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RECOVERY

Fraud

Uncovering fraud in an insolvency can complicate matters…

Plus
Careers and professional development supplement

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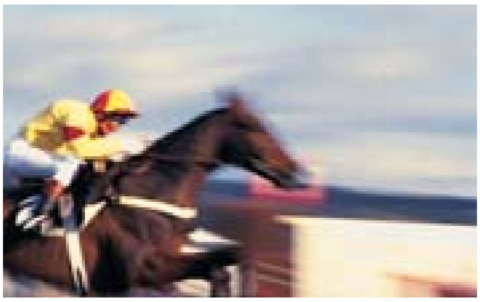

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Editorial

There are two calls from senior practitioners in this issue of *RECOVERY* for The Insolvency Service to enhance insolvency regulation. Bryan Jackson (p31), in the context of pre-packs, proposes that The Service should focus on specific cases of bad practice and root them out of the industry – a practical and unobjectionable task.

Alan Bloom (p47) addresses the broader issue of the number of regulators, describing the present arrangements as unwieldy, a 25-year-old issue and something perhaps to be tackled at the behest of the OFT. Alan's is not an isolated view: Austin Mitchell MP decried the abundance of regulatory bodies at the APPG meeting in February (which is reported in the president's column and our news pages) and was supported on the point by a leading practitioner.

It must be right in response to those opinions to raise the question, despite the actual efficacy of the present regulatory regime, of whether the profession and the public interest might benefit from a system of insolvency regulation that is more clearly *perceived* to be effective by those outside the industry.

As a profession we are often derided. We should satisfy our detractors with evidence and conviction that our professionalism and honesty are unimpeachable.

Alan Bloom notes that self-regulation is the best but not the only way forward. However insolvency regulation develops, it should help us to convince the public that we are honest and genuine professionals with nothing to hide.

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

The UAE: a maturing landscape

The UAE is an emerging market that is going through testing economic times – but by addressing the growing pains it seeks to emerge stronger and fitter to meet future challenges.

News reporting on the UAE over the past year has largely focused on the impact the global economic crisis has, or has not, had on the economy of this country. Interest in the UAE, in particular Dubai, has been high, at times appearing obsessed with this developing market – a market that has transformed itself over the past decade. In general, reporting has ranged from positive to negative, right through to the absurd. Much of the emphasis has been on the property market, corporate governance issues and, more recently, complications that arise when dealing with quasi-sovereign debt. Amid all of this dialogue lies one important point: the UAE is an emerging market and the current challenges offer great opportunities for it to mature and develop in many areas. Below, we offer specific examples of such developments as they help the UAE landscape mature and the spin-off effect this will have on the UAE economy.

Secured financing and enforcement

Until recently, we rarely saw any type of serious defaults on loans in the UAE. This absence of defaults extended across retail lending, corporate finance and larger project and infrastructure finance. The effect of this, and the lack of enforcement action for debt recovery, is that little to no legal precedent has been available to clarify the legal rights of the parties entering into secured debt transactions. This situation has now improved in the UAE and will continue to do so during 2010. While not an alarming number, we have now had a flow of retail and corporate defaults, followed by the resulting enforcement actions, working through the courts for the first time. Such cases allow both the courts and the legal community to fine tune the application of the relevant laws and clarify what parties can expect in relation to their legal rights when entering into secured debt transactions. While elementary, this is a fundamentally important development that is necessary for the UAE landscape to mature, a development that will offer greater certainty to lenders operating in the UAE, and should see the return of lending at all levels.

Restructuring

In the same vein, until recently, the UAE market had not seen a public corporate restructuring, but now there are at least two underway involving companies with significant operations and borrowings in the UAE. While these restructurings are progressing and the results are not yet known, the fact that the local stakeholders are participating in such a process will lead to more experienced and sophisticated regulators, lenders, advisers and executive talent for the future.

Insolvency laws

As a result of both these restructurings, and the generally precarious financial position many local companies face in the current economic climate, increased attention has been given by the government, regulators and local advisory community to the bankruptcy and insolvency regime available in the UAE. To date there has not been a significant corporate bankruptcy processed through the UAE courts so the existing regime remains largely untested. However, currently the government of the UAE is reviewing, updating and improving the bankruptcy and insolvency regime with a view to implementing a new federal law. If the new law is at all in line with international practice (which we are confident will be the case), it will improve the protections and procedures currently available. A rationalised bankruptcy and insolvency regime will provide comfort to businesses and other stakeholders and will be an important step in the maturing of the UAE landscape.

> “A rationalised bankruptcy and insolvency regime will provide comfort to businesses and other stakeholders and will be an important step in the maturing of the UAE landscape.”

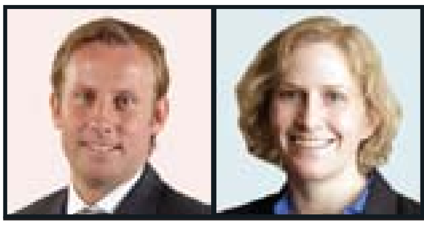
Improved credit risk analysis

Deriving from the increase in defaults and resulting enforcement actions is a related issue for lenders in the UAE. Due to a number of factors, not least being the booming UAE economy over the past five years, some practices in relation to credit risk analysis supporting lending decisions have been questionable and, as expected, have been the subject of review. The net result is that lenders are now more cautious when extending financing and in general are implementing improved risk and credit assessment policies and procedures internally. Such improvements are important for the long-term stability of the local economy and should contribute to an overall improvement in the quality of the financial services industry in the UAE and regional markets.

Summary

To summarise, the UAE is an emerging market and, as such, is facing certain challenges for the first time. One perspective on these current challenges is that they are normal and necessary for evolving into a more stable jurisdiction where businesses can come and rely on a certain level of predictability and consistency in the underlying legal and regulatory framework. In actual fact, the UAE already provides a baseline of stability that has led many businesses to set up in the UAE, from which to conduct their operations throughout the MENA[1] region and Asia. Merger and acquisition activity is on the increase locally, the IPO market is rumoured to be on the upswing, the UAE is actively used as a base for expanding into areas such as Iraq and Saudi Arabia and developments in the UAE have a knock-on effect on other countries in the region that also need to stabilise and mature. However, despite the relative stability and openness in the UAE, which makes it attractive throughout the region and beyond, there is room for improvement. Such improvements are underway and, backed by the proactive UAE leadership, will continue as the UAE experiences what can be considered the growing pains necessary for maturing. ☐

[1] Middle East and North Africa



Jody Waugh is a partner and Sarah Florer is an associate at Al Tamimi & Company

President's column

Peter Sargent highlights the key events and initiatives during his presidency and assesses the challenges ahead for R3's new president.

I find it hard to believe that this is the last time that I shall be writing as R3 president for *RECOVERY* magazine. The time has flown by and I would like to look back as well as outline the challenges I believe my successor Steven Law will face.

Steven takes over as an OFT market study into corporate insolvency is ongoing, a move that crystallises the scrutiny our profession finds itself under. I hope R3's submissions and those of other insolvency practitioner firms are taken on board as we are the ones who have to use the legislation. (See article on page 29.)

We have the material to explain the value of our work but I think the challenge for R3 and Steven will be making sure we keep delivering our messages to the key decision makers. However, the foundations of these messages were laid during my presidency and I would like to outline what they were. If I had to pick five key achievements that happened during my presidency they would be: the establishment of the All-Party Parliamentary Group (APPG) on insolvency; R3 at the 2009 party conferences; the memorandum of understanding with Jobcentre Plus (JCP); explaining the role of pre-packs; and the work of our regional R3 committees.

> "The point of SIP 16 is to influence behaviour and discourage inappropriate pre-packs and it does this by focusing the minds of IPs on how they conduct things in the pre-appointment period."

The All-Party Parliamentary Group on insolvency

Setting up the APPG on insolvency was no mean feat and has been in the pipeline for a number of years. Launched last summer by Natascha Engel MP, the first meeting was on 9 February this year discussing the topic of fees. This was an opportunity for IPs to explain the value of what we do, face to face to a group of MPs.

For me personally, attending both the Labour and Conservative party conferences and speaking at the fringe events was a highlight. The Labour fringe event in Brighton was a muted affair in contrast to the same event at the Conservative conference in Manchester, which was just like an old-fashioned creditors' meeting with plenty of heated debate and comment. This year's fringe events were co-hosted by the Smith Institute and, in the case of the Conservative event, the Centre of Social Justice in conjunction with the Smith Institute. R3 was able to secure the relevant minister (Ian Lucas MP, minister for business and regulatory reform) and shadow minister (John Penrose MP, shadow minister for business, enterprise & regulatory reform) alongside Jonathan Guthrie, enterprise editor for the *Financial Times*. I was able to use the platform to defend the UK's insolvency regime, call for changes to CVAs and demand more action on directors' disqualification.

Memorandum of understanding with Jobcentre Plus

The memorandum of understanding signed by R3, the Insolvency Service (IS) and JCP on 22 October was a positive development. IPs can help themselves by passing on employee queries directly to JCP whose staff will come out on site at short notice to advise those affected. One of the controversial issues in dealing with employees has been the lack of proper notice and consultation. In some cases because of the speed at which we must work or lack of funding, it is inevitable that consultation will not take place. Difficult decisions over whether or not to continue to trade have to be made and as a result, protective awards will happen. However, I urge IPs to embrace the consultation process wherever possible.

Pre-packs – a contentious issue

The most hotly debated issue last year must be pre-packs. We have had all the usual arguments about lack of creditor consultation and notice, as well as competitive advantage for the rescued business. It became such a big issue that the government got involved and required all SIP 16 reports be vetted by the IS, something that will continue until it is happy with its view of the compliance rate. The IS sees a list of items to be included in a report and it bases its view of the effectiveness of the SIP on compliance with this list. But the point of SIP 16 is to influence behaviour and discourage inappropriate pre-packs and it does this by focusing the minds of IPs on how they conduct things in the pre-appointment period. The way to see if SIP 16 is working is to see whether the number of 'bad' pre-packs diminishes – if it does, then it is likely to be because the SIP is working. I think this reflects both the government's concern over pre-packs and its desire to see businesses saved, which pre-packs clearly can do. I was personally harangued over pre-packs by guests at a private regional Bank of England agent's dinner and the strength of feeling was incredible. I held firm in our beliefs that a pre-pack, in the right circumstances, saves jobs and businesses for the good of all, even though some unsecured creditors may not get paid. In the media, R3 contributed to over 100 articles on pre-packs alone for 2009, often providing balance to skewed coverage. I should add the general media output has been phenomenal in all mediums during my term and I have featured in everything from the *Financial Times* to the *Huddersfield Examiner* and from Channel 4 News to the United Christian Broadcasters.

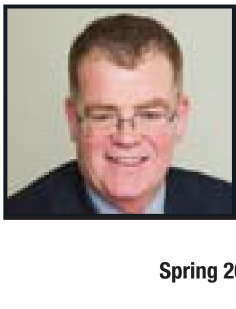
And finally…

Having visited most of the regions, I am amazed at the amount of hard work and dedication shown by the regional committees. At a national level, members give up their valuable time to work on both national committees and on council. To everyone a big thank you; without your hard work, R3 wouldn't be the leading light it is in forming opinion and providing technical guidance for our profession.

The staff at R3 have been fantastic to work with and they have taken me outside of my normal comfort zone every day of my presidency. It has been hard work, very challenging but great fun and to you the members of R3, a big thank you for allowing me to represent you. I hope you feel I have done a good job.

Finally I must thank my vice-president Steven Law for all his support and wish him every success for his year in office. We have just heard that Frances Coulson has just been appointed deputy vice-president, and she will be an excellent addition to the R3 presidential succession.

Au revoir. □



Peter Sargent is a partner at Begbies Traynor.

News update

First APPG meeting

The first All Party Parliamentary Group meeting on 9 February fulfilled its brief of breaking down and explaining insolvency issues to a busy Westminster audience, with clear presentations by Dr Sandra Frisby and Neville Kahn. Questions and concerns from Barry Sheerman MP and Austin Mitchell MP were addressed in the tight one-hour time slot. The meeting was also well attended by other stakeholders including representatives from Ernst & Young, British Property Federation, IPA, HMRC, RBS, IPC, ACCA and many R3 council members.

Sponsor's name change

R3 sponsor, Insolvency Risk Services (IRS), has changed its name from Lockton. The company is a wholly owned subsidiary of Amlin plc. IRS will still offer excellent customer service and claims handling, and operate from its national network of regional offices.

Dubai prepares for asset sales

Moody's *Weekly Credit Outlook* has reported that Dubai Inc. – the term used to describe the myriad of government-owned companies in Dubai – has started to place some of its performing non-core assets up for sale. This attempts to address the debt of government-related issuers of up to $100 billion, of which Moody estimates approximately half will fall due over the next three years. The sale of Dubai's investments is likely to be a long and drawn-out process, particularly as companies plan to avoid fire-sales and heavy discounts.

In contrast, *Weekly Credit Outlook* also reports that the Australian government is first to end bank debt guarantees. In a demonstration of confidence, from 24 March 2010, applications under its guarantee scheme for bank wholesale debt and deposits over AUD 1 million will no longer be accepted.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New communications officer at R3

Addy Frederick is R3's new communications officer in the press, policy and public affairs team. Prior to joining R3, she worked in the communications team at the payments association, UK Payments. She will be responsible for co-ordinating R3's regional PR activity and will provide media support on national PR campaigns.

Statistics from the IS

Company insolvencies

Figures from The Insolvency Service for Q4 2009 indicate that there were 4,566 compulsory liquidations and creditors' voluntary liquidations in total in England and Wales (on a seasonally adjusted basis). This was a decrease of 1.7 per cent on the previous quarter and a decrease of 1.1 per cent on the same period a year ago.

This was made up of 1,338 compulsory liquidations (up 2.7 per cent on the previous quarter but down 14.2 per cent on the corresponding quarter of 2008) and 3,228 creditors' voluntary liquidations (down 3.5 per cent on the previous quarter but up 5.7 per cent on the corresponding quarter of 2008). In the twelve months ending Q4 2009, approximately one in 114 active companies (or 0.9 per cent) went into liquidation, which is approximately the same as the previous quarter.

Company liquidations in England and Wales (seasonally adjusted)[1]

	08Q4	09Q1r	09Q2r	09Q3r	09Q4p
Company liquidations	4,615	4,919	4,944	4,648	4,566
Compulsory	1,560	1,560	1,442	1,303	1,338
Creditors' voluntary[2]	3,055	3,359	3,502	3,345	3,228

Sources: Insolvency Service and Companies House
p = provisional, r = revised

[1] Longer series back to 2000 are presented in tables on the IS website
[2] Where the CVL is the first insolvency procedure entered into

Individual insolvencies

There were 35,574 individual insolvencies in England and Wales in the fourth quarter of 2009. This was an increase of 24.9 per cent on the same period a year ago.

This was made up of 17,007 bankruptcies (down 5.5 per cent on the corresponding quarter of 2008), 13,219 individual voluntary arrangements (up 26.3 per cent on the corresponding quarter of 2008) and 5,348 debt relief orders.

Individual insolvencies in England and Wales (not seasonally adjusted)

	08Q4	09Q1	09Q2	09Q3	09Q4p
Total individuals	**28,471**	**30,253**	**33,073**	**35,242**	**35,574**
Bankruptcy orders	18,004	20,446	18,870	18,347	17,007
Debt relief orders			1,978	4,505	5,348
IVAs	10,467	9,807	12,225	12,390	13,219

Source: Insolvency Service p = provisional

Insolvent deals have doubled in a year

Acquisitions of insolvent businesses in the UK have more than doubled over the past year and remain at high levels, according to research into mergers and acquisitions by Experian Corpfin on behalf of R3.

During the fourth quarter of 2009, 67 out of the 630 deals completed in the UK – one in nine of all deals – involved companies acquired out of administration or other formal insolvency procedures. During the whole year, there were 345 acquisitions of distressed businesses: one in every eight M&As. This compares with 159 distressed acquisitions during 2008: one in 27 M&As.

R3 predicts time lag in insolvency

R3's research indicates that, during the 1990s, the peak in the number of corporate liquidations came five quarters after the return to growth and the high point for personal insolvencies came 18 months later. In the 1980s the lag was even greater: personal insolvencies peaked three years after the official end of the recession and corporate insolvencies took another year to reach that point.

The lag occurs because it takes time for any tangible benefits of recovery to feed through to companies. R3 predicts a similar lag this time and estimates that corporate insolvencies will reach 28,000 this year and remain high in 2011, at about 27,000.

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Obituary: Michael Green

There can be few in the insolvency industry who will not have known of Michael Green and his insolvency research work at Bangor University; and so it is sad to record that Michael died last December while recuperating from multiple-bypass heart surgery. His principal insolvency-related focus over the past six years or so was on IVAs, but his interest extended across the whole personal insolvency landscape, more recently taking in the current debate about Debt Management Plans and the question of their regulation.

In many respects, Michael was an atypical academic, as he came into academe relatively late in life after a career in accountancy and business, which had given him wide experience of business turnaround, rescue and restructuring.

Recurring and strong themes in Michael's work related to the disconnect, as he often saw it, between public policy (what it was and what he thought it ought to be) and the way those working with people in financial difficulty (insolvency practitioners; other debt solution providers; regulators; The Insolvency Service; banks; and advisory bodies) acted in practice. Michael's forthright and passionate advocacy of his ideas and principles could never be ignored; and with his passing the field of insolvency research, which is less fully populated by academics than its importance and significance to the economy and to the over-indebted arguably merits, will be the poorer and certainly less colourful.

Michael was a regular attendee at insolvency research seminars and conferences, often as a formal speaker and always from the floor, most recently the Third Insolvency Service Research Seminar

In addition to making his work and research readily available to the industry, on the personal front, Michael was equally generous with his time and advice, and very good company as well, as those who were ever privileged to have dinner with him will attest.

Our sympathies go to Gill, his wife, and his family; also to his students and colleagues at Bangor University and his academic peers. All of us have lost an irreplaceable friend and stimulator of thought and debate. Arthur Michael Green died 21 December 2009, aged 64 years.

Graham Rumney,
chief executive officer of R3.

The anti-deprivation principle rears its head

A recent feature of the credit-crunch insolvency landscape is the return to prominence of the anti-deprivation principle. The legal update explains what it is and examines two recent cases in which it has been invoked.

The anti-deprivation principle (sometimes known as the British Eagle principle) is often summarised in the maxim: '*There cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors.*' (per Lord Justice Cotton in *Ex p Jay* (1880) 14 Ch D 19).

What had traditionally been a seldom litigated and somewhat opaque aspect of insolvency law has been the subject of two recent cases, *Perpetual* and *Butters*. In each, it was argued that this principle rendered unenforceable parts of the complex contracts that the parties had entered. In an unusual step arising from their coincidental timing, appeals in each case were heard together. They are the subject of a combined judgment delivered by the Court of Appeal on 6 November 2009 (*Perpetual Trustee Company Limited* v. *BNY Corporate Trustee Services Limited and Another*; *Butters and others* v. *BBC Worldwide Limited and others* [2009] EWCA Civ 1160).

The principle, when applicable, operates to support the fundamental tenet of insolvency law that (absent security rights or statutory exceptions) a debtor's assets should be applied *pari passu* and in accordance with creditors' rights at the outset of any insolvency process. The scope of this principle and, in particular, its interplay with the equally fundamental but conflicting public policy rule that there should be freedom of contract has long been the subject of vigorous debate.

Perpetual

The *Perpetual* case arose in the structured finance arena, and involved a multibillion dollar synthetic collateralised debt obligation (CDO) programme created by Lehman Brothers. In summary, noteholders subscribed for notes issued by a special purpose vehicle (SPV) and the subscription money was used to purchase collateral. At the same time, the SPV entered into a credit default swap with Lehman Brothers Special Financing Inc (the swap counterparty), whose obligations were guaranteed by Lehman Brothers Holdings Inc (the swap guarantor).

These arrangements were embodied in an ISDA[1] master agreement governed by English law. They give the noteholders synthetic exposure to the credit performance of various entities identified in the swap agreement. The swap counterparty would pay the SPV sufficient funds to cover the SPV's obligations on the notes and, in exchange, the SPV would pass its income from the collateral to the swap counterparty.

The notes were constituted by, among other things, a principal trust deed and a supplemental trust deed (the trust deeds, governed by English law). These were binding on the SPV, the noteholders and the swap counterparty and, under these documents, the SPV granted security over the collateral to the security trustee. The trust deeds provided that if enforcement events occurred, after defraying various costs, the collateral should be applied by the security trustee:

- first, to pay any close-out amounts due from the SPV to the swap counterparty under the swap agreement, and thereafter towards sums due from the SPV to noteholders under the notes; unless

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- a default had taken place under the swap agreement and the swap counterparty was the defaulting party (as that term is used in the ISDA master agreement), in which case the priority was to be reversed so that the noteholders ranked ahead of the swap counterparty for repayment from the SPV's collateral.

Such clauses altering the waterfall priority of payments in different circumstances (referred to as a 'flip' clause by the Court of Appeal) are common in a number of structured finance contexts.

> "The swap counterparty contended that the contractual provisions, which purported to demote its priority status upon its bankruptcy, were unenforceable by virtue of the anti-deprivation principle."

The Lehmans collapse involved the swap guarantor filing for Chapter 11 bankruptcy protection on 15 September 2008, with the swap counterparty following suit on 3 October 2008. Each of these filings constituted a bankruptcy event of default under the swap agreement, with the swap counterparty in each case being the defaulting party. Each of these events was *prima facie* sufficient to trigger the flip in priority described above.

However, the swap counterparty argued that until it filed for Chapter 11 and so defaulted on the swap, it had enjoyed priority for any amounts that might be due to it on close-out of the swap. Upon its filing for bankruptcy, however, it became subordinated to the noteholders. The swap counterparty contended that the contractual provisions, which purported to demote its priority status upon its bankruptcy, were unenforceable by virtue of the anti-deprivation principle.

Upholding the first instance decision of the chancellor, Sir Andrew Morritt, the Court of Appeal unanimously rejected the swap counterparty's argument for reasons described further below. Permission to bring a final appeal has been sought, but at the time of writing has not yet been determined by the Supreme Court.

Butters

The *Butters* case was an intellectual property licensing dispute arising from the collapse of the Woolworths retail chain. It was very different factually to *Perpetual*. Focusing on the issues relevant to anti-deprivation, BBC Worldwide (BBCW) had entered into a joint venture with Woolworths Group plc (Group) and its subsidiary, Woolworths Media plc (Media). The joint venture vehicle was a company called 2 Entertain Limited (2E); 60 per cent of the shares in 2E were held by BBCW and 40 per cent were held by Media. BBC Video Limited (Video) was a subsidiary of 2E. It thus was also within the joint venture structure.

This dispute surrounded two closely related contractual documents:

- a joint venture agreement (the JV agreement) to which BBCW, Group, Media and 2E were parties; and
- a master licence agreement (the licence) between BBCW and Video by which BBCW licensed various intellectual property rights, including the right to manufacture and distribute DVDs, to Video.

The dispute stemmed from two expressly linked provisions. The joint venture agreement provided that if Media or Group suffered any of various defined insolvency events, BBCW could serve a notice compulsorily to acquire Media's shares in 2E. That acquisition was to be at fair value as determined by an investment bank, which was essentially to be the market value of the shares except that no discount was to be made for the fact that the shares represented only a minority (40 per cent) holding in 2E.

> "In *Perpetual*, Lord Justice Patten noted that the anti-deprivation principle sought to negate contractual provisions that purported to apply an asset of the insolvent debtor in a manner other than required by the *pari passu* rule."

The licence also contained a provision whereby, if Media or Group suffered an insolvency event and BBCW served a notice to acquire Media's shares in 2E, BBCW's licence with Video would terminate immediately. The effect of this termination would, in practice, be to reduce the market value that BBCW had to pay for Media's 40 per cent shareholding in 2E, because Video (2E's subsidiary) would cease to enjoy the benefits of the valuable licence.

In December 2008, Group was the subject of a winding-up petition, which was not withdrawn within 15 working days. This constituted an insolvency event for the purposes of the relevant contractual provisions. Further such events followed on 27 January 2009, when Group went into administration, and on 11 February 2009, when Media went into administration. On 2 February 2009, in the light of two insolvency events having occurred in respect of Group by that point, BBCW served notice to acquire Media's shares in 2E.

Mr Butters and the other administrators of Group and Media contended that the combined operation of these provisions offended the anti-deprivation principle, an argument that succeeded before Mr Justice Peter Smith at first instance. They argued that the provisions were designed to enable BBCW to acquire Media's shares in 2E at a discount in the event of Media's insolvency, pointing to the fact that the licence did not simply terminate if Media became insolvent but only if, in addition, BBCW had elected to buy out Media's rights. The fact that, in effect, the joint venture only became less valuable if BBCW was seeking to acquire Media's interest in it was said to be objectionable and contrary to the anti-deprivation principle. This time, reversing the first instance judge, the Court of Appeal was again unanimous that these provisions did not offend the principle and were enforceable.

The Court of Appeal's approach

In many ways, *Butters* can more readily be categorised within previous authorities, which is to be expected given the complex structured finance aspects of *Perpetual*. It has long been recognised that a provision within a lease whereby it comes to an end on the insolvency of the tenant is not contrary to the anti-deprivation principle. This is because there is no property of the tenant that is being taken out of his or her insolvency – he or she only ever had a determinable interest that is being brought to an end by the third party who created the interest in the first place (the landlord). This applies to licences also, as the administrators conceded in *Butters*. In principle, a provision within a licence by which the licensor can terminate upon the licensee's insolvency is unobjectionable and is indeed commonplace.

Further, the anti-deprivation principle does not strike down fairly drawn pre-emption provisions. Thus – absent special facts – a contractual provision whereby A agrees that, upon his insolvency, he will sell a particular asset to B is unobjectionable so long as B has to pay market value for the asset. Such clauses often appear in partnership deeds and shareholder arrangements. They would fall foul of the anti-deprivation principle if they required the insolvent company to sell at an undervalue.

In these circumstances, perhaps unsurprisingly, the Court of Appeal upheld the contracts in the *Butters* case. The termination of the licence was valid – the fact that the triggering insolvency was that of the joint venturer (Media), who co-owned the licensee, and not the licensee itself (Video) was not sufficient to displace the approach to licences described above.

Likewise, the right for BBCW to purchase Media's shareholding in 2E for (at least) market value upon Media's insolvency was unobjectionable – the fact that the price paid would be reduced by the termination of the licence did not mean the price was not the proper market value. This was because the licence termination was itself legitimate and could therefore be taken into account in the valuation process. Rather than considering that the linkage of these two provisions offended the anti-deprivation principle, Lord Neuberger MR considered that, if anything, the linking of the clauses favoured Media. If the two provisions had been independent, BBCW could simply have terminated the licence without any obligation to buy Media's minority stake in the joint venture.

In *Perpetual*, Lord Justice Patten noted that the anti-deprivation principle sought to negate contractual provisions that purported to apply an asset of the insolvent debtor in a manner other than required by the *pari passu* rule, as set out above. Lord Justice Patten considered that the anti-deprivation principle was, at its core, a principle of public policy that prevented contracting out of the Insolvency Act. Looked at from that perspective, in *Perpetual*, there was simply no asset of the swap counterparty that was being removed from its estate upon the swap counterparty's filing for bankruptcy to be applied in some other way and thus the anti-deprivation principle was not offended:

> *'The only interest or property which the* [swap counterparty] *ever enjoyed in the collateral was a charge granted by the* [SPV] *on the terms of the* [trust deeds]*. That security interest remains part of the property of the* [swap counterparty] *unchanged by the event of its bankruptcy. The reversal of the order of priority... was always a facet of the security designed to regulate the competing interests over the collateral… To say that its operation in the event of the* [swap counterparty's] *bankruptcy constitutes the removal of an asset from the liquidation is to confuse the security itself with the operation of its terms in the events prescribed by the charge'.*

Lord Neuberger MR expressed considerable sympathy with Lord Justice Patten's reasoning but adopted a slightly different approach. He concluded that an additional element was at least arguably critical to the outcome in *Perpetual* namely that the collateral had originally been purchased wholly (or in certain transactions, largely) with the noteholders' funds. Thus the Master of the Rolls placed weight upon the fact that:

> *'the assets over which the charge exists were acquired with money provided by the* [noteholders] *in whose favour the flip operates, and… the flip was included merely to ensure, as far as possible, that the* [noteholders were] *repaid out of those assets all that* [they] *provided… before the* [swap counterparty] *receives any money from those assets pursuant to its charge'.*

Seeking to draw guidance from the earlier authorities, Lord Neuberger MR considered that certain factual aspects of the *Perpetual* case brought into play a number of principles evident in earlier decisions, including the suggestion that *'the* [anti-deprivation principle] *may have no application to the extent that the person in whose favour the deprivation of the asset takes effect can show that the asset, or the insolvent person's interest in the asset, was acquired with his money.'*

> In Lord Neuberger's view, the anti-deprivation principle will be inapplicable where the debtor has been deprived of an asset before it becomes the subject of a formal insolvency process... In all other cases, it is necessary to look at the nature of the right to which it is suggested the anti-deprivation rule applies.

Commentary

The Court of Appeal's decision helpfully clarifies various aspects of the anti-deprivation principle. It is particularly valuable in the *Perpetual* context through its upholding of the validity of provisions commonly used in the market. That said, a number of uncertainties remain. The difficulty in shaping a coherent theory to explain the scope of the principle is reflected in the fact that Lord Neuberger MR and Lord Justice Patten adopted different approaches.

A positive theme to emerge strongly from the Court of Appeal's judgment is that the anti-deprivation principle operates in support of the insolvency legislation and that this is a key touchstone when considering its ambit. Indeed Lord Justice Patten went so far as to suggest, drawing on the somewhat opaque 1970s House of Lords decision in *British Eagle International Airlines* v. *Compagnie Nationale Air France*, that, in truth, the anti-deprivation principle was little more than the direct application of the Insolvency Act to the provisions under consideration and the only rationale for the principle.

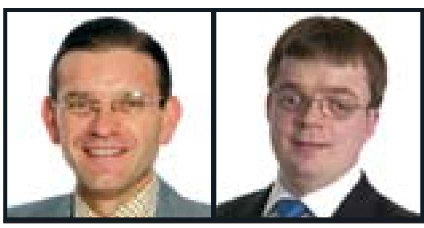
While Lord Neuberger MR's approach was perhaps not quite so narrowly drawn, he too accepted that the principle was *'dependent… on the operation of the* [Insolvency] *Act'*. It is suggested that this is a helpful starting point for practitioners who, as seems increasingly likely in the current climate, are asked to advise on the applicability of the principle to novel scenarios.

Read in this way, it could be possible to determine whether the anti-deprivation rule will operate through application of the following principles. First, the rule should only apply where the debtor has become subject to a formal insolvency process – ie, administration, liquidation or bankruptcy. In each of *Perpetual* and *Butters*, there were arguments as to when the alleged deprivation had taken place and indeed whether it could be of any relevance where a debtor had yet to enter into a formal insolvency process.

In Lord Neuberger's view, the anti-deprivation principle will be inapplicable where the debtor has been deprived of an asset before it becomes the subject of a formal insolvency process. The correctness of any allegation that the debtor had not received full value will then fall to be determined through the application of the rules on the adjustment of prior transactions – ie, preferences, transactions at an undervalue and the avoidance of floating charges.

In all other cases, it is necessary to look at the nature of the right to which it is suggested the anti-deprivation rule applies. Where a limited interest, such as a lease or a licence, is bought to an end in accordance with its terms on the insolvency of the licensee or tenant, the anti-deprivation rule will have no application. In *Perpetual*, Lehman Brothers Special Financing Inc had concluded arrangements that set out from the outset the circumstances in which two secured creditors would be entitled to payment in alternative orders of priority. To that extent, Lehman Brothers Special Financing Inc's rights could be said to be no different to the limited proprietary interest given to a tenant or the licensee of property. Read in that light, the question of whether or not an insolvent company or individual has been deprived of an asset purely through becoming the subject of an insolvency procedure becomes as much a question of fact as one of law. ☐

[1] International Swaps and Derivatives Association



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Recent case summaries

Corporate insolvency update from Ben Griffiths.

Corporate insolvency

***Goldacre (Offices) Limited* v. *Nortel Networks UK Limited* [2009] EWHC 3389 (Ch) (HHJ Purle QC)**

Facts: The respondent company (N) held two long leases over properties owned by the applicant landlord (G). N went into administration and N's administrators continued to use a relatively small part of the leased premises. An issue arose between G and N's administrators as to the amount of rent that was payable as an administration expense. G contended that the whole of each rental payment under the leases was payable as and when it fell due. N contended that, as it was using only a part of the premises, it should pay only a proportionate amount of the rent attributable to the floor space it occupied.

Held: The whole of the rental liability under the long leases was payable as an expense of the administration.

The question was whether the rental liability fell within one of the categories of administration expenses in the Insolvency Rules 1986. The judge held that the rental liabilities fell within r2.67(1)(f) as necessary disbursements by the administrator. The judge accepted that the Lundy Granite principle (as explained by the House of Lords in *Re Toshoku Finance UK Plc* [2002] 1 WLR 671) applied in this case, ie that pre-administration liabilities incurred in respect of property that is used or retained by an administrator for the better conduct of the administration are to be treated as necessary disbursements and thus expenses of the administration.

Once it was established that the rental liability fell within one of the categories of r2.67(1), then the liability was payable by N's administrators as a matter of mandatory obligation and not as a matter of discretion of the court or the administrators (dictum of Lord Hoffmann in *Re Toshoku* at [39] applied). The judge accepted that this conclusion was arguably not consistent with the decision of the Court of Appeal in *Sunberry Properties Ltd* v. *Innovate Logistics* [2009] 1 BCLC 145, which could be argued to require the court to exercise a discretion in these circumstances. However, as the *Sunberry* case had been decided on the basis of a concession and without citation of relevant authority (including *Re Toshoku*), the decision was held not to be binding. The judge went on to decide that, had he had discretion on the issue, he would have exercised it in favour of requiring N to pay the whole of the rent falling due.

Comment: The effect of the *Goldacre* decision is to require a company's administrators to pay the whole of any pre-administration contractual liability in respect of property that they wish to retain or use during the course of the administration. The administrators will not be able to seek a reduction of such liabilities in court. The decision will no doubt be welcomed by creditors. It significantly strengthens the bargaining position of creditors whose property the administrators require to use in the administration.

However, given that it is not consistent with *Innovate Logistics*, the case may not represent the final word on the matter. While the decision in *Innovate Logistics* was reached on the basis of a concession, there is no indication that the Court of Appeal regarded the concession as not having been correctly made. There remains a possibility, therefore, that the issue will come before the courts again in the future.

***Oakland* v. *Wellswood (Yorkshire) Limited* [2009] EWCA 1094, [2010] IRLR 82**

Facts: O was the general manager of Wellswood Ltd (W). W ran into financial difficulties and went into administration. The administration was a 'pre-packed administration' and certain assets of W were sold to Wellswood (Yorkshire) Ltd (N) and certain employees of W, including O, became employees of N. After just less than a year of employment by N, O was dismissed. O brought a claim against N for unfair dismissal under Employment Rights Act 1996 (ERA 1996). His claim could succeed only if he could establish that he had been continuously employed for at least one year.

In the Employment Tribunal W argued, among other matters, that by virtue of regulation 8(7) of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE), O's contract of employment had not been transferred to N because W, as the former employer, was 'the subject of bankruptcy proceedings or... analogous insolvency proceedings'. Accordingly, no account could be taken of O's period of employment with W and he had not been continuously employed for at least one year. This argument was accepted by both the Employment Tribunal and the Employment Appeal Tribunal and O's claim was dismissed. O appealed to the Court of Appeal.

Held: The Court of Appeal allowed the appeal on the basis of s218(1) of the ERA 1996, which provides that a person's period of employment is to be treated as continuous where the trade or business of the employer is transferred. Although the court declined definitively to decide whether as a matter of principle an administration necessarily precludes regulation 8(7) of TUPE, it emphasised that there were 'strong grounds for thinking that both the Employment Tribunal and the Employment Appeal Tribunal took the wrong approach to the construction of... regulation 8 [of TUPE]' and that it was a 'strongly arguable point'.

Comment: The decisions of the Employment Tribunal and Employment Appeal Tribunal in the Oakland case on the applicability of regulation 8(7) of TUPE to administrations had come as a surprise to many insolvency practitioners and lawyers. While the point is not yet finally settled, it is highly arguable that those decisions are not correct. In any event, most employees of businesses that are transferred as part of a pre-packed administration will have standing to bring unfair dismissal proceedings within the first year of their employment with the transferee company by virtue of s218(1) of the ERA 1996. They should not, therefore, be affected by the current uncertainty surrounding the scope of regulation 8(7). □

Ben Griffiths is a barrister at Erskine Chambers.

Technical update

Richard Heis examines online filing of corporation tax and VAT returns and reform of the bankruptcy petition and discharge processes.

Filing of company tax returns and corporation tax payments

As members may be aware, the way in which companies are required to deliver their tax returns for corporation tax purposes is changing. From 1 April 2011, for accounting periods ending after 31 March 2010, companies will be required to submit their company tax return online. Under this new regime, companies will need to file their 'full' return online, including statutory accounts and computations in an electronic format known as iXBRL[1].

Due to the lack of complete financial information typically encountered for companies within a formal insolvency procedure (eg outstanding statutory accounts, missing books and records etc), such a regime is likely to be problematic for insolvency practitioners. Consequently, failure to deliver returns in the prescribed format could lead to their rejection, imposition of penalties and, ultimately, delay and additional costs in exiting the relevant insolvency process.

Faced with these challenges, the R3 Tax Technical Group made representations (led by Barry Potter of KPMG, Steve Martins of PwC and Marcus Rea of Deloitte) to HM Revenue and Customs (HMRC). As a result, specific exemption from the regime has been secured in the published regulations for companies in administration, administrative receivership and compulsory liquidation (via the Income and Corporation Taxes (Electronic Communications) (Amendment) Regulations 2009 – SI 2009/3218). HMRC has also now agreed to extend this exemption to creditors' voluntary liquidations.

Therefore, companies within these insolvency procedures are exempted from filing company tax returns online. Existing HMRC guidance about accepting 'informal' paper returns based on relevant available information (eg unaudited management accounts, statement of affairs, schedules of receipts and payments, sale and purchase agreements etc) will remain in place.

The R3 Tax Technical Group is also currently making representations to HMRC in relation to the impact of the new online filing regime for solvent companies within a members' voluntary liquidation. It is hoped to provide details of the outcome of these representations in the next edition of *RECOVERY*.

For completeness, from 1 April 2011 companies will also be required to pay corporation tax-related payments electronically[2]. For the avoidance of doubt, this provision will apply for companies in administration, administrative receivership, compulsory liquidation, creditors' voluntary liquidation and members' voluntary liquidation.

> "Specific exemption from the regime has been secured in the published regulations for companies in administration, administrative receivership and compulsory liquidation."

Online filing of VAT returns

Last year HMRC consulted members of the insolvency profession on the impact of a proposed new regulation requiring traders with a turnover of £100,000 or more per annum to file their VAT returns online.

As a result of concerns raised by the insolvency profession during the course of that consultation, HMRC has announced that the requirement to file VAT returns online will not affect businesses subject to the following insolvency procedures:

- bankruptcy
- sequestration
- liquidation
- administrative receivership

Businesses subject to administration, voluntary arrangement and trust deeds will receive, or have already received, a notice from HMRC telling them that they are mandated to file VAT returns online. Any businesses subject to these procedures who wish to continue to file paper returns may request this using one of the following options:

- For five or more requests, e-mail marketing.online@hmrc.gsi.gov.uk and put 'Insolvency-Review' in the subject box. The VAT registration number of each business on the list on behalf of which the request is made will need to be included. The list will be e-mailed back with a confirmation that the cases have changed back to paper filing and, if not, why it wasn't possible.
- For less then five requests, e-mail as above or, alternately, dial 01432 365766 quoting the businesses VAT registration number and request that the business be exempted from the requirement to file online on the grounds of insolvency.
- If a specific written response for individual cases is required, then the request should be sent in writing to the address of the review team as indicated in the mandation notice.

Requests for administrations must obviously come from the administrator. In the case of voluntary arrangements and trust deeds, an IP acting as supervisor should advise the trader of the above options. HMRC will accept written requests from supervisors if they confirm that they have been authorised by the trader to make the request on their behalf.

Bankruptcy – reform of the debtor petition process and early discharge

In November 2009, The Insolvency Service published its consultation document, *Reforming Debtor Petition, Bankruptcy and Early Discharge from Bankruptcy*. This follows on from an earlier consultation on reform of the debtor petition process in October 2007 (which did not extend to early discharge).

The proposals are intended to address the problems caused by the pressure placed on the Courts Service by the increase in debtors' bankruptcy petitions in recent years. According to research carried out for The Insolvency Service, in some parts of England and Wales debtors face delays of up to three months between the time they

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first contacted the court to arrange an appointment to file their petition to the making of the bankruptcy order.

The consultation document proposes to deal with this problem by removing the courts from the process altogether, and providing for bankruptcy orders on debtors' petitions to be made administratively by an official specifically appointed for the purpose by the Secretary of State called the 'decision maker' (DM). The debtor would be able to fill out his or her application and statement of affairs electronically online, or alternatively make an application in paper form by post.

The DM would have the power to make a bankruptcy order if satisfied that the debtor was insolvent, that the debtor's centre of main interest (COMI) was in England and Wales, and that there was no reason to reject or refuse to make an order.

The DM would have the power to ask the debtor for more information, and there would be power to refuse a bankruptcy application and to refuse to make a bankruptcy order if the DM was not satisfied that the debtor was insolvent, that his or her COMI was in England and Wales, the application was not an abuse of process or if the debtor failed to provide satisfactory information.

The DM would have a duty to determine the application by either making the bankruptcy order or by refusing to do so and, in the case of refusal, would have to give his or her reasons.

The DM would have to make a decision within two working days of the application being made, and the debtor would have 14 days to ask the DM to review the decision if not satisfied. There would be an ultimate right of appeal to the court.

The DM would be a different person from the official receiver, who would continue to perform his or her functions following the making of the bankruptcy order as he does now.

The intention is to make the process self-financing, so the costs incurred in processing an application would be met in full from the fee charged, with no remissions or exemptions.

The document also proposes to remove the discretionary ability to grant early discharge, as it does not appear to have had any significant effect on reducing the stigma of bankruptcy or encouraging early rehabilitation.

As well as inviting responses to the consultation document, The Insolvency Service held a stakeholders' meeting on 12 January (at which R3 was represented) to hear the views of key interested parties.

> "The proposals in *Reforming Debtor Petition, Bankruptcy and Early Discharge from Bankruptcy* are intended to address the problems caused by the pressure placed on the Courts Service by the increase in debtors' bankruptcy petitions."

A matter of crucial importance, of course, is the level of qualification and experience that the DM would need to have in order to perform his or her functions. In its response to the consultation, R3 pointed out that there would always be some cases, which present issues of doubt or difficulty, that would best be dealt with at the petition stage, and that would benefit from judicial input. These would include the question of the debtor's COMI and eligibility to apply for a bankruptcy order in the jurisdiction, potential abuses of process and partnership cases. R3 therefore suggested that, in cases of doubt or difficulty, the DM should be able to refer the matter to a district judge.

At the stakeholders' meeting, The Insolvency Service explained that, as currently envisaged, the DM would be a person of equivalent to official receiver level. This would lead to a reservoir of expertise and, in view of the DM's level of seniority, it was not expected that there would be any need to refer questions to the court.

Another concern raised by R3 was the possible scope for abuse and malicious applications by third parties. At the stakeholders' meeting it was explained that the identity of the debtor would be cross-checked against other records such as National Insurance numbers. The meeting generally did not seem to feel that malicious applications were a problem.

With regard to fees, R3 suggested that the process should allow for fees to be waived for those on benefits, as is the case under the present system, and this view was shared by others at the stakeholders' meeting.

> "With regard to fees, R3 suggested that the process should allow for fees to be waived for those on benefits, as is the case under the present system, and this view was shared by others at the stakeholders' meeting."

Another important point, not dealt with specifically in the consultation document, is the question of the status and effect of the application. In its response, R3 argued that for the purposes of the Insolvency Act an application should have the status of a petition. This is to ensure that the provisions relating to restrictions on proceedings, protection of the estate and antecedent transactions continue to apply as they do now.

The proposal to remove the ability to grant early discharge appears to have general support.

Although the government seems committed to proceed with these proposals, there is no firm timetable at present. ☐

Technical Bulletin

Technical Bulletin 89 was issued in December 2009. Its contents included :

- Access to Residential Address Information at Companies House
- Companies House – Protected On-line Filing (PROOF)
- Collective Redundancies – Duty to Consult and Submit Form HR1
- Pension Protection Fund – Notifications of Insolvencies – reminder
- Administration – Acting in the Interests of the Creditors as a Whole
- Set-off in Administrations – Clarification from the High Court
- Companies Act Scheme of Arrangement Cannot Compromise Proprietary Rights
- Structured Investment Vehicle – Order of Distribution of Assets
- Trustee Discretion and PPF Compensation
- Going Concern and Liquidity Risk – New Guidance for Directors
- Charging Order Survives Bankruptcy
- Bankruptcy – Liability for Council Tax
- Pension Policies – Increase in Minimum Age for Taking Benefits
- Courts Service Liable to Trustee for Administrative Error
- Continuity of Employment – *Oakland* v. *Wellswood* judgment now available
- Settlement Finality Regulations.

[1] XBRL (eXtensible Business Reporting Language) is an international IT standard designed to make it easier for financial information to be communicated between businesses and on the internet. Online XBRL (iXBRL) is a way of displaying XBRL in human readable form either on screen or as a printed output.

[2] Methods and forms of electronic communication approved for the purposes of making payments under these regulations are the services known as: direct debit; BACS direct credit; CHAPS; debit and credit card over the internet (BillPay) or telephone; paymaster; bank giro; and Alliance and Leicester commercial bank.

Richard Heis is a partner in KPMG Restructuring.

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

Nick Melin answers your insolvency queries.

On 29 December 2009 I was appointed administrator of a small clothing retailer. The company traded from two premises – one in Mayfair and one in Canary Wharf. In order to sell off the stock, I traded from both premises for a week then closed and vacated the shops as it became apparent that continued trading was no longer viable. Rent was not paid on both premises on the last quarter day but was otherwise paid on time. The landlords of each of the premises have demanded a full quarter's rent to be paid now and claim it is payable as an administration expense – do I have to pay even though I only traded for one week?

Having looked at the lease for each of the premises, the Mayfair lease provides that rent is payable quarterly in advance on traditional quarter days (the key date here being 25 December) whereas the Canary Wharf lease required rent to be paid quarterly in advance on modern quarter days ie 1 January, 1 April etc.

It is clear that in each case the premises were used for the benefit of the administration as the shops were traded for the week. The vital difference is that the rent on Mayfair did not fall due during the week trading period (it had fallen due four days before your appointment) but the rent at Canary Wharf did fall due on 1 January – three days into the week trading period. Accordingly the rent is payable for Canary Wharf as an administration expense but not payable for Mayfair (indeed you could have traded at Mayfair until 24 March without rent becoming payable as an administration expense). See *Goldacre (Offices) Limited* v. *Nortel Networks (UK) Limited (in administration)* [2009] EWHC 3389 (*Goldacre*) discussed on page 13.

The High Court stated in *Goldacre* unequivocally that any rent payable as an administration expense would not fall to be apportioned so the entire quarter's rent is payable notwithstanding the length of use was a single week.

Goldacre simply states that rent is, in certain circumstances, payable as an administration expense – when that rent is paid will depend on and if the administrator has sufficient asset realisations to do so. If the doomsday scenario occurs where there are insufficient assets to meet liabilities to pay the administration expenses then the court does have the power to alter the order of priorities under Rule 2.67.

"The court will not generally interfere with your commercial judgment as the liquidator unless it was a judgment that no reasonable insolvency practitioner could come to."

I have recently been appointed a liquidator of a company that owns shares in a subsidiary. I have had competing bids for the shares from former directors of the company in the sum of £15,000.00 and £25,000.00 respectively. I do not have any confidence in the ability of the higher bidder to complete the transaction and think this is simply an attempt to stifle a sale of shares to the other party. I do not believe that the shares will have any significant value in the open market. Can I accept the lower offer?

The court will not generally interfere with your commercial judgment as the liquidator unless it was a judgment that no reasonable insolvency practitioner could come to. See *MTI Trading Services Limited* v. *Winter* [1998] B.C.C. 591. This approach has been mirrored in cases covering the spectrum of insolvency processes. For example, in a recent bankruptcy case, *Miller* v. *Bayliss* [2009] EWHC 2063 (CH), the court confirmed that it would only intervene where the trustee in bankruptcy had acted so unreasonably that no reasonable person could have acted in that way. In that case an offer for shares for £30,500.00 was rejected in favour of an offer for £20,000.00 and this was upheld to be reasonable in the circumstances. A factor in that case favouring the acceptance of the lower value offer was that the lowest bidder provided cash on the table.

I have been appointed liquidator of the company that entered into two contracts with a Mr C. Under the contracts, Mr C is due to pay the company £100,000.00 and £50,000.00 respectively for services rendered; however, Mr C is claiming damages of some £140,000.00 as a consequence of alleged late performance under the first contract. There are no assets in the liquidation other than the fruit of the contracts. The directors of the company believe that Mr C's claims are spurious and if challenged would result in Mr C having to pay the company substantial sums so would be willing to pay £50,000.00 for an assignment of the contracts. The contracts between the company and Mr C expressly provide that they cannot be assigned without the consent of both parties and Mr C has confirmed that he would not consent to any assignment. Is there anything I can do?

As opposed to assigning the contracts themselves you could assign the balance of any sums due to the company under Rule 4.90 of the Insolvency Rules 1986, which provides for mutual credits and set-off. This principle was recently revisited by the court in the case of *Enterprise Managed Services Limited* v. *McFadden Utilities Limited* [2009] EWHC3222 (TCC). The thrust of the reasoning behind the principle is that the effect of Rule 4.90 is that the claims between the parties are replaced by a single claim for a net balance under Rule 4.90. Although Rule 4.90 applies only to liquidations there are similar provisions for administrations (Rule 2.85) and bankruptcies (section 323 of the IA 1986). ☐

Nick Melin is a partner at Judge Sykes Frixou.

Dealing with fraud

Kevin Mawer gives an overview of the circumstances that may give rise to fraud and the things IPs can do to mitigate its effect on an administration and on themselves as practitioners.

Fraud is a cause of many insolvencies and certainly receives the blame for a significant number of the largest collapses, such as Enron, World Com, Barings etc, but it is also a feature of all too many other insolvencies. The fraud may be the cause of the business's losses, or may be instigated as a result of the financial and other pressures likely to be experienced when a business is failing; an opportunity for the directors or others to extract something for themselves before matters are taken out of their hands.

As a result, all insolvency practitioners (IPs) are likely to find themselves appointed over a company in which a fraud has been perpetrated. In my case, specialising in insolvency cases where fraud or misfeasance is suspected, it is the norm rather than the exception.

Identifying fraud

In many instances, IPs will be aware that there are concerns regarding a fraud prior to accepting the appointment, either because of their own findings during an independent review or because major creditors or other directors have brought the matter to their attention when seeking advice. There can be many indications of the possibility of fraud. Some of the more common ones are likely to be:

- few book debts prove to be realisable;
- properties are found to be worth significantly less than the valuations obtained at the time funds were advanced to acquire them – assuming that the property to which the company has title and the property that was valued are the same!
- the company's books and records are missing or incomplete;
- large unexplained deficiencies;
- large unexplained transactions with related or other parties; and
- failure to file statutory returns and other documents on a timely basis.

Reporting obligations

Whatever the position, the considerations are similar. The IP's first thoughts must be for him or herself. Surprising? Not if you consider the penalties, which fall on the IP personally, for a failure to submit a suspicious activity report to their firm's money laundering reporting officer.

Other reporting considerations include: Should the insolvency practitioner immediately contact the authorities? Is there a duty to do so and/or would such contact result in some interference that might have an impact on the ability of the IP to realise assets or cause him/her to incur additional costs?

There is a duty to report fraud, or other criminal acts. This can stem from the simple common law duty, which applies to all citizens, to statutory obligations under the provisions of the Insolvency Act or Directors Disqualification Act.

Interaction with authorities

It has never been my experience that the police, or any other prosecuting body, will immediately seize computers or records that are required by an insolvency practitioner. Nor that the police or other authority will interfere in the trading of a genuine business, albeit I am aware of a number of cases where the Companies Investigation Branch has proceeded with a public interest petition to wind up a company after an administrator has been appointed in circumstances where the administrator has sought to sell or trade on a business that they do not consider to be in the public interest. Then why would an IP want to risk trading or otherwise assist perpetuating such a business?

It is more often the case that there is little immediate response to a report of fraud by an IP. Why should there be? The business is no longer under the control of the suspected fraudster but is now in the hands of a licensed professional. The horse has bolted and there are unlikely to be any new victims – at least from that fraud.

The objectives of the IP and a prosecuting authority are different. The focus on the former is the recovery of assets, while the latter is primarily tasked with convicting the fraudster and protecting the public. The Proceeds of Crime Act 2002 has changed that to a degree, with prosecuting authorities being tasked with and rewarded as a result of recovering the proceeds of criminal activity. What the prosecuting authority will be concerned about, should they consider investigation and prosecution of the particular fraud to be a good use of their limited resources, is the protection of evidence. Provided the prosecuting authority is comfortable that computer and other records are secure, there should be little immediate pressure.

So, if there is little downside in reporting the fraud early, is there any upside? Tipping off can be a difficult area. For example, I once sought advice from a predecessor organisation to SOCA[1] about the risks facing a typical trustee in bankruptcy. I had a bankrupt who I suspected of owning an asset in which he (most fraudsters are male) had claimed that he had no interests. Failure of a bankrupt to co-operate with his trustee in bankruptcy, particularly with a view to avoiding assets being realised for the benefit of his estate, is a criminal offence.

> "The objectives of the IP and a prosecuting authority are different. The focus on the former is the recovery of assets, while the latter is primarily tasked with convicting the fraudster and protecting the public."

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The asset is, therefore, the proceeds of crime and challenging the bankrupt in relation to the matter is, technically, tipping-off. Does that mean that the trustee should not challenge the bankrupt with his or her suspicions? Doing so through a lawyer acting for the bankrupt would not change the facts. In my case, the prosecuting authority declined to provide any advice on whether such tipping-off would be an offence by me as trustee. Common sense clearly applies but again, there is no harm in seeking advice from the appropriate source.

Practical steps to obtain evidence to assist in recovering the missing assets

IPs have very wide powers to assist with the investigation of fraud and secure the recovery of the associated losses. These powers are often used to compel directors, co-conspirator suppliers or customers, auditors or solicitors to provide information concerning the business or affairs of the company. However, these powers can also be used to compel the police, HMRC[2] or SFO[3] to share information required by the IP to gain a proper understanding of the business and affairs of the company and those who might have its property.

These powers provide a gateway for information to be shared; information that might not otherwise become available unless and until there is a successful prosecution.

Concerns about interaction with prosecuting authorities aside, and that is the concern that appears to be raised most frequently, what else should an insolvency practitioner do?

First and foremost, you need to move to secure evidence that will be required to understand what has happened, quantify the losses and identify means to recover those losses. In many fraud cases, there will be little that can be done immediately. All too often, computer and other records have been 'lost' prior to appointment – often attributed to fires, floods, break-ins (to steal just manual records from companies with little or no intellectual property of any value?). In other cases, directors claim to have posted the records to the IP, or even to have delivered them, but fail to provide evidence of posting or delivery.

However, where there are computer records available, those should be imaged as soon as practicable where they are likely to contain relevant information. Those computers of most interest are generally the file servers, those of the CEO, FD and sales director and of their PAs.

> "Discovery of a fraud will undoubtedly result in the IP incurring increased costs. However, the level of those additional costs is, to an extent, manageable and should not be the primary concern."

Manual records cause a different problem, usually because of the quantity, the costs of sorting, cataloguing and storing them. Generally, records relating to cash, sales and purchases are key; identifying what is missing but would be expected to be present being an important matter. The appropriate step will depend on the nature and magnitude of the fraud.

What about the directors and employees? Concerns are often expressed about the risk of tipping-off (again a threat to the personal liberty of the IP) or of being sued for defamation where suggestions of involvement of individuals in a fraud or other criminal act is suggested. Again, appropriate legal advice should be sought.

The fraudster and his advisers will try to increase costs and delay matters for any party seeking to investigate a fraud and recover losses, at every opportunity. If it becomes more cost effective to cease investigations than to proceed, the fraudster has won. Accordingly, if there is any chance of raising an argument that the IP has somehow overstepped the mark, the fraudster and his advisers will do so. Others will discuss this pitfall in more detail; all I would counsel is there is a balance between action and prudence. Too much of either works to the advantage of the fraudster.

Costs

Discovery of a fraud will undoubtedly result in the IP incurring increased costs – unless the practitioner chooses to resign from the appointment. However, the level of those additional costs is, to an extent, manageable and should not be the primary concern. There have been instances where a prosecuting authority attempted to put the onus on me, as administrative receiver, to conduct very detailed investigations, the primary purpose of which related to the prosecution of the fraud. However, I was entitled to, and did, refuse to do so, only agreeing to take those actions that were in the interests of the creditors or otherwise appropriate. The prosecution proceeded to a successful conclusion, but not to the cost of the creditors.

The other consideration as to costs is in relation to bringing legal action to recover the misappropriated assets. It is often the case that the fraud has left the insolvent company with minimal assets. This means there may be insufficient funds in the estate to bring the action required. Nevertheless, there are many options available to an office-holder to ensure that he/she can still seek to recover the assets, including:

- contingent fee arrangements with solicitors and counsel;
- adverse costs insurance; and
- contributions to, or underwriting of, costs and fees from major creditors of the company.

Recoveries

Discovery of a fraud also presents opportunities for recoveries, not all of which will be from the fraudster or his associates. Many corporate frauds involve the overstatement of turnover and profits, and many of those frauds continue for a number of years. In those cases, it is not unusual to find that the company has accounted for and paid VAT on the overstated sales or corporation tax on the non-existent profits. Those taxes can, with the appropriate evidence, be recovered – often with supplements.

Generally, there is no need to prove fraud or seek recovery under such an allegation. It is far simpler and cheaper to proceed on the basis of a breach of fiduciary duty claim; not to seek to demonstrate that a director had deliberately defrauded the company, but to show that through some action or inaction the director committed a breach of fiduciary duty that led to the company incurring a loss. This requires a lower burden of proof and is much more likely to be capable of a negotiated settlement.

And finally…

One final tip, for which I give thanks to Robert Hunter of Allen & Overy, is that many fraudsters have similar traits to psychopaths. Not violent, but certainly (hopefully?) different from most of us. It is their psychological make up that often makes them such convincing liars and so able to commit frauds against highly experienced and educated bankers and other stakeholders. These fraudsters can lie to themselves and believe that they have done nothing wrong, no matter how compelling the evidence may appear to be. Do not expect admissions from this type of fraudster or to make progress in negotiations with them unless and until you actually receive the consideration. Negotiations are a further means to gain time and cause you to incur costs. Confer with them by all means but keep to strict timetables and keep the pressure on. ☐

1 Serious Organised Crime Agency
2 HM Revenue & Customs
3 Serious Fraud Office

Kevin Mawer leads the national forensic recovery team and is a director at KPMG.

The role of a forensic accountant in corporate insolvency

An IP may suspect that there are fingers in the till – but whose fingers and where's the till? Diane Hughes explains that the forensic accountant has to dig deep to obtain evidence in an investigation.

It's almost impossible to begin an article on fraud-related insolvency without using a cliché. Fraud is going on all the time: it is therefore hardly surprising that the noughties truly earned its epithet in its closing year. Following a lengthy period of healthy profits for many, with the accompanying management complacency, the recession has turned the spotlight back on both spending and internal financial controls, and in the process, revealed some unexpected problems.

Insolvency practitioners (IPs) are called upon every week to take control of companies in severe financial difficulties. Their primary function is to protect the value of assets for creditors and, naturally, they will want to establish what has gone wrong in order to turn the situation around. Their hearts tend to sink at the point it becomes clear that fraud may be behind part or all of the problems. And I get a call.

What aroused the IP's suspicions?

The IP is alerted to the possibility of fraud in several ways – a company's primary lender might not be fully satisfied by the explanations of management for the decline in financial performance (often prior to the IP's formal appointment); or a creditor or an individual within an organisation might express their concerns to the IP; or the statutory auditors might not have completed their audit work as expected. Of themselves, these do not mean that fraud has been committed, but the IP knows, on the first day of his or her appointment, that there may be a fraud-related problem.

Occasionally, the pre-appointment investigations of the IP bring the problem to light. In a recent matter, one of our partners was engaged to perform an independent business review for a lender. The review highlighted a number of inconsistencies between the financial statements and other source documentation. When management was presented with the findings, no sensible explanation could be provided.

Subsequently, the financial position of the business worsened and he was appointed as administrator. Still unclear as to the reason for the accounting inconsistencies, he asked one of our forensic specialists to broaden the scope of her investigations. During the course of her team's work, the finance director (FD) confessed that he had been falsifying invoices to artificially inflate the business's turnover. Unfortunately, this had not been identified by the auditors during a recent audit. The fraudulent invoices had been created by taking original invoices and then inserting false information before making photocopies for the auditors (who never saw the originals). In this case, the FD did not take any money and it was not his fraud that had caused the underlying financial problems of the business. The fraud disguised the true extent of the financial problems of the business and ensured that the lender supported the business for longer than it otherwise would have.

Based on the forensic specialist's findings, the administrator and the lender had to decide whether to pursue the now ex-FD. Not surprisingly, his lack of assets (as identified during our investigations), meant that the likelihood of recoveries was negligible and, for the purposes of the administration, this was the end of the matter.

Of a completely different magnitude are the cases where almost the entire enterprise is a fraud, Madoff being the most high profile but certainly not the only case. In these circumstances, the authorities and the lawyers are the first on the scene and the latter will usually work hand in hand with the appointed IPs and direct the work of the forensic specialists.

The role of the forensic accountant

Back to that telephone call. I get the call because IPs and forensic accountants are very different beasts – to such an extent that I think my colleagues expect to see one of my kind on TV in *Silent Witness*, counting the dead bodies! In fact, the 'forensic' tag simply refers to the method of obtaining evidence in any investigation, not only in a criminal or legal matter. This means that a forensic accountant might get involved in a variety of work types, such as insurance claim adjustments or analysing the financial impact of market events.

Of course, fraud, by its very definition, is a wrongful act. In this context, the role of the forensic accountant, or, as I prefer, the forensic financial expert, is to investigate and analyse financial information with the ultimate aim of being able to give expert testimony should those who have suffered

> "The finance director confessed that he had been falsifying invoices to artificially inflate the business's turnover. Unfortunately, this had not been identified by the auditors during a recent audit."

losses decide to pursue the perpetrators of the fraud through the courts.

In a corporate insolvency, the IP's role is effectively to replace the directors as stewards of the entity concerned, to achieve the stated objectives of the administration and to maximise the return to the creditors. This involves taking commercial decisions and executing them. The forensic financial expert needs to have a similar level of business understanding, but also a different core set of skills, which include deep investigative capabilities, experience of technical analysis methods, a thorough knowledge of accounting principles and a familiarity with the legal process.

> "Depending on the scale of the fraud, arriving at the answers to questions [of cash] can be small projects in themselves, almost always involving both the lawyers and the forensic financial experts."

Such is the increasing complexity and variety of matters referred to the forensic financial expert that it is now unusual to find all the required skills in one individual, and fraud is no exception. In particular, the challenges inherent in finding electronic data in numerous forms and locations (such as hard drives, laptops and the ever-present Blackberrys and iPhones) require forensic specialists familiar with electronic storage devices and IT-specific search techniques.

Their role is to compile all electronic data, including recovering deleted material, and provide the forensic accountant with a platform to search the evidence bank. Modern systems have excellent search capabilities, allowing the user to search for key words, dates, people, file types, etc.

The realities of a fraud investigation

Unfortunately for an IP, fraud is not a quick win. When I take the phone call, my IP colleague typically has practical issues on his or her agenda, rather than wanting to receive a detailed scope for the work my team might have to undertake. Not surprisingly, practical issue number one is cash. Put simply, in the first instance, cash breaks down into three basic questions:

- If we can prove that fraud has occurred, do the alleged perpetrators have the resources to pay the damages?
- At this point in time, how much is the estimated loss?
- What's it going to cost (that is, proving the fraud and recovering the monies)?

Depending on the scale of the fraud, arriving at the answers to these questions can be small projects in themselves, almost always involving both the lawyers and the forensic financial experts. Where the alleged fraud has caused the financial distress of the business, it is self-evident that the business might struggle to find the monies to pay for further investigation work. The creditors, who have already lost money, will have to decide whether to invest in the possibility of recovering their losses by funding the detailed work necessary to take legal action.

A forensic accountant colleague worked on the insolvency of a finance company that failed as a result of fraud. In this case, the directors had intentionally mis-stated financial information within a prospectus to encourage investment. Funds invested in the company were partially used for their intended purpose, but they were also used to fund the directors' lavish lifestyles, including exorbitant salaries, luxury cars, a luxury launch, paying their mortgages and funding expensive holidays. Unfortunately, the losses faced by investors were substantial, and once the cars and boat were taken from the directors, there were few material assets left to pursue.

> "The forensic accountant's work led to three thoroughbred race horses, complete with their own vehicle registration numbers."

In this case, the creditors were asked if they would forgo part of their proposed distribution to fund the necessary investigations and subsequent actions against the directors. The creditors voted almost unanimously in favour of pursuing the directors, expressing moral outrage as well as the desire for financial return. The investigations resulted in the directors being stripped of their remaining assets, bankrupted and banned from acting as directors in the future.

Timing is everything

The passage of time between a fraud being perpetrated and its existence being suspected creates its own set of problems, and for practical reasons, the fraudster may have time to attempt to cover his or her tracks before an investigation commences. From the perspective of the forensic specialist, this increases the likelihood that critical evidence will be moved, adjusted or simply lost. By the time I start work, it is not unusual to discover that a company's systems 'failed' for a period of time and electronically stored data is missing or hard copy back-ups of financial documents have been inexplicably shredded.

Ideally, as soon as an IP suspects fraud, he or she should authorise the forensic specialists to locate and secure all possible sources of evidence, obtain key information related to users of IT (such as encryption and passwords), delay the decommissioning of equipment if necessary, suspend any automated data destruction processes and retain the services of knowledgeable IT and finance representatives at the company for as long as possible.

Whose fingers?

Both the IP and the forensic specialists are often faced with having to work closely with the suspected fraudsters. Further, the IP may not want certain individuals to know that they are suspected, since gaining their trust can be critical to maximising recoveries. At the same time, the forensic accountant wants to put certain transactions under detailed scrutiny, requiring lengthy reconstruction work and interviews. The situation is much more complex than investigating a lesser fraud in a going concern where the investigation is fully supported and funded by management.

One colleague recalls a case where he was asked to investigate certain issues identified in an automobile dealership. The company records showed more vehicles on the asset register than were physically present after a stock count. He suspected that the managing director was involved in the missing assets but needed to maintain good relations with this director to help realise best value for the vehicles present, while engaging forensic assistance to trawl through bank statements and other records in search of the missing assets. In fact, the forensic accountant's work led to three thoroughbred race horses, complete with their own vehicle registration numbers.

In several recent large-scale frauds, which have led to financial collapse, the fraud has emanated from the very top of the organisation and significant numbers of people are involved, both knowingly and unknowingly. Only the detailed work will separate the two, but they both need to be carefully managed – so add to the job specification of the forensic accountant, perhaps surprisingly, the need for a high EQ (emotional intelligence) and a sixth sense!

Of course, having done the detailed work to prove the fraud, the forensic expert leaves the toughest decisions to the IP and the lawyer. ☐

Diane Hughes is head of litigation services at Zolfo Cooper LLP.

How the courts can assist IPs to help victims of corporate fraud

Laurence Katz looks at one possible response for victims of a fraud.

Where a company has been used as a vehicle for committing fraud, the powers of insolvency office-holders can be used to good effect in combination with orders available to ordinary claimants (such as asset freezing orders, search orders and orders requiring third parties to disclose information) to obtain evidence about the fraud, to trace assets and to make recoveries for creditors. In each case, a careful cost–benefit analysis is needed before particular powers are exercised and before orders of these types are sought. This article looks at an example scenario.

Assumed fact pattern

The two directors of an English company orchestrate the diversion away from the company of ten million pounds received from customers such that the company becomes insolvent on both a balance sheet and cash flow basis. A small group of the company's suppliers are together owed several million pounds and become suspicious of the company's failure to pay any of them despite the company having a substantial turnover. The suppliers receive no proper explanation for the delay in payment. The suppliers have learned from an employee of the company that monies have been diverted away from the company and that the two directors have been absent from the company's premises for a week. The suppliers have also learned that the directors have been making plans to leave the country.

Although the creditors do not yet have enough information to know where the money has been moved to, there is sufficient evidence for them to take steps to protect and improve their position. One option is for the creditors to work together and seek the appointment of a provisional liquidator.

The appointment of a provisional liquidator

Steps can be taken at any time after the presentation of a winding-up petition to appoint a provisional liquidator who will be empowered in the order appointing him or her to carry out the functions set out in the order. As was noted by Blackburne J in *Re Namco UK Ltd* [2003] 2 BCLC 78 at 82: 'The usual purpose underlying the appointment of provisional liquidators is to collect and protect assets of the company in question pending the making of a winding-up order and the appointment of liquidators. Usually this happens in cases where the assets are, or are credibly believed to be, in jeopardy. In some cases its purpose is to take control of a company to safeguard its records, or to prevent the company from trading or otherwise acting in some improper manner.'

A provisional liquidator has the powers in sections 234 to 236 of the Insolvency Act 1986 to get in the company's property (s234); to require co-operation with the office-holder as to the provision of information concerning the company (s235); and to summon a limited range of people for a private inquiry before the court in relation to the company (s236). These powers are exercisable in order to enable the provisional liquidator to carry out the duties contained in the order appointing him or her, specifically to establish where the company's assets are and to secure them.

A lead creditor with a substantial undisputed debt can present a winding-up petition relying not only on the company's inability to pay its debts but also on the ground that it is just and equitable that the company should be wound up. A without-notice application can then be made immediately to a judge of the Companies Court seeking the appointment of a provisional liquidator to the company. A freezing order can also be sought on the application of the company (now in provisional liquidation) against the two directors for the sums due to the suppliers and the anticipated costs of the litigation against, at this stage, the directors. The applicant for the appointment of a provisional liquidator, as the application is without notice, owes a duty to the court of full and frank disclosure of all material facts and law. If appointed, the provisional liquidator owes the same duty on any without-notice application that is then made by the company (in provisional liquidation).

> "Steps can be taken at any time after the presentation of a winding-up petition to appoint a provisional liquidator who will be empowered in the order appointing him or her to carry out the functions set out in the order."

The freezing order

The freezing order is sought ancillary to proceedings by the company (in provisional liquidation) against the directors (in which the company will seek to establish, among other things, that the directors are liable to account for their breach of fiduciary duty and for the tort of conspiracy). It will be sought in both a personal form and in a proprietary form (on the basis that the directors retain a particular asset in which the company asserts a proprietary interest and/or the traceable proceeds of the monies diverted from the company). One can anticipate that steps will rapidly be taken to increase the amount of the freezing order to cover the costs of litigation against entities (most likely controlled by the directors) that received monies from the company in the knowledge that the monies were being paid away in breach of the directors' fiduciary duties to the company.

In its wide form, a worldwide freezing order prohibits defendants from removing their assets from England or in any way dealing with or diminishing the value of their assets up to the amount stated in the order, subject to any exceptions set out in the order (for example, in relation to a defendant's living expenses, ordinary and proper business expenses and the cost of legal advice and representation). In order to assist with policing compliance with the order and also with tracing assets, associated asset disclosure orders will be sought. As part of the initial order, the provisional liquidator may also seek an order for delivery up of the directors' passports pending their compliance with the asset disclosure order.

Search orders

A decision will also need to be made whether to seek search orders against each of the two directors with a view to preserving evidence that is or may be relevant to the proceedings (both in hard copy form and on computers and removable media such as floppy disks and

CD-ROMs, on personal organisers and on mobile telephones) given the real possibility that they will destroy such material. A search order may also be made to preserve property that is or may be the subject-matter of the proceedings or as to which any question arises or may arise in the proceedings. A search order typically requires a defendant to allow specified persons (including an independent supervising solicitor) to enter specified premises; to allow the claimant's solicitors to search for, examine and remove or copy specified listed items; to hand the listed items to the claimant's solicitors; to give effective access to computers containing listed items; and to inform the claimant's solicitors of the whereabouts of all listed items. Further detail in relation to asset freezing and search orders, the conditions for obtaining these and the safeguards for defendants can be found in an earlier article by this author (see *RECOVERY*, winter 2007 issue).

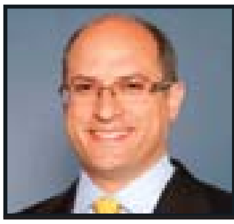
Analysis of bank statements

Prior to service of the freezing order on the two directors, a rapid analysis of the company's bank statements can be undertaken in order to establish where monies have been paid away to. This analysis may trigger a need for additional applications to protect assets in England or overseas and will assist in identifying the banks and other third parties to which immediate notice of the freezing order needs to be given. The analysis may also identify knowing recipients of the company's monies, which the provisional liquidator may wish to add as additional defendants in the proceedings and potentially as respondents to the freezing order. The analysis may also identify the need to seek additional orders from the court in order to obtain evidence from third parties, for example:

- *Norwich Pharmacal* orders directing a non-party to disclose the identity of a wrongdoer and provide information;
- *Bankers Trust* v. *Shapira* orders directing a non-party to disclose documents assisting the claimant to trace funds; and
- orders directing a non-party to disclose specified documents or classes of documents likely to support the claimant's case or adversely affect another party's case where the disclosure is necessary to dispose fairly of the claim or to save costs.

In relation to each of these possible applications, the relative costs and benefits of the orders sought will need to be weighed up; the documents disclosed as a result of these applications may lead to further applications for protective relief (in England or overseas).

The matter will come back before the court within a very short time frame for a hearing at which the provisional liquidators will seek a continuation of the orders obtained. The hearing of the winding-up petition will take place in the ordinary course. One can expect as the case proceeds and further documentary evidence is obtained (in particular, as a result of the execution of the search order and as a result of the provision of documentation by third parties) that the claim will be further particularised and that entities owned or controlled by the directors will be added as defendants to the claim. In the short term, the objective of securing assets will have been achieved by the appointment of the provisional liquidator and the protective orders sought from the court. ☐



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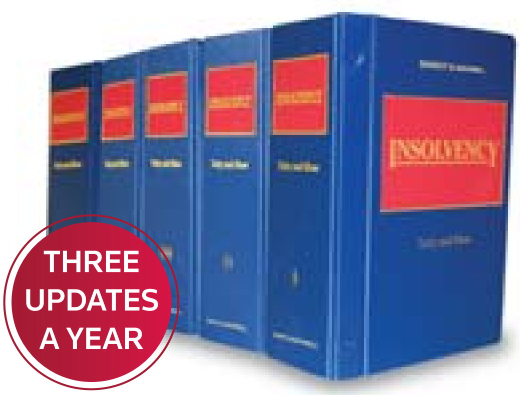

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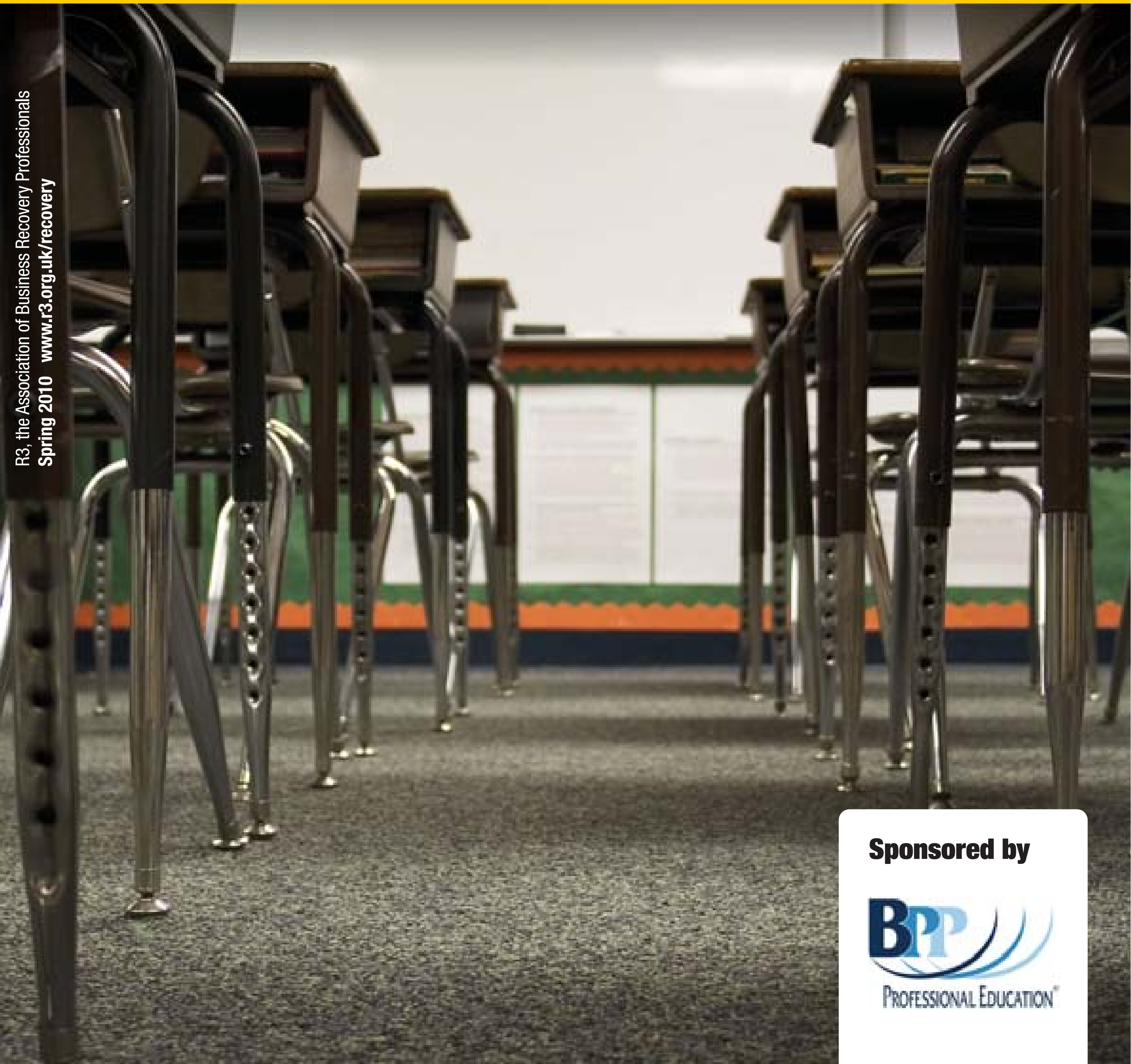

Insolvency training in interesting times

André Evans explains what the training needs are in the insolvency sector, what options are available and how trainers, firms and personnel seek to balance the competing demands of staff development and professional practice.

'Of all the mysteries of the stock exchange there is none so impenetrable as why there should be a buyer for everyone who seeks to sell… 24th October 1929 showed that what is mysterious is not inevitable. Often there were no buyers and only after wide vertical declines could anyone be induced to bid.'

This was written by J K Galbraith in *The Great Crash 1929* but he might equally have been writing of the morning of Friday, 10 October 2008.

On that day, I was helping to facilitate a course at one of the larger law firms. It was just before 9.00 am and one of the lawyers picked up the news item on (inevitably) his Blackberry that the FTSE 100 had just fallen ten per cent in seven minutes. This was a week that would have seemed impossible to most observers even a year earlier. Icelandic banks were put into administration, the government bailed out familiar high street names such as the Royal Bank of Scotland and Lloyds banking group: these stock market-listed institutions now virtually nationalised industries. Three weeks before, Lehmans had become the biggest Chapter 11 filing in US history and AIG, the world's largest insurer, had been kept afloat by a $200-million cash injection.

Back at BPP Professional Development, it did not take very much foresight to realise that the knowledge and skills of our clients who specialise in insolvency and corporate recovery would be in more demand than ever – and so, of course, it has turned out to be. In this harsh economic environment, directors and managers of businesses and over-indebted individuals have needed specialist advice as never before while the number of formal insolvencies has continued to rise. Somehow firms and staff need to fit their training needs around all these other myriad pressures on their time.

Training needs

Training forms an essential part of a staff development strategy for our client firms. Entry-level employees must be familiarised with the UK's famously complex array of insolvency procedures as well as with the firm's own internal processes. Prospective insolvency practitioners must sit the demanding examinations set by the Joint Insolvency Examination Board (JIEB). Qualified staff are also required to comply with the continuing professional development requirements of the various Recognised Professional Bodies. All need to undertake technical and skills training to equip them for their developing role within the firm.

Starting out

For new joiners, a range of beginners and foundation level courses are available, which are designed to give those relatively new to insolvency practice an overview of corporate and personal insolvency procedures.

Many organisations steer appropriate candidates who need a basic grounding in insolvency law and practice towards the Certificate of Proficiency in Insolvency (CPI) of the Insolvency Practitioners Association (IPA). No minimum period of work experience is required to sit the CPI and the exam aims, in a single three-hour paper, to test a broad range of the areas most commonly encountered in practice such as IVAs, bankruptcies, voluntary liquidation and administrations. The exam, sat in June of each year, consists of multiple-choice, short form and written questions.

> "Those who want to become licensed insolvency practitioners will have to pass the JIEB examinations. These consist of three three-and-a-half-hour examinations, which constitute a formidable barrier to entry to the insolvency profession."

Candidates can be required to draft documents and prepare straightforward insolvency accounts as well as answering hypothetical problem questions.

Recently, two new qualifications have entered the market. Firstly, the IPA introduced the Certificate of Proficiency in Personal Insolvency (CPPI) last year. The exam is structured similarly to the CPI but focuses on, and gives a thorough grounding in, personal insolvency issues, including those relating to insolvent partnerships and deceased insolvents. Candidates are expected to have a good working knowledge of non-statutory solutions such as debt management plans. The new qualification is a welcome innovation at a time when personal insolvencies were up 28 per cent in 2009 over their 2008 figures.

Meanwhile, the ICAEW will go live this year with its new insolvency qualification – the ICAEW Certificate in Insolvency. The syllabus is very broadly based covering all aspects of corporate and personal insolvency. A key feature of the new qualification is flexibility in that it will be entirely tested through objective test questions so that examinations will be computer based with frequent exam sittings and the opportunity for unsuccessful candidates to re-sit very shortly after their first attempt.

IP licence

Those who want to become licensed insolvency practitioners will, of course, have to pass the JIEB examinations, which are sat in November of each year. These consist of three papers: paper 1 (liquidations), paper 2 (administrations, company voluntary arrangements and receiverships) and paper 3 (personal insolvency). These three-and-a-half-hour examinations constitute a formidable barrier to entry to the insolvency profession. Candidates must be adept at giving practical written advice, drafting documents, preparing insolvency accounts and financial projections as well as having a good working knowledge of law regulation and best practice.

The exams have a practical and topical bias – recent papers, for instance, have featured questions on pre-packaged administrations and statutory and non-statutory debt solutions for individuals. Those preparing for the exam tend to be qualified accountants or solicitors or have considerable experience of insolvency work – the type of people who are well established in their firms and will have to juggle the courses and home study with the demands of busy professional practice. Despite the challenges (and perhaps not surprisingly), numbers enrolled on courses for the 2010 examinations are high.

Many client firms provide generous amounts of study leave to aid candidates in balancing these demands, as well as ensuring that their staff have the best possible opportunity of passing at the first attempt. The seniority of the candidates and the costs in lost chargeable time make it vital for training and study to be really effective.

In recent years, changes in the JIEB rules have helped by allowing candidates greater flexibility in the order in which the papers are sat. It is now possible to sit just one paper in year one and then, subsequently, take the remaining two papers at the same sitting. Another option, which has been available for some years now, is to take two papers at the first sitting and then the third paper in the subsequent year. The changes are welcome and increasing numbers of candidates are taking advantage of them. However, 'credit accumulation' – the process of acquiring examination passes over a number of sittings – will not suit every candidate nor every firm. There are two main advantages to taking all three papers at the one sitting.

- Firstly and obviously, a successful candidate has got the whole qualification 'out of the way' and can now get on with the rest of his or her life safe in the knowledge that he or she will never have to, for instance, sit a mock exam ever again.
- Secondly, it is arguably more efficient to work on passing all three exams, given that so many areas of the syllabus are relevant to all three papers – including many of the areas covered in the statements of insolvency practice such as remuneration, records of meetings and the rules relating to creditors' committees.

> "The process of executing a study plan is so important that some firms employ training providers or consultants to provide mentoring or coaching programmes to manage the task of motivating and preparing candidates."

Study strategies

Alas, many professional people acquire the bad habit at the academic stage of their training of leaving study to the last minute. This may have been effective as a 21-year-old with few calls on his or her time outside of the need to eventually get down to some study but it is a high-risk strategy for a busy professional, one who often has family and practice management responsibilities as well as the obligation to study for exams.

So planning when study is going to take place and what topics are going to be looked at is crucial. In particular, it is vital that candidates gain hands-on experience of attempting old JIEB questions in exam conditions. The more a candidate's time is limited, the more important it is to treat study as if it were a work obligation – something that will be done to deadlines and must be done to the best of the candidate's ability. The process of executing a study plan is so important that some firms employ training providers or consultants to provide mentoring or coaching programmes to manage the task of motivating and preparing candidates. Other students form their own study groups to help members stick to a programme of structured study and these informal groups have proved very effective in the past and provide a welcome break from solitary study.

Regulatory changes drive regular updating

Insolvency and recovery work takes place within a complex regulatory structure extending far beyond the insolvency legislation itself. Practitioners will regularly encounter issues in areas as diverse as employment law, intellectual property, data protection, landlord and tenant, money laundering, consumer credit – the list is endless. The law in many of these areas, as well as in insolvency itself, is constantly changing. A few recent examples, which will be familiar to readers, include the final tranche of the Companies Act 2009 coming into force on 1 October 2009, the new version of the Insolvency Rules to come into force this year, new regulatory guidance in the form of SIP 13 and the pronouncements of The Insolvency Service on the subject of pre-packs and the constant trickle of cases on the topical area of Centre of Main Interests migration under the EC Insolvency Regulation.

So the need for updating courses is clear – and not only on the technical but also on the practical aspects of insolvency as types of business that were previously thought to be relatively safe come under pressure. A colleague and I, for instance, recently attended an excellent R3 course on insolvent partnerships, which covered, among other things, the insolvency of solicitors' practices.

Why train?

Training benefits organisations that need to ensure that their staff are competent, appropriately qualified and regularly updated. It is also highly valued by staff who recognise that it represents a heavy investment in their own development. That in turn helps to attract and retain the best talent – perhaps the most important reason why organisations are prepared to make the investment they do in training. □

André Evans is a director of BPP Professional Development.

Career progress

2008's JIEB award winners talk about how the exams helped their careers.

Surinder Bougan is restructuring director at Ernst & Young. He won the Insolvency Practitioners' Association prize for first place and the Institute of Chartered Accountants of England and Wales prize in 2008.

Jane Garvin is an associate in the insolvency team at Ward Hadaway. She won the Price-WaterhouseCoopers prize for second place in 2008.

Anthony Moss is senior manager in transaction advisory services at Ernst & Young. He won the Leonard Curtis prize for third place in 2008.

WHY DID YOU CHOOSE TO WORK IN THE INSOLVENCY SECTOR?

Like most people I know in the profession, becoming an insolvency practitioner was not my career choice when I was young. I graduated in law but decided that I wanted a career that made better use of my numerical and commercial skills. I joined Arthur Andersen in 1997 and Ernst & Young in 2002. Training as a chartered accountant within an insolvency and restructuring environment provided the perfect balance between the rules-based grounding from my law degree and the numerical skills and commercial acumen developed as a chartered accountant.

After graduating from LSE in 2000, I knew I wanted to become a lawyer but had no idea which area I wanted to specialise in. I started as a trainee solicitor seven years ago and insolvency was my first seat. I enjoyed the interesting and varied work, the fast pace, the interesting characters and quickly became hooked. I qualified into Ward Hadaway's insolvency team in 2004 and have specialised in both contentious and non-contentious recovery and insolvency work ever since.

I was looking for a career that would build on the numerical and analytical disciplines of my degree – engineering, manufacture and management. After attending a number of accountancy fairs and presentations, I realised the traditional role of an accountant didn't appeal. I then met someone who worked in restructuring who talked me through the nature of the work and the career I could build while studying for a well respected professional qualification. I signed up soon after that.

WHAT DO YOU ENJOY MOST ABOUT YOUR JOB?

The opportunity to work, at grass roots level, with such a variety of people and businesses – this often includes being parachuted into a business with little notice and, within days, helping to make business-critical decisions, which could determine whether that business survives as a going concern.

From being in court one day to completing a transaction the next, no two days are the same. I also act for a wide range of clients – IPs, directors, creditors and financial institutions to name a few. Looking at things from different angles certainly keeps you on your toes.

I enjoy the variety and fast pace of the work. I work on a range of assignments with entrepreneurs, from owner managers to multinational corporations. You need to think on your feet, grasp and understand a situation very quickly and work with stakeholders to solve issues in a short time frame. I have also been lucky enough to work in cities across the globe.

HOW IMPORTANT ARE PROFESSIONAL QUALIFICATIONS?

Both the accountancy and insolvency professions hold professional qualifications in high regard. Therefore, having qualified as a chartered accountant in 2000 and having worked in the restructuring arena for over ten years, I felt it was important to take the next step and obtain the insolvency qualification to complement my practical insolvency experience. Becoming a licensed insolvency practitioner was also a key step in progressing my career at Ernst & Young.

As a lawyer, it is unlikely that I will take appointments. However, many of my clients are IPs. Taking and passing the JIEB exams has increased my understanding of the profession, giving my advice to clients that something 'extra'. Brushing up on the law and regulation in the insolvency field has also been a useful exercise.

As a senior manager, I'd been thinking about the exams for some time and in early 2008, I found the time to fully commit to them and took the plunge. The exams have a fearsome reputation but I looked forward to a different form of challenge to the day job. I found that starting to study early and being very disciplined, with detailed subject preparation and comprehensive question practice, was the key to success in these exams. You will also need to learn ruthless time management skills.

WHAT DEVELOPMENTS WOULD BENEFIT THE INSOLVENCY SECTOR?

One of the interesting developments seen recently in the insolvency sector is the increased prominence of CVAs for the restructuring of larger companies. Widening the pre-CVA moratorium to medium and larger companies could prove to be a useful tool in giving IPs the opportunity to seek creditor approval for the CVA proposal. The industry appears to be eagerly awaiting The Insolvency Service's guidelines on this.

That's not a question that can be answered in one line! Helping those not involved in the insolvency profession to understand what we do and what we are trying to achieve might be a start.

The new communication options introduced in The Insolvency (Amendment) Rules 2010 should make communication with creditors more efficient and effective and may also improve creditors' participation and representation in the process. They will allow IPs to send and receive documents electronically and permit greater use of websites and meetings to be held by telephone or other means. The new Rules may be of particular benefit in large, complex and cross-border insolvencies through providing a statutory solution that will reduce the IP's need to seek directions from the court.

WHAT ATTRIBUTES DO YOU NEED TO BECOME A SUCCESSFUL IP?

A successful IP is one who quickly grasps the key issues facing a business and works pragmatically and commercially to deliver a practical solution. An IP needs to demonstrate strong leadership and communication skills to ensure that the agendas of all key stakeholders are managed through the restructuring process. Above all, an IP should ensure that he or she acts objectively and makes decisions based on doing the right thing for the creditors.

Insolvency situations can be complex and involve processing large amounts of information. The ability to see the real issues and deal with them commercially is key, as is the ability to manage and communicate effectively with the people involved with that insolvency, who often have competing agendas.

IPs must approach a distressed situation with an open mind and be prepared to listen and communicate efficiently. They must also be able to marshal significant quantities of information and immediately separate relevant and important facts. This will ensure key commercial decisions are implemented with strong leadership, which should protect or enhance value for creditors.

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Joint Insolvency Examination – November 2009

Congratulations to all the successful candidates, as listed below.

A

Adcock S (8159) Birmingham
Allison A (8239) North Ferriby
Andrews M (8103) Haywards Heath
Armstrong S (8032) Lisburn
Ashford D (8287) Norwich
Azhari M (8113) London

B

Bailey J (8217) Cheshire
Bain G (8013) Glasgow
Bains S (8073) Hitchin
Baker B (8106) London
Barnett N (8071) London
Barriball S (8274) Cardiff
Bass J (8038) Hoddesdon
Behagg R (8126) Aylesbury
Berry S (8216) Keighley
Birchall G (8200) Leigh
Birnie D (8022) Aberdeen
Breese K (8241) Ilkley
Burton K (8247) Leeds

C

Carr J (8062) London
Casey J (8264) Chichester
Cave S (8031) Bangor
Clarke A (8288) Ipswich
Collins T (8184) Manchester
Colman M (8213) Bury
Conway S (8208) Georgetown
Cook E (8112) London
Cook J (8101) London
Crangle E (8016) Glasgow

D

Dartnaill D (8041) Epsom
Dickson S (8015) Glasgow
Drury J (8048) Westcliff-on-Sea
Dunn C (8277) Middlesbrough
Dunn J (8042) Woking

E

Evans J (8276) Swansea

F

Fairbairn J (8004) Edinburgh
Farzadi H (8100) London
Fayers E (8116) Loughton
Flatt J (8127) Orpington
Frew K(8025) Ardrossan

G

Gardiner T (8083) London
Gillard M (8196) Altrincham
Graham I (8111) London
Gribble J (8205) Manchester
Griffin D (8066) Road Town
Grime M (8040) Reading

JIEB 2009 prizes winners

Insolvency Practitioners' Association Prize for First Place Jacqueline Parsons

PricewaterhouseCoopers Prize for Second Place Annabel Allison

Leonard Curtis for Third Place Kevin Wall

Insolvency Lawyers' Association Prize (awarded to the lawyer with the highest mark) Caroline Leeds Ruby

Institute of Chartered Accountants of England and Wales Prize (awarded to the ICAEW member with the highest mark) Jacqueline Parsons

Institute of Chartered Accountants in Scotland Prize (awarded to the ICAS member with the highest mark) Sarah Dickson

BPP Prize (awarded to the candidate with the highest mark in the Personal paper) Annabel Allison

H

Hamilton S (8125) Ashford
Hammonds T (8214) Sale
Harrison R (8188) Sale
Hastings L (8024) Kilmarnock
Hawksworth J (8036) Woking
Hebenton R (8209) Manchester
Henson S (8284) Newton Abbot
Hill S (8166) Coventry
Hodges H (8087) Milton Keynes
Hodgson S (8243) Bradford
Holland Y (8266) Southsea
Hyslop D (8006) Haddington

I

Innes W (8171) Birmingham

J

Jackson M (8044) Brentwood
Jerrard S (8267) Southampton
Jones A (8051) Chelmsford

K

Keat D (8077) London
Kelly S (8059) London
Kilkenny D (8219) Cheadle
Kiljan J (8172) Leicester
King L (8275) Reading
Knight S (8078) Brighton

L

Lavender P (8115) Chigwell
Lee T (8163) Birmingham
Leeds Ruby C (8037) London

M

McCulloch I (8215) Preston
McDermott T (8088) London
McGinness D (8027) Glasgow
McIntyre G (8026) Glasgow
Makaruk R (8175) Cheltenham
Maxwell R (8290) Leicester
Millar S (8121) London
Mitchell J (8283) Exeter
Moran R (8053) London
Moxon L (8195) St. Helens
Murphy T (8045) London

N

Newton M (8067) London

O

Oates J (8268) Lewes
O'Brien C (8131) Worthing

P

Pallott M (8068) London
Parla G (8117) Broxbourne
Parsons J (8212) Carlisle
Playford J (8286) Norwich

Q

Quenby G (8139) London
Quinn G (8207) Manchester

R

Ranford L (8129) Banstead
Rashid T (8292) Nottingham
Rathmell S (8210) Bolton
Richards M (8052) London
Riley J (8203) Stoke-On-Trent
Russell T (8262) Southampton

S

Sembi R (8176) Birmingham
Shokar M (8065) Welling
Smith A (8294) Grantham
Soden D (8104) London
Sykes L (8095) Marlow

T

Tackie F (8218) Manchester
Tait J (8003) South Queensferry
Timpson N (8096) Bedford
Tonks R (8177) Walsall
Trembath J (8282) Saltash
Tucknott M (8238) Wakefield

W

Wall K (8183) Hyde
Ward N (8169) Sutton Coldfield
Wheeldon B (8064) London
Wiles B (8058) London
Williams J (8254) Bristol
Williams S (8187) Manchester
Wooffinden M (8235) Manchester
Wright A (8110) London
Wright D (8130) Orpington
Wright G (8236) Newcastle upon Tyne

Analysis of November 2009 results

Papers sat	Papers passed				
	3	2	1	0	Total
3	66	20	20	17	**123**
2	–	28	12	16	**56**
1	–	–	75	34	**109**
Total	66	48	107	67	288

The evolution of the JIEB examination

Peter Windatt was the first chairman of the JIEB to pass the exams, so he knows how tough it can be. Below, he outlines the changes to the examination system that have taken place over the last few years.

Passing the JIEB examination is quite a challenge. I can vouch for that as, when I sat the exam on 4 November 1992, it was the same day as my daughter, our first child, was born at home. I had to abandon my wife to go and sit the exams, which, in those days, were two papers sat on the same day. One day I might receive forgiveness but perhaps 17 years is too soon?

Interesting times

Since July 2008 I have been chair of the JIEB board. Stephen Allinson, consultant to Moon Beever, is the vice-chair and he has been a great support to me during an interesting period – I believe it is a Chinese curse to wish people to 'live in interesting times'.

I've been involved with the JIEB at board level for some six years now, prior to which I was a personal insolvency lecturer for ATC and an assistant examiner for the JIEB on the ACVAR (Administrations, CVA and Administrative Receiverships) paper. So what has changed during that time?

- We have moved from a strait-jacketed, ever-lengthening standard syllabus to a learning-outcomes syllabus (akin to principles-based). There is no need for us to publish a list of every conceivable piece of legislation that could be examined.
- Examination entry requirements have been reduced in order that any restrictions are now dealt with through the licensing process of the individual RPBs.
- R3 introduced, and have continued to support, a graduation ceremony. This is a tremendous event and I would urge all successful candidates to attend in order to celebrate their achievement publically and to receive their graduation certificate.
- Compulsory questions were introduced in 2005.
- A move from whole-script marking to single question marking (SQM) was partially introduced in 2006 and fully implemented in 2008.
- A personal insolvency-only qualification was introduced and later dropped.
- Candidates are now allowed to pass one paper and then two, or two and then one. The majority view of RPBs is that the JIEB examination remains a sufficiently rigorous test for candidates.
- There is a move towards holistic marking. This is
  - part of continuous improvement, designed to increase reliability of results (as is SQM);
  - it provides a holistic assessment to assist, in particular, with the process of deciding marginal results; and
  - it replaces and expands upon marks previously awarded for presentation.
- An additional half-an-hour reading time has been added to papers.
- Exam dates have been bought forward to November (once again).
- There have been more non-insolvency practitioner/statutory-type developments, in personal insolvency in particular, with the introduction of the Debt Relief Order (DRO) and the increase in Debt Management Schemes (DMS), which all now have to be taken account of.

Interestingly, fewer accountancy RPBs are now putting candidates in for the JIEB examination; there is an increasing trend towards IPA and away from accountancy bodies.

Changes around the corner – within JIEB and without

- This year's exams will be the last for which the JIEB provides a clean copy of Butterworths' *Insolvency Law Handbook*. The costs of providing a book that is now updated each year are too much to bear; candidates will be able to bring in their own clean copy from 2011.
- Regulators are being asked if there should be designatory letters for graduates of the JIEB. Not all IPA/R3 members are licensed, not all licence-holders are JIEB graduates. Should there be some recognition, as with, for example, IoD membership where you get to put 'Grad' after either of these designatory letters in recognition of this tough exam having been passed?

Changing times

A regular issue for those sitting the exams, now in early November as opposed to early December, is the delay between the exams being sat and the results being issued. The change in the exams dates was to enable an additional half-an-hour to be added to the exams while tying in with existing ICAEW exams of the same duration, as they currently organise the exam halls, attendance, invigilation etc. The markers are still made up of paid volunteers from within the profession and they mostly undertake marking during the Christmas break – hence, while the exams are being sat a month earlier, the timetable for results publication has not changed. Although this is regretted, the cost of changing would be prohibitive.

JIEB board members give their time for free

The JIEB would not exist and could not function without an awful lot of goodwill from a great number of people. All of the board members give of their time freely. Last year, in particular, this was not an inconsiderable burden. Barbican Trust and Artemis Trustees have supported the provision of Butterworths and a large part of our educational consultancy costs for many years. Our examiners and assistant examiners, question-setters and moderators are paid well below what would be commercial rates for exams at this level and always go the extra mile. I would like to record my thanks to them all. ☐

Peter Windatt served the ACCA at a regional and national level for several years and was a member of council for a three-year term. In 2004 he replaced the former ACCA president and fellow IP, Peter Langard, on both the board of IPR Services (the company that appoints members to the Insolvency Practices Council) and on the JIEB (Joint Insolvency Examination Board). The boards of both of these companies comprised RPB nominated representatives. Since 1 July 2008 he has been chairman of the JIEB, replacing Ron Hodkin, on his retirement, who represented IPA.

Peter Windatt is an IP at BRI Business Recovery and Insolvency and chairman of the JIEB.

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R3 events, courses and conferences

Date	Event title	Venue
March		
1	Eastern Regional Meeting	Imperial War Museum, Duxford
1	North West Regional Meeting	TBC
4	Property, Construction and Health & Safety Issues	Hyatt Regency, Birmingham
4	West Midlands Women's Group Cuisine Evening	La Bastille, Birmingham
4	Yorkshire Regional Meeting	Crowne Plaza, Leeds
9	Introductory Programme Personal Insolvency 1	etc Venues, London
11	Introductory Programme Personal Insolvency 1	Deloitte, Birmingham
11	Introductory Programme Personal Insolvency 1	Irwin Mitchell, Leeds
11	Trading Insolvencies	Copthorne Tara, London
11	West Midlands New Professionals Networking Event	Must, Birmingham
16	Yorkshire Women's Group Personal Insolvency Event	Irwin Mitchell, Leeds
23	Business & Options Reviews	Novotel City South, London
25	Property, Construction and Health & Safety Issues	Cedar Court Hotel, Huddersfield
April		
1	Yorkshire New Professionals Launch Event	TBC
13	CPI Student Workshop	Ernst & Young, Manchester
13	Introductory Programme Personal Insolvency 2	etc Venues, London
13	Introductory Programme Personal Insolvency 2	Deloitte, Birmingham
15	Introductory Programme Personal Insolvency 2	Irwin Mitchell, Leeds
15	Liquidations	Radisson Portman SAS, London
15	Midlands Regional Meeting and AGM	TBC
19	CPI Student Workshop	Lawrence Graham LLP, London
20	Trading Insolvencies	Queens Hotel, Leeds
22	SPG Technical Review	Holiday Inn Bloomsbury, London
22	Midlands Women's Group Spring Ball	Hyatt, Birmingham
27	Debt Restructuring	Marriott City Centre, Bristol
27	CVAs under the new regime	Marriott City Centre, Bristol
28	South West and Wales Half Day Conference	TBC
May		
6	Trading Insolvencies	Novotel City Centre, Birmingham
11	Liquidations	Midland Hotel, Manchester
11	Introductory Programme Rescue 1	etc Venues, London
11	Introductory Programme Rescue 1	Deloitte, Birmingham
13	Introductory Programme Rescue 1	Irwin Mitchell, Leeds
19–22	20th Annual Conference	Vilamoura, Portugal
20	South West and Wales Golf Day	Bowood Hotel, Wiltshire

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2010 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

regional events   R3 events

Proceeds of Crime Act: a brief guide for IPs

Adrian Hyde outlines how POCA offers the legal reach to ensure that crime doesn't pay.

In the month of the deadline for submission of tenders to the CPS for the provision of proceeds of crime services, I was asked to give a brief history of the area, for the uninitiated.

Drug trafficking legislation

In the early 1980s, the government was becoming aware that with the huge sums that could be generated by drug dealing, prison was not enough to deter drug barons. They would happily serve 20 years in the certain knowledge that their multi-million pound assets would be waiting for them when they were released.

In 1986, the government passed the Drug Trafficking Offences Act, its first attempt at introducing effective financial penalties to hit drug traffickers where it really hurt. This act required the court to confiscate the proceeds of drug trafficking upon convicting defendants of such offences. The Criminal Justice Act 1988 widened the confiscation regime to include all indictable offences. Finally, in this phase, the Drug Trafficking Act 1994 tidied up and strengthened the 1986 act.

Proceeds of Crime Act

In 2002, significant steps forward were taken with the enactment of the Proceeds of Crime Act (POCA). This consolidated the existing legislation and, additionally, provided for the recovery of what are the proceeds of crime, through civil proceedings but without the need for a criminal conviction. This article refers throughout to the regime under POCA, although there are cases still being dealt with under the older regimes.

There are a number of different aspects to the legislation, which I discuss below, but it is useful to start by looking at the chronology surrounding a criminal conviction. The process starts with the arrest of the defendants. On the basis that they are then charged with offences, they are then either remanded in custody or released on bail. Subsequently they will be tried and, if convicted, a confiscation order will be made. The key part to this is that there can be a significant period between arrest and conviction.

A confiscation order

In making a confiscation order, the court will first assess the defendant's benefit from their crime(s). This assessment falls into two distinct and different types; (i) general criminal conduct – the benefit that was obtained from all and any criminal conduct, whenever it occurred, and whether or not the defendant was prosecuted for it; and (ii) specific criminal conduct – the benefit from the crimes for which the defendant has been convicted and any others 'taken into consideration'. The court will then assess the 'recoverable amount', ie the amount that might be realised. It is important to note that in assessing the amount that might be realised, the court does not look to trace the specific proceeds of the crimes, rather it looks to the value of the defendant's assets, whether or not they were purchased with the proceeds of crime. The recoverable amount will be either the same amount as the benefit figure or, if the defendant's assets are less than this amount, the realisable value of the assets (their 'realisable property').

Clearly, without more, confiscation could be a wholly pointless exercise. The Crown could convict the defendant and assess his benefit, only to find that 'the amount that might be recovered' is minimal. If, during the time between arrest and confiscation, the defendant has transferred his assets to third parties, hidden the assets, or generally put things beyond the sight and reach of the court, recovery could be difficult or impossible.

> "POCA consolidated the existing legislation and, additionally, provided for the recovery of the proceeds of crime, through civil proceedings but without the need for a criminal conviction."

Tools of the prosecution

1) The first tool that the prosecution has is the restraint order. A restraint order is, effectively, a freezing order. Where certain conditions are met, the prosecution can apply to the court for a restraint order. The effect of the order is to 'restrain' a specified person from dealing with any 'realisable property'. Such an order can be against third parties who, for example, may be holding assets on behalf of the defendant or who have received gifts from the defendant, where those gifts meet the criteria under POCA and may be attacked.

2) The second tool that exists is the ability to appoint receivers. Once the court has convicted a defendant and made a confiscation order, it has the ability to appoint an enforcement receiver. The enforcement receiver's role is to get in and sell the realisable property of the defendant to satisfy the confiscation order. In larger and more serious cases, particularly where there are businesses involved, the prosecution can seek the appointment of a management receiver at the time that it applies for a restraint order. Such a receiver has wide-ranging powers but the role is to preserve the assets that may be realised upon conviction while the defendant goes through the trial process.

Get your timing right

To give an example of timing, in the matter of Craig Johnson, the defendant was arrested in September 2002 and restraint and management receivership orders were made immediately prior to his arrest. Conviction took place in June 2007, sentencing took place in August of that year and a confiscation order was made in November 2008.

Finally, there is always a chance that insolvency will intervene somewhere in the picture. The rule of thumb is very simple; if restraint comes first and ends with confiscation, the restrained assets do not fall into the bankruptcy estate. If restraint or confiscation (where there was no prior restraint) comes after bankruptcy, then the restraint only bites against assets that do not form part of the bankruptcy estate. So first in time scoops the pot! □

Adrian Hyde is a partner at Chantrey Vellacott.

Threat of insider fraud grows

Mark Kenkre looks at the latest estimates of the cost of fraud to UK businesses and the growing trend of insider fraud.

The National Fraud Authority (NFA) is the government's strategic lead on counter-fraud activity in the UK. In January 2010 the NFA reported that it estimates that fraud costs the UK over £30 billion per year.

In this, the UK's first comprehensive fraud estimate, the new £30-billion national fraud figure is more comprehensive than the last widely accepted figure of £13 billion from the Association of Chief Police Officers (ACPO) report. It indicates a much higher level of the cost of fraud to businesses than previously believed.

Internal threat

Businesses often concentrate their efforts on combating the external threat of fraud to a business by putting systems in place to alert them to certain triggers. These products are often brought to their attention by their insurers following an audit. However, in the current economic climate, the greater threat to a business may exist internally. The temptation to commit fraud for personal gain has never been greater as employees seek to maintain lifestyles they enjoyed prior to the downturn.

It has been reported that 96 per cent of insider fraud is committed by individuals employed for more than twelve months, with 85 per cent of all business fraud committed by employees or former employees.

> "The temptation to commit fraud for personal gain has never been greater as employees seek to maintain lifestyles they enjoyed prior to the downturn."

Work-expenses fraud is the most commonly reported fraud, according to the Home Office *Offending, Crime & Justice* survey, and dishonest actions by staff to obtain benefits by theft and deception increased by 69 per cent in the first half of 2009, according to the Credit Industry Fraud Avoidance System (CIFAS), the UK's Fraud Prevention Service.

The recession has doubtless played a part in the significant rise of detected insider fraud last year, as employees look to other means of sustaining their previously good lifestyles. Employee fraud takes a number of forms, from falsifying invoices, redirection of computer fund transactions and procurement collusion, to company credit card misuse and false expense claims.

Toys 4 Paul

The importance for employers to remain vigilant to the issue of employee fraud has recently been highlighted by the case of 'down to earth' and 'quiet' Paul Hopes. He was the purchase ledger manager of international retailer Toys R Us, who has been charged with embezzling £3.7 million to fund a secret life of fast living and women.

Employed by the company for 23 years, he was known by his colleagues as a polite and quiet individual living the 2.4 children lifestyle with no signs of affluence at all. However, in less than three years, he took sums ranging from £101,000 to £350,000 from the company to fund a life of five-star hotels, fast cars and escort girls. He used bogus invoices to siphon off the money for encounters with call girls: buying one a Bentley and paying off the mortgage of another, but gave none of the money to his wife and children.

The case of 57-year-old Paul Hopes was described by police as 'a classic case of a valued, long-standing employee who was able to act with autonomy,' and should sound a warning bell for all employers as it proves any employee, even those considered to be quiet and living a life of suburban normality, is capable of this type of insider fraud.

Paul Hopes was sentenced to seven years' imprisonment in December 2009. Toys R Us is understood to have launched civil proceedings against him but investigators suspect that up to £2.7 million of the missing money may be impossible to recover.

A turn-up for the books

All sectors have been targeted by insider fraud. However, it is the finance and insurance sectors that have suffered major losses, both in terms of their bottom line and their business reputation.

The CIFAS survey also revealed that in the first half of 2009, two out of five frauds were identified through internal processes and audit procedures, which highlights the importance of correct and robust internal systems to increase the chance of the employee being identified before the effects of the fraud are too great.

Employers are now making an effort to protect themselves and there are better tools and services available to us as lawyers to assist them in their fight against fraud, including continuously screening employees and retrospectively screening employees who were not adequately checked when they joined a business. Implemented and managed properly, workplaces can become less vulnerable. □

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Modernisation changes coming soon to insolvency legislation

Stephen Leinster outlines the changes to insolvency legislation that The Insolvency Service is rolling out in order to streamline the process and reduce costs.

From 6 April 2010, The Insolvency Service's project reviewing the insolvency secondary legislation is set to provide further changes to the way in which insolvency cases can be administered. The changes will be implemented through a package of measures that will modernise the way in which insolvency cases are dealt with in future. The Service estimates that these changes, together with those delivered in April 2009 to modernise insolvency advertising, will cut more than £45 million a year from the costs of administering insolvencies and lead to better returns for creditors.

The Insolvency Service consulted widely with users on how the legislation should be modernised and improved. This dialogue informed the type of changes that will be implemented on 6 April 2010 by the Insolvency (Amendment) Rules 2010. That instrument is accompanied by The Legislative Reform (Insolvency) (Miscellaneous Provisions) Order 2010, which made the necessary changes to the Insolvency Act to allow us to modernise the procedures in the Rules. Both the Rules and Order can be viewed through our website link at: **www.insolvency.gov.uk/insolvencyprofessionandlegislation/consolidation/consolidationhome.htm**. Some of the key changes are summarised below.

Electronic communication

The new Rules expressly permit notices and other documents necessary in insolvency proceedings to be sent by electronic means. Currently there is uncertainty about the extent to which such documents can be sent by e-mail or their publication on a website. The new Rules will allow e-delivery of insolvency documents between consenting parties. Creditors will be permitted to give consent either in a specific case or generally. This will allow creditors who feature regularly in insolvency proceedings to give a single consent covering all cases dealt with by a particular insolvency practitioner. Office-holders will similarly be able to give consent to receiving documents from creditors and others electronically.

Websites

Office-holders will be able to send notices to creditors referring them to a website at which they can view and download a particular insolvency document. This provides scope for cost savings in the delivery of information to creditors, particularly in administrations involving the sending of bulky documents to large numbers of creditors. Creditors will have the right to request a hard copy of any document that is published in this way, at no cost to them.

Authentication

New authentication provisions replace the existing requirement that all insolvency documents must be physically signed. Where e-delivery of insolvency documents is made the document will not need to be signed, provided that the identity of the sender is confirmed to the satisfaction of the recipient.

Flexible meetings

Office-holders will be able to decide the media through which meetings can be conducted. It will no longer be necessary for all meetings to be held at a physical venue and it will be a matter for the convenor to decide how attendees can participate in the meeting. This might include remote attendance by telephone, or other electronic means, provided that the creditor can participate fully and can vote at the meeting. It is hoped that by allowing remote attendance creditors will be encouraged to engage in the insolvency process. Creditors who wish to continue attending meetings in person will have that right.

> “Administrators and other insolvency practitioners will be able to seek to recover unpaid pre-appointment costs as an expense in administration proceedings, so long as they are expressly approved by the creditors committee, the creditors or the court.”

Remuneration and reporting

The new Rules will provide office-holders with more flexibility in the setting of the basis of their remuneration in a particular case. Fixed fees will be an option across all insolvency procedures and different bases may be agreed for the different functions to be performed by the office-holder. To improve transparency for creditors, more regular and complete reporting to creditors has been provided for and in the light of these new reporting provisions, requirements for the summoning of annual meetings in creditors' voluntary winding up will be abolished. Accountability will be increased by changes to the way in which creditors can challenge excessive remuneration and expenses.

Pre-appointment administration expenses

Administrators and other insolvency practitioners will be able to seek to recover unpaid pre-appointment costs as an expense in administration proceedings, so long as they are expressly approved by the creditors' committee, the creditors or the court. To ensure creditors are provided with sufficient information to form a view on whether to approve such costs, details of how they arose must be disclosed within the proposals, including an explanation as to why the pre-appointment work was necessary.

Other changes include:

- replacing affidavits with verification of documents by statement of truth in accordance with the Civil Procedure Rules 1998;
- removing certain unnecessary filings of documents at court;
- providing standard content of certain basic details for notices placed in the *London Gazette*. □

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The OFT market study into corporate insolvency services

Sheila Tormey examines how the OFT conducts a market study and what this might mean for IPs involved in corporate insolvency services.

On 12 November 2009, the Office of Fair Trading (OFT) launched a market study into corporate insolvency in the UK. The study will look at the structure of the market for the provision of corporate insolvency services, the appointment process for insolvency practitioners (IPs) and any features of the market that could result in harm, such as higher fees or lower recovery rates for certain groups of creditors. Personal insolvency services are outside the scope of the study.

What is a market study?

Much of the OFT's work comprises investigations under specific statutory regimes. For example, civil cartel investigations are carried out under the Competition Act 1998, which may only be opened if a statutory threshold is met and which, once opened, can be difficult for the OFT to close. By contrast, market studies are flexible in nature. They are carried out under the OFT's general information gathering powers (section 5 of the Enterprise Act 2002 (EA02)) and reported on under the OFT's general reporting powers (section 4(4) EA 02). A market study is relatively easy for the OFT to open and close, and enables the OFT to 'have a look' at a market without committing itself to a formal procedure. John Fingleton, CEO of the OFT, has described market studies as a 'diagnostic tool' (Beesley Lecture, London, 16 October 2008).

Major market studies that the OFT has undertaken recently include the study into airports, which led to BAA being ordered to sell Gatwick Airport, and the study into Payment Protection Insurance (PPI), which led to a ban on the sale of PPI at the credit point of sale (following reference to the Competition Commission in both cases).

> "The OFT is seeking evidence from accountants, lawyers, government, regulators and trade bodies and hopes to complete the initial phase of the study by the summer of 2010."

Why has the OFT launched this study?

The OFT states that one of the main motivations for the study is the increased amount of corporate insolvency arising as a result of the economic downturn. It also cites concerns raised within government and industry and a World Bank report, *Doing Business 2010*, according to which the costs of closing a business in the UK are higher than in other countries with similar or even better recovery rates.

What issues is the OFT likely to consider?

The OFT is likely to consider issues such as:

- How IPs are appointed.
- How IPs' fees are set and structured, and whether fee levels are subject to constraint. In 2001, the OFT published a report on *Competition in the Professions* (OFT328), which noted that in the administration of receivership, creditors do not always have an incentive to get the best deal from their IP. For example, where the creditor is a bank and the value of the assets exceeds the amount of the loan, the bank's incentive to reduce IP costs is diminished, since the bank can only recover the amount of the loan.
- Access to the profession. The *Competition in the Professions* report, cited above, noted that due to the increasing demand for IVAs there may be a bottleneck for IPs, hence restricting competition and forcing up prices. IPs will need to demonstrate that they operate in a highly competitive marketplace.
- Recovery rates for certain groups of creditors.

What are the possible outcomes?

The most common outcome of OFT market studies is recommendations to government, in some cases for regulation. The OFT may also make recommendations to industry and/or use its findings to inform its policies.

In cases where the OFT finds that there are features of the market that prevent, restrict or distort competition, it may make a market investigation reference to the Competition Commission under Part 4 EA02, or accept undertakings in lieu of a reference.

The OFT could open an investigation under the Competition Act 1998 if it uncovers anti-competitive conduct, although this is not a common outcome of market studies.

Finally, the OFT could give the industry a clean bill of health.

The OFT's process

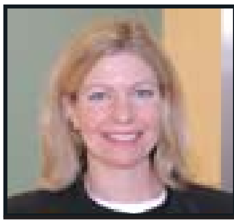
The OFT is seeking evidence from accountants, lawyers, government, regulators and trade bodies and hopes to complete the initial phase of the study by the summer of 2010, at which point it may publish its findings for consultation. If the study proceeds to a second stage, the OFT hopes to complete this by the end of 2010.

Further details of the OFT's process can be found in the OFT's guidance on market studies (OFT519, November 2004) and draft revised guidance on market studies (OFT1080 con, May 2009), available on the OFT's website **www.oft.gov.uk**.

Engaging with the OFT

As noted above, the OFT conducts market studies under its general information-gathering powers under section 5 EA02. These powers are not compulsory and there is therefore no obligation on parties to respond to the OFT. However, where parties wish to respond, they should bear in mind that the OFT seeks to make evidence-based decisions and it is therefore imperative that parties substantiate arguments with data wherever possible.

Evidence submitted to the OFT, whether in writing or given orally in meetings, will remain on the OFT's files. Parties should be careful when making submissions to the OFT not to prejudice their position in any future process. Furthermore, while there are restrictions on the disclosure of confidential information by the OFT under Part 9 EA02, this does not always guarantee confidentiality. Parties should consider confidentiality carefully when submitting information to the OFT and should ensure to make appropriate confidentiality claims. □



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The pre-pack promise: signs of fulfilment?

Sandra Frisby summarises the final conclusions of her review of pre-packs and finds that there may be cause for cautious optimism.

Deliberations on pre-packaged administration continue in the pages of the press and, as is often the case in that particular medium, the focus is on the allegation that pre-packs prejudice creditors. This article considers the validity of that allegation by reference to the most recent analysis of the author's databases on pre-packs and business sales (where the business of an insolvent company is sold as a going concern without that element of pre-commencement negotiation associated with pre-pack going concern sales). The databases in question contain information on cases of both types of sale during the period September 2001 to January 2006, which includes the amounts owed to creditors at the commencement of an insolvency procedure and returned to them by the presiding insolvency practitioner in each case.

> Pre-packs, because they allow for a seamless transfer and continuation of the business, facilitate the certainty necessary to avoid the deterioration of goodwill, which, in turn, feeds into the price a purchaser is willing to pay for a trading business.

Analysis of cases commencing between September 2001 and September 2004 appeared to confirm that pre-packs returned a considerably lower dividend to *unsecured creditors* than that observed from business sales, while, at the same time, performing better for *secured creditors* in terms of returns. This might be seen as evidence of a bias towards secured creditors, although it was noted at the time of analysis that the pre-pack sample in question excluded a reasonably large number of 'ongoing' cases, where information on a final return to unsecured creditors was not yet available. The updated database contains a much smaller proportion of ongoing cases and so the current analysis is more representative of the overall performance of both pre-packs and business sales in this regard.

The pre-pack rationale vindicated?

It is worth recalling, at this point, the fundamental justification for the use of the pre-pack strategy put forward (largely) by insolvency practitioners: it is argued that not only do pre-packs save businesses that would otherwise see their assets liquidated on a value-destructive piecemeal basis, but that they may also *enhance* going-concern value by avoiding the insolvency-related depreciation associated with the commencement of a formal insolvency procedure. Pre-packs, because they allow for a seamless transfer and continuation of the business, facilitate the certainty necessary to avoid the deterioration of goodwill, which, in turn, feeds into the price a purchaser is willing to pay for a trading business. While earlier analyses of the data suggested that this contention was probably correct as far as *secured creditors* were concerned, the value-optimising potential of pre-packs did not appear to be filtering down to *unsecured creditors*.

One might, of course, argue that as long as one category of creditor benefits from the use of a pre-pack then that use is justified. The obvious response would be to question whether that one category is advantaged at the expense of other classes, in which case the merits are rather more ambiguous. A number of explanations for the seemingly superior performance of business sales over pre-packs as far as unsecured creditors were concerned have been considered in the author's earlier reports. However, the most up-to-date analysis is far more promising in this regard, reflecting as it does the outcome of a sizeable number of more recently 'closed' pre-pack cases.

As far as secured creditors are concerned, pre-packs in general offer a better chance of a higher return than do business sales, although it should be noted that the gap between the two has shrunk somewhat. The percentage of cases of full repayment to secured creditors is almost identical, at 39 per cent and 38 per cent for pre-packs and business sales respectively. However, a secured return of 75 per cent or above is recorded in 3 per cent more pre-packs than business sales and a return of 50 per cent or above in a further three per cent more pre-packs. The percentage of secured creditors receiving a zero return is identical (nine per cent) for both types of sale, and the overall average return to secured creditors is 35 per cent from pre-packs and 33 per cent from business sales. There appears, therefore, to be some support for the argument that pre-packs maximise value from this analysis, *unless*, of course, the strategy simply shifts value towards secured creditors and away from unsecured creditors.

As it turns out, this would appear not to be the case. The percentage of pre-packs that return nothing to unsecured creditors has shrunk quite startlingly, to the extent that it is now identical, at 77 per cent, to the same figure for business sales. Moreover, and perhaps remarkably, two per cent of pre-pack cases resulted in a *full return* to unsecured creditors, as compared to one per cent of business sale cases. Finally, the average return from pre-packs to unsecured creditors is, at five per cent, higher than that seen in relation to business sales (four per cent). While one might not choose to applaud the fact that unsecured creditors can expect such miserable dividends in insolvency, there are certainly grounds for suggesting that, contrary to the perceived wisdom, such creditors may well be better served by a pre-pack strategy.

Cautious optimism

It would be overly optimistic to expect that unsecured creditors (and, of course, their credit insurers!) are likely to warmly embrace the pre-pack in the future: concerns about propriety, transparency and disenfranchisement are absolutely understandable and are likely to persist at least in the short term. However, this research suggests that their financial interests, far from being prejudiced, are marginally enhanced where the pre-pack strategy is employed. If the insolvency profession is able to demonstrate that this is a reasonably consistent outcome in pre-packs there may well be grounds for a *volte face* in popular opinion. □

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Pre-packs and SIP 16

Bryan Jackson gives his perspective on pre-packs and SIP 16 based on his experience as an IP in the firing line.

Pre-packs have been and will continue to be in the public eye. A vocal minority of creditors has complained about pre-packs and, having been blown up by the media and parliamentarians, this has led to the official tightening up of the regulation of IPs per SIP 16. The fact that jobs and businesses are saved in the process seems to be completely lost in the debate, which is a real shame. A pre-pack I dealt with recently saved 900 out of 1,400 jobs and saw the continued operation of 36 out of 58 stores and the survival of the brand, which led to continuity of the major suppliers. While I think all IPs have sympathy for and understand creditors' concerns, the attack on pre-packs feels pretty relentless and I'm not sure that the worst is over.

> "Let us be clear about the point of SIP 16. While one aim was to provide better information for creditors and improve transparency and perception of the process, its overarching aim was to produce better pre-packs."

The Insolvency Service's monitoring of SIP 16 reports

The Service began monitoring reports to creditors in January 2009 and will publish its 'one year on' report in March 2010. The main findings of its review of the first six months' operation of SIP 16 demonstrated that pre-package sale administrations provide better information for creditors at an early stage and a greater degree of transparency. The report also revealed that just three per cent of IPs did not materially comply, demonstrating that there is no systematic abuse to the detriment of creditors.

However, the interim report stated that 65 per cent of reports were 'compliant with the disclosure information in SIP 16' and so the maths dictate that 35 per cent of reports were 'non-compliant' and, of course, this is how it was picked up by the media and politicians. I take issue with The Service's definition of compliance and, therefore, non-compliance. Non-compliance doesn't mean that IPs are flouting the SIP 16 rules: rather the reports may not, in some way, have provided all of the information The Service was looking for. Perhaps The Service could use another term for these reports, mindful of how compliance and, subsequently, non-compliance are generally understood.

At the end of October 2009 (in an issue of *Dear IP*), The Service issued information/guidance on what it would like to see in the reports. This provided useful clarity for IPs. Before having this information, it was like sitting an exam without having any idea what the marking scheme was! We'd still like to see some examples of what makes a 'good' and a 'not quite there' report, but at least there is progress.

It is really helpful to now know that The Service expect reports to creditors to be sent within 14 days (or a full explanation provided as to why this was not possible). However, I hope that there is a clear cut-off point in The Insolvency Service's report. It would be unfair if IPs' reports throughout the whole year were marked against the guidance issued in late October 2009. To use a driving analogy, if the speed limit changed from 70 to 30 mph from one moment to the next, drivers would take an understandable amount of time to reduce their speed. They should neither be penalised for not being able to reduce their speed immediately nor should they be penalised for driving in a 30-mph zone when they were previously told they could drive at 70 mph. Reports received after the information was issued in late October should be differentiated from the proceeding period.

Is The Insolvency Service's monitoring and guidance producing better pre-packs?

Let us be clear about the point of SIP 16. While one aim was to provide better information for creditors and improve transparency and perception of the process, its overarching aim was to produce better pre-packs. It aims to influence behaviour and discourage inappropriate pre-packs by focusing the minds of IPs in the pre-appointment period. So the way to see if SIP 16 is working is to see if the number of 'bad' pre-packs diminishes – this will be the measure of SIP 16's success. The goal of perfect reports to creditors (as identified by The Service) is a somewhat narrow view.

How the perception of pre-packs can be improved

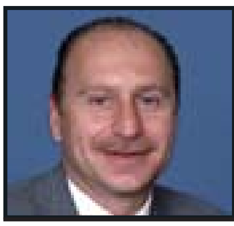
I understand that the number of referrals to recognised professional bodies (RPBs) is minimal, with not one official complaint about an IP in Scotland made to the Institute of Chartered Accountants of Scotland. Yet the perception of IPs undertaking dodgy pre-packs endures. Here's what I propose should be done about it. The Service should:

- focus on the specific cases of bad practice, such as the ambulance chasers, and root them out of the industry
- tell us where we are going wrong – if we are not providing information the way it thinks we should, let us know!
- report fairly on its monitoring of SIP 16 reports – not apply the guidance retrospectively
- focus on the cases of real non-compliance where the matter has been referred to the RPB.

> "A pre-pack I dealt with recently saved 900 out of 1,400 jobs and saw the continued operation of 36 out of 58 stores and the survival of the brand, which led to continuity of the major suppliers."

Going forward

In these testing economic times where the need for pre-packs – to save businesses and jobs – has never been greater, IPs must continue to work with businesses, creditors and government to prove the worth of pre-packs. I am sure that there are some challenging times ahead but if we work together as an industry we may be able to start winning the battle on the perception of pre-packs. □



Bryan Jackson is senior partner with PKF (UK) LLP in Glasgow

JJB-style CVAs revisited – reasons to be cheerful?

Parts of Jeremy Goldring's article 'JJB Sports CVA – fair enough' in the autumn 2009 edition of *RECOVERY* concerning the JJB CVA caused Kevin Pullen in the winter edition to feel a little grumpy. But are there reasons for lawyers to be cheerful after all?

Rarely in my professional career have I set out to make a fellow lawyer grumpy – I've found it to be a generally unproductive strategy. Anyway, life's too short for that. Since it is said that every cloud has a silver lining, let us look for the bright side.

The cause of concern is my suggestion that the JJB and Focus CVAs might not have withstood challenges for material irregularity or unfair prejudice. Several cases, notably *Re Cancol* and *Thomas*, are cited to support these CVAs and support them they do. There is no doubt that the commercial objectives of the debtor companies were (admirably) achieved. That seems reason enough to be cheerful.

However, sometimes an argument can be correct on existing case law but dangerous to rely on because it is based on questionable analysis or the logical extension of it reveals odd and undesirable consequences, which a subsequent court may well find unpalatable. When that happens, lines of legal 'authority' can take sudden changes of direction or come to abrupt ends.

The issues thrown into the spotlight by the JJB and Focus CVAs are:

- Can a CVA prescribe how votes should be calculated?
- Can a CVA differentiate in its treatment of 'future' creditors?
- Can a CVA vary the contractual terms between the debtor and third parties?

Voting rights

There's little more to be said on material irregularity. I think it uncontroversial to say that it would be wrong for a CVA to propose a formula to calculate voting rights for landlords (or any other creditor for that matter) to the exclusion of any other valuation method. As long as the chair's discretion and right of the creditor to put information before him or her is preserved and the proposal doesn't mislead creditors in respect of their voting rights, there should be no issue.

Differentiation between 'future' creditors

The decision in *Re Cancol* was that if an asset of one future creditor (in that case a lessor of chattels) is to be used to earn future profits, while that of another (the leased premises) is not, treating them differently is not unfairly prejudicial, provided the latter is not deprived of its remedies. Only two paragraphs of the judgment address this question. Because the right to forfeit of the landlord whose premises were not required was preserved, his challenge failed.

In *Thomas*, the court held that cramming down rent (replacing the right to arrears with a share in a fund), and so limiting the operation of the right to forfeit (so that the landlord could forfeit only if he did not receive a share of the fund or for non-payment of rent falling due in the future), was not *in itself* unfairly prejudicial. However, in that case, there were no landlords whose future rent was to be paid in full to compare him with.

Or take two ordinary unsecured suppliers, both of whom refuse to supply post-CVA unless their unsecured claims are paid. The CVA proposal applies assets to pay one but not the other.

In both of these examples, the obligations of the company were incurred before the CVA but the CVA proposes that creditors in the same class be treated differently. That was once thought to be the sole test for determining unfair prejudice. Has this principle been abandoned? Why are obligations to a landlord any different? What is really happening is that the company is cherry picking between those it wants to trade with and those it doesn't. It would be illogical if the principle of equal treatment between creditors of the same class were to go out the window when dealing with landlords (or, as in *Cancol*, chattel lessors) on the notion that such parties are 'future' creditors. So how safe is it to rely on *Cancol* and *Thomas*? In simple but ultimately fundamental terms, the question is whether a company can, through a CVA, treat its creditors as it pleases on the grounds that it needs to do so for the success of its new business plan?

> "In simple but ultimately fundamental terms, the question is whether a company can, through a CVA, treat its creditors as it pleases on the grounds that it needs to do so for the success of its new business plan?"

Pausing there, I have never felt comfortable with the conclusion that the right to forfeit can be restricted in this way, while a secured debt cannot be compromised, so restricting the right to enforce security. The justification is that the Insolvency Act provides that it is not possible to affect the right of a secured creditor to enforce security without his or her consent. Thus, security rights appear to be prioritised over ownership rights, which feels fundamentally wrong.

Ignoring my discomfort, I was discussing rent falling due under a lease post-CVA. *Cancol* and *Thomas* refer to this as a 'future' claim. That is correct in the sense that it falls due in the future but it arises under an obligation that was created when the lease was acquired.

This is important. Consider a situation where a company has entered into an obligation to buy goods, which are yet to be delivered, from two suppliers. The CVA proposes to pay in full one debt in order to secure delivery but to pay only a dividend on the other (because it no longer wants the goods).

Contractual variation

The JJB and Focus CVAs did not just differentiate between landlords. They also varied the leases. The question of whether a CVA can vary a contract so as to force a counterparty to continue to be bound on new un-bargained for terms is another matter. Forcing a landlord to supply premises at a reduced, or more or less frequent, rent or on any otherwise varied terms ought not to be permissible. In my last article, by way of analogy, I imagined a law firm becoming obliged to provide services at reduced rates. I could also have mentioned a supplier being obliged to provide raw materials at reduced prices or a bank being obliged to vary covenants and extend facilities on reduced interest rates.

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Secured creditors appear to be protected, as described above, although perhaps my 'dangerous to rely on' point applies.

Even if we assume that secured creditors are safe from being crammed down, the problem remains for creditors without security. Leaving aside landlords, an unsecured lender may be crammed down and obliged to continue to lend on varied lending terms. Similarly, a chattel lessor may be denied rights to repossess and obliged to accept reduced rent. A factor may be required to advance smaller sums against purchased invoices. The list is endless, extending to all existing contractual relationships.

If we take the view that it should not be possible for a CVA to create such havoc, the question is what, legally, prevents it from doing so? There are only two answers. One is the limits imposed on a CVA by the right to have it set aside as being unfairly prejudicial to the interests of a complainant and the grey area is, again, against what exactly should the complainant's position be compared?

It seems from *Powerhouse* that rights may be crammed down by a CVA if the position of the complainant would have been worse had the debtor entered liquidation. If that is the correct test, the evidence is likely to be highly subjective and dependent on market conditions at any point in time. And what if the market for landlords and the markets for lenders of money and suppliers of goods are equally depressed? Why should the contracts of only the former be singled out for variation by cramming down under a CVA? The question of whether contracts can be varied by cram down does not readily fall to be resolved as a question of unfair prejudice.

"A CVA that crams down executory contractual rights is not a CVA. It is not within the statutory definition under s2 of the Insolvency Act, being (in that respect) neither 'a composition in satisfaction of [the company's] debts' nor 'a scheme of arrangement of [the company's] affairs'."

The second answer is that a CVA that crams down executory contractual rights is not a CVA. It is not within the statutory definition under s2 of the Insolvency Act, being (in that respect) neither 'a composition in satisfaction of [the company's] debts' nor 'a scheme of arrangement of [the company's] affairs'. This seems a neater solution, although it requires the notion that contractual variation going further than compromise of debt is not a scheme of arrangement of the debtor's affairs and, therefore, not permissible. This has not been debated before the court – yet.

The good news

The conclusion we are drawn to is that the law surrounding the CVA is considerably underdeveloped and the current authorities on unfair prejudice leave room for anomaly and uncertainty. We lawyers are, of course, engaged to advise in areas of legal uncertainty in order to promote our clients' commercial objectives, which is, after all, a very good reason indeed to be cheerful. ☐

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New data protection guidance could prove costly for office-holders

A new guide to data protection could have unwelcome repercussions for office-holders.

The Data Protection Act 1998 (DPA) has recently received considerable press interest. High-profile data breaches and a more political Information Commissioner (ICO) have resulted in a strengthening of the legislation. The ICO will, from April 2010, have the power to issue civil monetary penalties of up to £500,000 for serious breaches of the DPA. The government is also considering introducing custodial sentences of up to two years for misuse of personal data.

Until now, office-holders have been relatively immune from the impact of the DPA on their work with insolvent companies. However, one small passage in the ICO's new plain English *Guide to Data Protection* appears to change the view of the ICO towards the industry.

Office-holders could now find themselves at risk of enforcement action for their own actions, those of the employees and former employees of the insolvent company, and breaches caused by those providing services to it. Enforcement action can result in enforcement notices, civil monetary penalties, prosecution and claims for compensation.

The 1996 guidance

In 1996, the then Data Protection Registrar (the ICO's predecessor) issued in-depth compliance guidance to insolvency practitioners (IPs) on the handling of company data under the Data Protection Act 1984 – company data being personal data attributable to the activities of the insolvent company or the individual for whom the insolvency practitioner acts.

The advice was that an insolvent company could continue to be responsible for compliance under the legislation 'for as long as [it] remains in existence without being dissolved'. The view expressed was that where the IP acts as agent for a company, the company would have statutory responsibility for the personal data held and used as part of the company's business. This would be the case even though the control of the company's affairs was to a great extent in the hands of the IP. As an agent, the IP's position would be analogous to that of the directors before insolvency. The directors manage the affairs of the company but are not themselves responsible for compliance. In short, for as long as the IP acted as an agent of the existing company, he or she would have no liability under the data protection legislation.

The new guide

The ICO issued a *Guide to Data Protection* in November 2009, which touches on insolvency. It contains the uncontroversial comment that 'even if an organisation goes out of business, individuals are still entitled to expect that their personal data will be processed in accordance with the data protection principles. However, responsibility for ensuring this happens may shift, depending on the circumstances.'

The guide then provides two examples of where responsibility may shift. The second example raises concerns:

> "Office-holders could now find themselves at risk of enforcement action for their own actions, those of the employees and former employees of the insolvent company, and breaches caused by those providing services to it."

'A high street retailer (which operates as a limited company) goes into administration. Control of the company's assets – including an extensive customer database – passes from the board of directors to the administrators, who decide to sell some of the assets. Because the administrators now control the purpose and manner in which the database is used, they become data controllers of the personal data it contains. The administrators must comply with the Data Protection Act in connection with any possible sale of the customer database.'

This view is unsatisfactory for a number of reasons:

- It appears to suggest that because the board of directors had control over the assets, they were responsible for compliance with the DPA. This was not the case in the 1996 guidance and does not reflect the position under the DPA. The limited company, not the board, is the data controller. As such, the company has, for as long as it exists, the statutory responsibility to comply with the DPA.
- The ICO does not appear to have considered the in-depth guidance issued by his own office in 1996.
- The example does not address insolvency law.
- It is over-simplistic. For example, it fails to differentiate between a company that is still in existence and one that has been dissolved.
- It fails to consider the position of the administrators as agents of the company. For as long as the administrators process any personal data on behalf of the company, they will be data processors. Crucially for IPs, data processors have no statutory obligations under the DPA. The ICO has no power to take direct action against data processors. He or she can only pursue data controllers.

The impact of the guide

The example in the guide will, if it accurately reflects the ICO's considered view, have a significant impact on the liability of office-holders for any breach of the DPA that occurs during their appointment. To date, one of the major concerns of the ICO has been data security. To avoid liability for breach of security, office-holders would need to take steps, such as ensuring that:

- databases containing customer details are not stolen, lost or otherwise misused by departing staff
- IT equipment, including hard drives and laptops, is properly decommissioned to remove any personal data before it is resold
- mobile devices, such as USB sticks, CDs and laptops, containing personal data are encrypted
- information about employees or customers is disposed of in a secure manner.

The list goes on…

What should the industry do?

The apparent contradiction between the new guide and the 1996 guidance is unsatisfactory. Clarity is needed from the ICO so that office-holders can understand their potential liabilities. The time may be right to engage with the ICO for clarification. That way, the industry will have an opportunity to exercise its influence and, hopefully, obtain clear and pragmatic guidance from the ICO. ☐

Mark Gleeson is head of data & information at Addleshaw Goddard LLP.

Whither Ireland Inc?

Jim Luby analyses the prospects for recovery in the Irish economy and the challenges the recession poses for insolvency practitioners.

The past year has been a difficult one for Ireland. The start of 2009 saw the demise of one of our iconic brands, Waterford Glass, and its UK subsidiary Wedgwood. Our over-hyped property market continued to implode. Parts of the country experienced the worst floods in a generation and the year ended with the big freeze. And Thierry Henry's perfidy put us out of the World Cup finals!

Reasons for our problems

The period from the mid 1990s to the early noughties was a period of sustained growth, driven by foreign direct investment, principally from the US, into an economy with easy access to the EU market, a competitive wage structure and a skilled, well educated workforce. As the economy grew, our competitiveness declined in the face of wage demands and a bloated public service sector. Ireland became a less attractive location for foreign direct investment.

Much of the wealth generated in the Celtic Tiger years was invested in a highly leveraged property market. This was fuelled by historically low European Central Bank (ECB) interest rates, liberal availability of credit and tax incentive allowances, which were originally devised to improve the general property infrastructure but were continued well past their sell-by dates.

Our economy became over-reliant on property and construction and on selling services to each other on the back of consumer demand fuelled by cheap credit. The property market commenced its decline in early 2007. The credit crunch of autumn 2008 triggered a significant downturn in the economy.

Remedial actions

While many have been critical of the government's efforts to address the problems, the difficulties of dealing with a serious recession in this small open economy, with no local control over interest or exchange rates, are almost unprecedented. A government decision was made quickly and under pressure to guarantee banks' liabilities. A National Asset Management Agency (NAMA) has been set up to buy distressed assets from the banks and work them out over an extended period. Only time, perhaps a generation, will tell whether these decisions were correct, or very costly mistakes.

Emergency budgets are attempting to manage our budget deficit by cuts in public spending and targeted tax increases. This is in the face of significant political and public sector union opposition. A period of labour unrest is likely.

These efforts are being viewed by the international markets as positive and, hopefully, will provide the platform to allow us to benefit from an international recovery, which should give early benefits to open economies such as Ireland's.

Insolvency practitioners' perspective

Insolvency and restructuring cases doubled from 2008, primarily in construction and property development, hotels and leisure, retail and car dealerships.

While the volume of work has increased significantly, the lack of availability of credit has reduced the potential to rescue businesses and jobs. Bank lending generally is restricted and this applies in particular to lending to distressed positions. Hopefully, the combination of NAMA and the progressing recapitalisation of the banks will remedy this situation over time.

Creditors and bondholders are adopting a realistic approach to working with rescues and in their expectations for recovery. For example, my firm recently completed a scheme of arrangement for a telecoms company where bondholders can look forward to receiving a 30 per cent distribution, without interest, after two years.

The number of companies entering our examinership rescue process has fallen because of lack of availability to fund investment and also as a result of more stringent court requirements to prove survivability.

Distressed property

Rescues in the property sector are proving particularly difficult. Courts have been unreceptive to extended rescue plans dependent upon an eventual upturn in the market. The default position is the appointment of receivers to hold and manage the properties, pending either a property market recovery or, in some cases, the purchase of the related loans by NAMA.

There has been interest from external distressed debt investor groups in acquiring property-related debt and this is likely to increase as NAMA is implemented and the market is perceived to have bottomed out.

A major challenge for practitioners is the rescue of insolvent individuals with very significant personal liabilities arising from personal guarantees or unlimited structures for leveraged property investment. These include not just the developers themselves, but also lawyers, accountants and other professionals who borrowed to invest in tax-structured developments. Irish bankruptcy legislation is outdated (based on a review in the 1960s) and overdue for reform. While formal personal schemes of arrangement are provided for, my firm's experience of these is that they are unduly procedural and costly. We are using informal schemes, which have all the usual difficulties, and are working in conjunction with lenders on co-operative workouts to complete projects and asset sales.

Road to recovery

While it appears that we insolvency practitioners will be busy for some time, the recovery of Ireland Inc is dependent upon a restructuring of our economy. This has commenced but will require the continuation of tough and decisive government until international recovery happens, which should impact quickly on Ireland's economy. ☐

> “While the volume of work has increased significantly, the lack of availability of credit has reduced the potential to rescue businesses and jobs. Bank lending generally is restricted and this applies in particular to lending to distressed positions.”

Jim Luby is a partner at McStay Luby and is vice-president of INSOL Europe.

DMP consultation

R3 members have reservations about current DMPs. Graham Rumney reviews the options suggested in the MoJ consultation.

Operating outside formal insolvency procedures, Debt Management Plans (DMPs) play a significant, but insufficiently understood, role in the personal debt and insolvency landscape. There are no official records of the numbers of individuals in DMPs, but estimates suggest they dramatically outnumber those in IVAs and bankruptcy. Given the apparent popularity of DMPs, the government's current interest in them is both timely and welcome.

Presently, DMP providers operate under the OFT 'debt management guidance', although a significant proportion of DMP providers are also covered by either the Debt Managers' Standards Association (DEMSA) or the Debt Resolution Forum's (DRF) codes of conduct. R3 has been active in voicing concerns about the way the industry (the banks, those vetting proposals and the DMP providers) operates. Calls for change have gained pace as the recession has hit; and the Ministry of Justice (MoJ) launched a consultation last year to explore key concerns and to test its ideas for the better management of the industry.

> "If implemented, [option 3] would not affect non-statutory DMPs (the current kind), so bad practice could continue."

R3 research

Even if the majority of DMPs are working to an acceptable standard, R3 research has identified several worrying practices. Our research highlighted creditors continuing to threaten debtors while they are in a DMP; DMPs lasting over a decade; providers failing to make individuals aware of other options for dealing with their debts; confusion about fees, allowing individuals to enter DMPs without explaining that there were charges; and some providers making late payments to creditors despite receiving timely payments themselves.

The MoJ consultation

The MoJ consultation offered three options:
1) continuing with the 'status quo';
2) improved self-regulation; and
3) the introduction of statutory DMPs.

The last of these options seems to appeal to many in the 'free' advice sector and several providers, but the kind of statutory DMP outlined in the consultation is flawed. If implemented, it would not affect non-statutory DMPs (the current kind), so bad practice could continue. Essentially it would introduce a new product (the statutory DMP) co-existing alongside non-statutory DMPs. The introduction of these statutory DMPs would inevitably add to the existing puzzling maze of solutions facing excessively indebted individuals, while being insufficient to address legitimate concerns regarding those outside the regime.

> "It is little short of a scandal that there are no verifiable figures available to central government; consequently this part of the personal insolvency iceberg remains hidden from view."

Options 1 and 2 are not necessarily mutually exclusive. Option 1 does not mean 'no change'. The DEMSA and DRF codes are beginning to bite (and would be more effective if they were to harmonise their standards into one); and the OFT is already engaged in reviewing its existing debt management guidance. These parallel work streams in combination already have the potential to cause beneficial change and eliminate bad practice, the more so if upgraded OFT guidance is to be accompanied with a more frequent exercise of its powers of sanction: for example, the suspension of Consumer Credit licences of DMP providers or creditors would ensure the line was toed.

New measures to ensure debtors understand the alternative options

Inter alia we would like to see new measures introduced to ensure debtors have a greater understanding of the alternative options available to them; with suitable safeguards introduced to ensure DMPs are agreed on the basis of robust, tested supporting information; more frequent updates for debtors on the progress of their DMP, and greater transparency about fees charged. R3's research of its members shows the majority support mechanisms to ensure that debtors do not enter a DMP when their debt is so high as to make the DMP unworkable or excessively lengthy, and that restraints on creditors taking enforcement action against debtors who are abiding by an agreed plan should be voluntarily adopted.

What we propose will take time to take effect but less than the flawed option 3. Like the IVA Protocol, which is still work-in-progress, it will need to be worked on, monitored and revised in the light of experience. Responsibilities need to be adopted in equal measure by DMP providers, intermediate approving agents, and the banks and credit card companies – who collectively are the DMP industry. Transparency as to process and behaviour; respect for the principles of 'Treating Customers Fairly' and the 'Unfair Commercial Practices Directive' must be applied and visibly demonstrated.

Statistics are required

It remains to be seen which way government jumps and when, but there has to be one common feature: the accurate collection, analysis and publication of the numbers of DMPs agreed and extant. It is little short of a scandal that there are no verifiable figures available to central government; consequently this part of the personal insolvency iceberg remains hidden from view. The OFT should require, as part of its licensing regime, the collection of data on DMPs. If that cannot be achieved under the OFT's current powers then it, or the MoJ, should find the legislative time to achieve this simple measure, perhaps via a Legislative Reform Order. Who could possibly object to that? □

Graham Rumney is the chief executive officer of R3

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Economic snapshot: North East Region

The North East escaped the worst effects of the recession but still faces testing economic times ahead, according to Jim James.

The end of the spell of extreme weather that we 'enjoyed' at the start of the year, and the gradual thaw of the snow that had lain on the ground in north east England for over a month, seemed to provide a fitting metaphor for news of the official end to the recession we endured throughout 2009. But just as the melting snow doesn't necessarily mean the end of winter, the north east is still, despite what the official figures might say, bracing itself for continuing cold economic winds.

Weathering the recession

The North East is different in many ways to the rest of the UK, but from an economic point of view, it has enjoyed something of a buffer from the recession due to the high proportion of the regional economy that is occupied by the public sector. Estimates vary, but it is generally accepted that around one pound in every three spent in my region comes from public sector sources and many of the region's biggest employers are also very much part of it.

As well as the usual types of organisations, such as the NHS and schools, the North East is also home to a significant number of employees of the Department of Work & Pensions, 18 further education colleges and five thriving universities (as well as a more recent and controversial entrant to the public sector, to which I will return shortly).

The distance, both geographically and (as it is often perceived here) mentally, between the North East and the UK's economic and political centre tends to mean that, while we don't enjoy the economic booms to the same extent as our cousins in the south, we also tend to have slightly softer landings when boom turns to bust.

While many organisations here have, of course, experienced significant difficulties and have had to implement major cost-cutting exercises, often driven by the loss of scores or even hundreds of jobs, to ensure they made it through the recession, until now the region has been spared the outright loss of high-profile companies and major employers that has been so apparent in almost every other part of the UK. However, the closure of the Corus plant on Teesside will deal another blow to a traditional industry, its associated support services and all who work in them.

The painful fallout of Northern Rock's nationalisation

The one key codicil to this comes in the shape of the controversial new entrant to the public sector that I mentioned earlier – and considering the international waves its plight caused, it could hardly have been more visible. It's hard to underestimate the psychological, as well as commercial, impact that the near collapse and subsequent nationalisation of Northern Rock had on the North East. Pretty much everyone here knows someone who works for it; it is a brand that people of all ages here have known all their lives and a huge proportion of the population has always had its savings accounts or mortgages with it.

> "The key to our future prosperity or otherwise is what the promised public sector spending cuts will actually turn out to entail and where their impact will be most keenly felt. We know they are coming but we just don't know where, leading to nervousness across the board."

To suddenly see something that is so much a part of the region's heritage brought to its knees and to then witness around 2,000 of its 6,000 employees being made redundant within just a few months of the first problems becoming apparent was traumatic in the extreme.

The immediate rallying round Northern Rock that followed the revelation of the full extent of its plight was typical of the North East's attitude towards supporting our own and it still, even in its current much-reduced state, retains a reservoir of regional goodwill.

An uncertain future

The relatively diverse nature of the modern north east economy, where internationally recognised scientific expertise, a still-burgeoning tourism industry and a fast-growing technology sector sit alongside more traditional manufacturing and engineering businesses, has meant that we have perhaps not felt the impact of the recession as much as we might otherwise have done.

We are no longer wholly dependent on dominant industries, as we have been on coal or shipbuilding in the past, so while we have undoubtedly experienced problems across the board, no individual sector has dragged down the rest.

The key to our future prosperity or otherwise is what the promised public sector spending cuts will actually turn out to entail and where their impact will be most keenly felt. We know they are coming but we just don't know where, leading to nervousness across the board.

Taking the higher education sector as an example, the five north east universities (Newcastle, Northumbria, Sunderland, Durham and Teesside) currently have a combined population of 84,000 full- and part-time students. What impact will a reduction in the number of places available at each one, as indicated by the recent removal of over £300 million from the UK higher education budget for the 2010–2011 academic year, have on the numbers of people employed by each institution and on the businesses, both large and small, that provide services to these shrinking student and staff populations?

This sort of question is certain to be repeated across all areas of public sector spending, regardless of which political party is in power, and both the undoubtedly uncomfortable answers we get and the ways in which we deal with them will shape the fortunes of our regional economy for years to come.

There is good reason for optimism, especially given the entrepreneurial spirit that north east England has always encompassed, but it will be a good while yet before we can say that the region is truly leaving the impact of the recession behind. □

Jim James is the outgoing chair of the R3 North East Region and head of the Insolvency and Corporate Recovery Unit at Ward Hadaway.

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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.

Industry announcements

Freeth Cartwright LLP

Midlands heavyweight law firm FREETH CARTWRIGHT has appointed leading insolvency lawyer MIKE GILMOUR to head up its Birmingham office insolvency practice.

He joins from Clarke Willmott, where he was a partner and head of the Birmingham insolvency team. He has over 15 years' experience in the region.

Mike's team will be dealing with all aspects of corporate and personal insolvency work.

Freeth Cartwright's Birmingham managing partner, Richard Beverley, said: *"Mike has an excellent reputation in the profession and has the skills and knowledge to be an outstanding asset to the firm."*

Begbies Traynor

Begbies Traynor, the leading business rescue, recovery and restructuring specialist, is pleased to announce the appointment of David Wilton as Partner in its London office.

David has 34 years experience in restructuring and insolvency work and before working in London he had worked in Cardiff, Nairobi and Birmingham. David's role will include restructuring work in both the private sector (focusing on automotive, construction, media and travel) and the public sector (focusing on health and transport). He will act as restructuring adviser to companies or their financial stakeholders.

Mark Fry, regional managing partner in London & South East, commented: "David joins the team of more than 20 professionals in London with experience that includes banking, accounting, corporate finance, strategic consulting and insolvency and reconstruction. David's experience on company and financial stakeholder work and extensive sector experience will help us deliver the best results possible for our clients."

www.begbies-traynor.com
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Insolvency Business Development Manager	Niche	£50K	Cheshire
Personal Insolvency Practitioner	IVA Business	£100K	Manchester
Personal Insolvency Practitioner	IVA Business	£80K	Lancashire
Personal Insolvency Practitioner	IVA Business	£Neg	Cheshire
Corporate Insolvency Administrator	Top 20	£25K	Manchester
Mixed Insolvency Administrator	Niche	£25K	Stoke

Interview with Alan Bloom

Alan Bloom is well respected in the insolvency profession. His skill lies in trying to consider all the angles, whether dealing with a complex case or contemplating the future of the profession.

Alan Bloom

2006 to date	Global head of restructuring at Ernst & Young
1992 to date	Major cases worked on: Nortel (the European arm of a major telecommunications company); Kaupthing Singer & Friedlander (formerly Iceland's largest bank); Landsbanki/Heritable Bank (formerly Iceland's second largest bank); Railtrack; Metronet; Barings Bank; TXU and Canary Wharf.
2000	Served as the only practitioner on the government's DTI/Treasury Working Party on the review of Insolvency and Company Rescue Mechanisms.
1999–2000	R3 president
1981	Joined Ernst & Young.

As a former president of R3, what advice do you have for the current and future presidents in taking R3 into the next decade?

Never give up the quest to state the positive things that insolvency practitioners (IPs) do and demonstrate the value that we bring, even if it's like pushing water uphill! We don't make the problems and only get involved when a company becomes insolvent. We need to emphasise that we save jobs, rescue businesses and return money to creditors. The more we can demonstrate value the less concern there will be about fees.

Don't be afraid to explain that ours is a complex business, and getting more so. We tend to assume that people understand this. But things are complex and cost money, and that needs to be made clear to them.

R3 is a broad church. It needs to make sure it has good representation of all types of firms across the sector – in its membership, in committees and in council. All scale of organisations should be represented – very large, mid-tier and smaller firms.

> “R3 is a broad church. It needs to make sure it has good representation of all types of firms across the sector – in its membership, in committees and in council.”

What have been the new challenges of the major administrations in this recession compared with those encountered in preceding ones?

In some of our largest administrations, we have found ourselves in situations where the edges are blurred between the private and public sectors. For example, in relation to Railtrack (the national railway company), and Metronet (the London Underground maintenance company), there were special administration regimes with an obligation to continue the business. This in itself presented pressures and strains that were different to those you encounter in a normal private sector insolvency.

Many private sector companies we deal with now are multinational; even if the debtor is based in one country, which is by no means always the case, its lenders, suppliers and customers may well operate in many different jurisdictions. As a result, corporate restructuring is becoming ever more complex, the laws are different in each jurisdiction and you have to work with the legislation in each jurisdiction in order to achieve your objectives.

> “If you are dealing with a highly regulated sector such as banking or infrastructure, you find yourself dealing with regulators and politicians and there are thousands, sometimes millions, of customers who depend on business continuity.”

Generally speaking, legislation and case law over the past 10–20 years has made it tougher to achieve a rescue through insolvency. For example, employment law is stringent, TUPE regulations impact on the ability to restructure a business; retention of title and other proprietary rights make the stabilisation of the business extremely time consuming.

If you are dealing with a highly regulated sector such as banking (Kaupthing Singer & Friedlander and Heritable Bank) or infrastructure (Railtrack and Metronet) the framework within which the business operates is clearly much tighter. You find yourself dealing with regulators and politicians and there are thousands, sometimes millions, of customers who depend on business continuity. As an example, when we were appointed as administrators to TXU (a significant energy supplier and trader), a few years ago, at the end of the first days of the administration, we had to phone into the energy regulator in order to enable him to reach a view as to whether he would need to implement special powers to maintain >>

required energy levels to major cities in the UK. In the first few days of the administration of Metronet, two lines failed to open due to workers leaving a tarpaulin on one of the tracks during overnight work and, a couple of months into the administration, we were subject to a three-day strike, which brought the London Underground system to a halt. Such are the other responsibilities in these cases.

The other significant feature of latter day administrations is the range of different stakeholders. It is now normal in any major administration to be dealing with at least three or four tiers of lending: bondholders, hedge funds, credit insurers, default swap counterparties, landlords, leasing creditors and trade suppliers. This multiplicity of stakeholders means that communication is critical and you need to assign members of your team to deal with different stakeholder groups so that when major decisions need to be made, they are informed and, hopefully, supportive.

> "I like the government consultation document on the automatic stay for companies. Having 60 or 90 days breathing space would help directors to make the decision to file early – when there is a better chance of saving the company."

How do you see industry regulation developing and how would you like it to develop? Is self-regulation the only way forward?

It would be good to see a significant reduction in the number of regulators of IPs (there are nine). This has been an issue for over 25 years. The present arrangement is unwieldy for third parties dealing with a case. For example, if there is a complaint and there are three partners who are joint administrators, all three of them might be regulated by different organisations. The OFT seems to have latched on to this problem and I wonder if its enquiry will make observations that The Insolvency Service (IS) can act on to remedy the situation?

Self-regulation is not the only way forward but there are issues that the profession needs to deal with – so oversight by the IS of self-regulation is still the best way forward.

Do you believe there are any major changes needed in UK insolvency law, and if so why?

Yes. I like the government consultation document on the automatic stay for companies – although it won't see the light of day before the election, and maybe not even then. It is a good idea. Having 60 or 90 days breathing space would help directors to make the decision to file early – when there is a better chance of saving the company. At the moment, directors fear they will lose control but with an automatic stay they could reach a compromise with their creditors and reschedule their debt with some changes to the draft proposals. It should become law.

Administrators have to deal extensively with customers and suppliers. They have to persuade the former to continue to buy from the company and the latter to continue to supply it. If they do so and the company becomes insolvent and unable to supply orders or pay suppliers then their claims rank first before those of other creditors. It is a straitjacket for an IP. In the Nortel administration, we went through extraordinary machinations for up to 90 days to get the supply lines re-established and customers reordering. Having a system that doesn't hamper trading in an administration would help to keep businesses operating and make them more likely to be rescued.

There has been much talk of the benefits of a Debtor in Possession (DiP) regime like Chapter 11 in the US being adopted by the UK. Do you endorse that view? If not, what do you see as the strengths of the UK regime?

There are a number of benefits of the Chapter 11[1] system, not least being the automatic stay that I have touched on in my earlier response.

I have always been impressed by the ability and speed of access to courts in the US, this is largely as a result of there being a separate judicial bankruptcy circuit. Of course this is because US bankruptcy is essentially a court-driven process but I think that we would do well to follow suit in this country. It is slightly concerning that access to the courts in the UK always seems to be a negotiation between the clerk to your counsel and the clerk to the court.

Secondly, within Chapter 11 there is the ability to deal with onerous contracts without creating a significant burden on the estate. In the UK, the termination of a lease, a contract of employment or any other long-term arrangement, will almost certainly result in a significant unsecured claim that has a diluting effect on other pre-filing claims. If such claims could be capped on such contracts, more restructuring could be done within administrations and businesses could be rescued more easily.

Finally, we have a situation where in the UK a company has to be insolvent before it can file for administration, whereas this is not the case under Chapter 11. If companies could file earlier it would mean that there is a greater opportunity to achieve a rehabilitation of a company by restructuring the balance sheet and undertaking operational improvement. The skills of the turnaround profession would be more evident in filed situations in the UK if boards were able to file sooner.

Do you think SIP 16 has been helpful [effective] in addressing the very public criticisms of pre-packs? If not, how do you think the problem could be better addressed?

SIP 16 is helpful and comprehensive. It is a professional response to the criticisms about pre-packs. The problems have been addressed really well. People will always complain if they lose money but the pre-pack system is now quite transparent. IPs are on full alert that they have to be able to justify their actions – or suffer the consequences. This is a good demonstration of self-regulation.

> "SIP 16 is helpful and comprehensive. It is a professional response to the criticisms about pre-packs. The problems have been addressed really well."

Do you have any thoughts for the future of the profession?

Although nobody could have anticipated the level of the recession, both lawyers and IPs got very stretched, very quickly. The profession needs to be able to sustain itself in good times and in bad (everyone, including work-out bankers and regulators etc). We need to think about this. Between say 1998 and 2005, the profession was shrinking, and we need to be able to attract more talented people to avoid this happening again. We need to broaden our interests so that people can be advisers and not just implementers of the legal process. Perhaps some of the ideas incorporated in Chapter 11 would help to grow the sector? □

[1] See *The bluffer's guide to Chapter 11 of the US Bankruptcy Code*, Michael Rutstein, *RECOVERY*, winter 2009

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