail:* c.towerton@r3.org.uk
Public Affairs Officer ....Laura Harvey *e-mail:* lharvey@r3.org.uk

Smaller Practices Group

Smaller Practices Group Committee Support Executive ....Emma Lovell *e-mail:* elovell@r3.org.uk

Education, Courses and Conferences

(Tel: 020 7566 4234; Fax: 020 7566 4225)
Training Director ....David White *e-mail:* dwhite@r3.org.uk
Head of Courses and Conferences ....Angela Stannard *e-mail:* astannard@r3.org.uk
Courses and Conferences Organiser ....Natalie Harvey *e-mail:* nharvey@r3.org.uk
Courses and Conferences Producer ....Zoï Fletcher *e-mail:* zoi.fletcher@r3.org.uk
Courses and Conferences Co-ordinator ..May Ghaghda *e-mail:* mghaghda@r3.org.uk
Course Administration ....Maggie Dean *e-mail:* mdean@r3.org.uk
Course Bookings ....*e-mail:* courses@r3.org.uk

Technical

Technical Director ....John Francis *e-mail:* jfrancis@r3.org.uk

Committee Chairs

Constitution Adviser ....Deborah Gregory 020 7296 2000
Education, Courses and Conferences ....Jane Moriarty 020 7311 1000
General Technical Committee ....Giles Frampton 01752 690101
Membership and Member Services ....Lee Manning 020 7936 3000
Regional Communications Committee ....Chris Williams 01603 877540
Scottish Technical Committee ....Rachel Grant 0131 273 3771
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Regional Chairs

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Northern Ireland ....Brian Murphy 028 9043 9009
Scotland ....Judith Howson 0141 204 2800
Southern ....Nick Keitley 0845 415 000
South West & Wales ....Andrew Sheridan 0117 945 2000
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Women's Group ....see www.r3.org.uk/womensgroup

Regional Representatives on the R3 Council

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London & South East ....Stephen Grant 01491 725544
Midlands ....James Nicholls 01743 453050
North East ....Jim James 0191 204 4000
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Northern Ireland ....Joan Houston 02890 443500
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Southern ....Julie Palmer 01202 786 560
South West & Wales ....Richard Hill 0117 905 4069
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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 examination of the Joint Insolvency Examination Board (JIEB) or Certificate of Proficiency in Insolvency (CPI). Pass students of these exams are eligible to apply for full R3 membership.

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

Leading firm of Property and Asset Consultants, **Edward Symmons** has announced that after 8 years as Senior Partner, **Paul Proctor** has been appointed to the new position of Chairman. He will be responsible for client development and market direction, building upon the firm's strong reputation, particularly within the Recovery, Banking and ABL markets.

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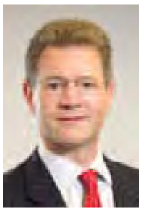

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James sits on R3's Education and Courses Committee, and speaks regularly at restructuring seminars.

Tel: 020 7065 0733
Email: james.money@uk.pkf.com

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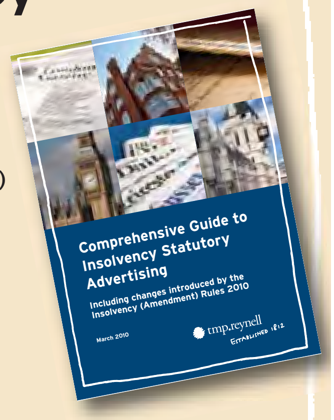
Comprehensive Guide to Insolvency Statutory Advertising



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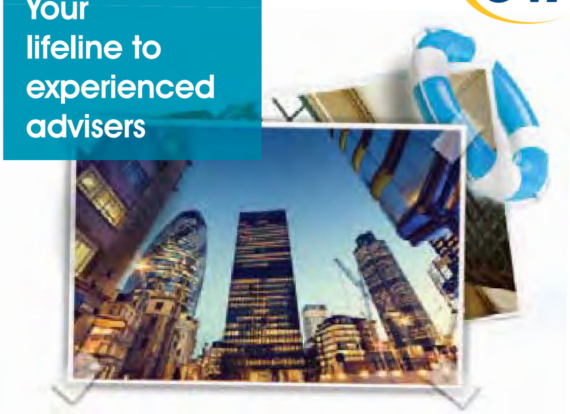

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Interview with Frances Coulson

Frances Coulson is the new president of R3. She is keen to ensure that the voice of the profession is heard as changes to insolvency law are being considered that could impact on practitioner work for years to come.

Did you set out to become an IP?

I am not an IP. My clients are mainly IPs, however. I did always know (from aged nine) that I wanted to be a solicitor, first because I was impressed with my dad, who was a solicitor, and secondly, because it seems infinitely variable, challenging and interesting. Insolvency (as for many people) was not a plan, but if there is a clue, I did qualify in 1986!

Do you specialise in particular types of insolvency/restructuring?

I specialise in insolvency litigation, mainly involving antecedent transactions and fraud. This may be foolhardy so on the back of my office door hangs a stab vest! I enjoy the complexities of fraud and the satisfaction, where possible, of recovering something for creditors. Otherwise I undertake various elements of corporate and personal insolvency.

What are you most looking forward to in your year as president?

Having an input on behalf of the profession and trying to ensure our voice is heard, not only to prevent unnecessary change but also to prevent wasted costs, which at the end of the day cost the creditors. I am also keen to see discussion on things like the level of bankruptcy petition fees, which I think may act as a barrier to entry to that relief, and a single, regulated gateway so that people in distress get the best advice.

What outcomes from The Insolvency Service consultation on regulation (following the OFT market study) have R3 been particularly keen to achieve, and how do you hope to do this?

Well, as stated above, I do not want to see costs added to the process to no good end, nor an erosion of the statutory order of creditors, but I think we do need to tackle transparency, as well as educate unsecured creditors on how to get involved and where they can make a difference. That said, it has to be accepted that when the insolvency profession becomes involved we are always starting at less than 100 per cent of what people want, and so have to handle disappointment from the start. I would like to see a longer period of evaluation of the April 2010 proposals before any decisions are taken on changes aimed at forcing greater engagement of unsecured creditors.

Frances Coulson became R3 president on 15 April 2011.

> "I specialise in insolvency litigation, mainly involving antecedent transactions and fraud. This may be foolhardy so on the back of my office door hangs a stab vest!"

What other challenges will R3 have to address on behalf of its members during your term of office?

Many and various I am sure. We will be looking at the consumer credit and personal insolvency review, the Jackson proposals, expenses in administration and many other issues that may affect our members as well as creditors overall. The key, it seems to me, is to ensure balance and proportionality, not change for the sake of it, and there are many issues that should be tackled for the better management of insolvency cases, such as admin expenses. I would like to ensure that we listen to our members and that we engage with all sizes and types of firm within R3 so that we get the broadest input we can into our work with government and stakeholders.

Globally, what challenges does the UK face in terms of competing for growth?

I wonder whether the baton has already passed irrevocably from West to East, with the latter henceforth enjoying healthy growth and the former pretty sluggish. There are massive implications for businesses that are even trying to compete head-on with the Far East. I recently travelled in India and have done so in Thailand and elsewhere in Asia and am impressed with the energy and entrepreneurialism found there.

We could experience a real-term contraction in the UK economy (with inflation now 4.4 per cent) possibly year-in, year-out. That means the level of public services and welfare state we are used to is unaffordable – not just this year, but forever. And we need to learn how to live with that, and how to educate our people to succeed in that environment.

Other interesting questions involve the impact of the internet and technology on the so-called 'knowledge-based' economy, which is big in the UK. By this I mean media, music, books, TV, film, images, software and games. Once it's digital, it's 'clonable', and kids who know no better (with parents who don't even understand the question) have become used to helping themselves to all of this stuff for free.

What are your interests outside of work?

Being on a horse or mucking out, playing real tennis, or socialising with friends; but mainly being on a horse. I am rarely clean and presentable at weekends!

Sarah Houghton is the publishing manager of *RECOVERY*.

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