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RECOVERY

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Editor
Chris Laughton, Mercer & Hole

Editorial board
David Fletcher, Farrer & Co
Cynthia Matthews, R3
Kevin Murphy, Chantrey Vellacott DFK
Mike Pink, KPMG
Dan Redstone, Addleshaw Goddard
Graham Rumney, R3
Michael Rutstein, Denron Wilde Sapte
Angela Swarbrick, Ernst & Young
Paul Williams, Menzies Corporate Restructuring

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

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

Art editor Thomas Gray

Administration Jodie Pratt

Printed by Stephens & George

Forthcoming themes & advertising
www.r3.org.uk/recovery

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

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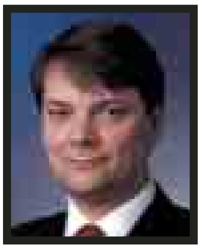


As an antidote to Shay Bannon's half empty glass (p22) and Gerald Krasner's fantasy football (p24) illustrating the profession's interaction with the leisure sector, let's consider some numbers.

GDP growth forecasts are continuing to fall, which suggests empirically (according to Euler Hermes' Insolvency Outlook reports) that business insolvencies will rise. The rate of change indicates a marked effect in coming months, and with GDP growth currently expected to bottom out well below two per cent this summer, there is a prospect that higher levels of business insolvency will be sustained well into 2009.

Although the Insolvency Service statistics showed a drop in total corporate insolvencies from 2006 to 2007, adjusting for anomalies and looking at non-liquidation cases gives a five per cent rise (compared to a nine-year trend of three per cent) that is likely to be exceeded this year.

So far so good for insolvency practitioners and turnaround professionals, but which sectors are most at risk? The ICAEW's Business Confidence Monitor (currently at an all-time low) unsurprisingly suggests finance, property, construction and retail, but with manufacturing remaining positive.

Lenders are open for business, but with an attitude to risk and pricing that many had forgotten, while recovery bankers are busier than they have been for some years. Gone are the days of businesses being able to try borrowing their way out of trouble; the only remedy now is to take decisive action at the first sign of stress, which many fail to achieve.

Consumer confidence was at a record low in January by Nationwide's index, which also recorded significant employment pessimism, so a demand-led recovery any time soon looks unlikely.

Personal debt levels remain high but the maturing IVA market seems less attractive to some of the bulk providers than it once was. The IVA code of conduct (see *News Update*, p6) prompted Nick O'Reilly to urge debtors to talk to their card issuers and other lenders early because it would be cheaper. I would go half a step further and take consumer debt out of the insolvency regime altogether.

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

IS policy on SIP4 and disqualification

Tony Wilkin outlines recent changes to SIP4 at the IS.

We are all being told that 'change is the new constant' and this is no less true for the Insolvency Service (IS) than it is for the wider insolvency profession. This can been seen in the new bankruptcy regime, the movement of jobs away from London, the appointment of a new chief executive and also in the organisational and process changes in dealing with disqualification matters. Yet among all this change, both SIP4 (E&W) and SIP4 (Scotland) have remained unchanged since September 1998 and August 1999 respectively. To this end, the IS has been liaising with the Joint Insolvency Committee over amendments to SIP4 so that it properly reflects current working practices. Whether such guidance should be in a 'Statement of Insolvency Practice' or an 'Insolvency Guidance Paper' is open to debate, although there should be little doubt that SIP4 requires updating. In the meantime, practitioners need to be aware of some changes within the IS that may have an impact on them and how they deal with disqualification matters.

Changes in the Insolvency Service

1) Since April 2006 the Service's Case Targeting Team, based in Birmingham, has reviewed all D1 full reports, including all those reports submitted by practitioners in Scotland. Centralising the targeting resource has lead to efficiency gains while also allowing the Disqualification Team in Edinburgh to focus on their core activity of investigating disqualification matters in Scotland. To this end, the IS is seeking, where possible, to unify the targeting (and investigation) processes irrespective of whether the case originated in Scotland or in England and Wales.

> "the IS has been liaising with the Joint Insolvency Committee over amendments to SIP4 so that it properly reflects current working practices."

2) The IS is also looking to reduce the time taken for the submission of conduct reports. It appreciates that practitioners often need time to make the necessary enquiries and come to a view on each individual case, but the early submission is driven by the desire to maximise the available time for detailed investigation so that proceedings may be brought in a timely manner. In essence, it aims to bring proceedings against the right directors for the right reasons at the right time. The IS is therefore operating a much more stringent system of monitoring the submission of reports and sending reminders to practitioners. This is not intended to cause practitioners any additional work but to complete the same work at the earliest time in the insolvency. However, the current legislation has its flaws in this area: with the submission of a D2 interim return effectively giving a practitioner an open-ended timeframe within which to submit a D1 full report. It is for this reason the Service's Case Targeting Team monitor the submission of D2 interims and, through the so-called extension system, seek to agree deadlines with practitioners for the early submission of D1 full reports thereafter.

3) A further significant change within the IS has seen officials take the role of the principal witness in disqualification matters. This change properly reflects the different roles of the investigator and the practitioner, and has lead to a dramatic reduction in the need for practitioners to review and swear affidavits and reports, or to attend court as a witness. However, there will continue to be a number of cases where the IS would like the practitioner to act as witness of fact, particularly where the alleged misconduct occurred during the course of the insolvency and may have caused difficulties to the practitioner or losses to the estate. Obviously, where a practitioner is fulfilling such a role beyond his or her statutory duty the IS will pay the cost of the IP's time, although the IS would wish to discuss and agree the detail with the IP beforehand for cost control purposes.

Hopefully, practitioners will now feel more informed with regards to changes within the IS, and be reassured that the IS is simply seeking to bring SIP4 up to date and does not wish to extend the role of the practitioner and/or impose obligations that would be inconsistent with those imposed under legislation. □

> "Hopefully, practitioners will now feel more informed with regards to changes within the IS, and be reassured that the IS is simply seeking to bring SIP4 up to date."

Tony Wilkin is the director of enforcement at the Insolvency Service.

President's column

Patricia Godfrey reviews her year as president and charts the progress made.

I cannot believe the speed at which my presidential year is passing. Initially, I set myself three goals at the start of my year, all directed toward increasing member satisfaction. These were (i) to improve the effectiveness of communication, both internally and externally; (ii) to boost the profile and influence of R3 and with it, its membership; and (iii) to continue our focus on delivering 'value for money' and look for ways to up the current offering. I am pleased to report some good progress has been made and I know there are a number of ongoing initiatives that Nick O'Reilly will be driving forward when he takes over from me.

In addition to the progress on these topics, outlined below, just before Christmas I was pleased to report on an unexpected bonus from the Department for Communications and Local Government. After much lobbying, we were delighted that our warnings on the implications of *Trident* were heeded. Members were pleased and relieved at the announcement of a permanent exemption in the case of empty properties where a company is in administration.

Communications

We continue to work hard on communication. We have recently improved the format of both the E-Bulletin and the Technical Bulletin, hilighting key issues and making it easier for readers to focus on those matters most relevant to them. Whereas the detail of many issues discussed at council must remain confidential, 'hot topics' and items under discussion are now being communicated to the membership, either through your regional representatives or as part of our E-Bulletin briefing.

I have particularly enjoyed attending numerous regional and committee meetings and the opportunity to chat to a wide cross-section of members on particular burning issues has been really useful. I have covered most regions but, before the end of my presidency, I will speak at the NE Region meeting in February, a Yorkshire ladies lunch in March and visit Northern Ireland in April.

Boosting our profile and influence

Trident represents a good example of how R3 must continue to champion and anticipate 'hot topics' affecting our members. On that very point, the new changes referred to above require legislation and are expected to be in force on 1 April 2008, but they will not be retrospective. As a result, our lobbying

must continue to protect those cases affected in the interim.

On the media and politics front it has been a particularly active year with good coverage across a range of media and press, educating and informing the public on a variety of issues. A lot of effort has gone into building links with politicians and peers so that the benefit of R3's views and expertise can be brought to bear far earlier in the process. I was delighted to host our first reception for peers and MPs at Westminster on 12 November, following which there have been concerted efforts by Graham Rumney and the communications team to increase links with all parties.

> **"I was delighted to host our first reception for peers and MPs at Westminster on 12 November, following which there have been concerted efforts by Graham Rumney and the communications team to increase links with all parties."**

Value for money

This is an ongoing challenge and there are a number of 'extras' we managed to deliver during the year. By all accounts, the Lite Conference in Cambridge went down extremely well. This is something we will be running in 2008 too. A lot of effort went into our first E-Learning product on pensions, which was launched last year. It is vital with these new initiatives that we get your feedback (whether positive or negative) to ensure you are getting true value for money from your subscriptions and the amounts you pay for our education, training and technical products.

Another first this year was the launch of Sandra Frisby's report into pre-packs, which I chaired in early September. On the back of it, I am delighted to say that we have proactively moved towards a SIP on pre-packs on which the technical committee have been hard at work. I am hopeful that it will work its way speedily through the necessary channels and land on your desks soon. I still believe there is more we can do on the technical side to make your day jobs easier and this is one area I will be directing extra time to in my remaining term.

Council elections

By the time you receive *RECOVERY*, the elections for council will be almost upon us. As with last year, we have a number of vacancies for the national slots and I would encourage you to do two things. First, if you have the energy and commitment to devote some extra time to R3, please consider putting yourselves forward or, at least getting yourselves involved in one of our many committees. Secondly, as postal voting can result in notorious apathy I was delighted we managed to get the overall voting numbers up last year. Again, I would like to see a measured increase this year so don't just 'file' the ballot paper when you get it – tick the boxes and send it back!

Last but not least – THANKS

It would be remiss of me to sign off without huge thanks to all of our council and committee members who give so freely of their time and manage to juggle the competing needs of a busy practice. Your efforts are greatly valued and R3 would not be the organisation it is without your commitment.

Sincere thanks also to Graham and the team at R3 who have been tremendously supportive to me over the last year and continue to work tirelessly in the interests of the membership. The presidency has been an honour and a pleasure. □

Patricia Godfrey is head of the Restructuring and Insolvency Group at Nabarro and president of R3.

Obituary

Sandy Brown, associate partner in Deloitte, died on 9 November 2007.

Sandy's insolvency career began in 1981 when, aged 21, he joined Alfred Tooke & Co in London's West End as a temporary office assistant. However, he never left, seeing his firm merge with Spicer & Pegler in 1985, become part of Touche Ross in 1990 and most recently adopt the Deloitte identity.

Immensely respected by junior staff, whose careers he carefully nurtured, by his peers to whom he was always available with sound counsel and by the successive generations of partners he worked with, Sandy's technical knowledge and commercial flair were unsurpassed. Showing loyalty and commitment to his team was of paramount importance to him.

Sandy had conduct of many eminent assignments. In recent years he handled such major administrations as ITV Digital, Mayflower Corporation, Dolphin Telecommunications, Powerhouse and Eurodis. He helped the Railtrack board to maximise value for shareholders and was involved in strategic government consulting work for British Energy, BNFL and other entities.

Golf was one of Sandy's passions and he had just played two rounds when he was taken ill on 3 November. His enthusiastic participation in sport as player and spectator are well remembered by his many friends in the insolvency, legal, banking, surveying and related professional disciplines where Sandy was so well known and liked.

Archibald Alexander Brown was born in Edinburgh on 10 August 1960. He was educated principally at St Andrews Secondary School, Blantyre, Malawi and Licensed Victuallers School, Ascot.

Sandy married Bev in 1985 and we extend our sympathy and condolences to her and to their daughter, Kate and son, Ross.

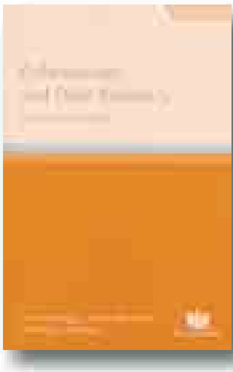
Nick Edwards

New publications

Companies Act 2006: A Guide for Private Companies

Edition: First
Author: Peter van Duzer
Publisher: Jordans
ISBN: 978 1 84661 038 7 **Price: £65**

Companies Act 2006: A Guide for Private Companies is a concise guide to interpreting and implementing the Companies Act 2006. It focuses on the provisions of particular relevance to private companies and highlights changes to company procedure, obligations and liabilities. These include: the proposed model form of articles for a private company limited by shares, the ending of the requirement for a company secretary, the new statutory statement of directors' duties and new procedures for resolutions, passing resolutions in writing and company meetings.



Enforcement and Debt Recovery

Authors: Peter Levaggi, David Marsden and Peter Mooney
Publisher: The Law Society
ISBN: 978 1 85328 653 7 **Price: £59.95**

Enforcement and Debt Recovery provides practical and authoritative commentary on the reforms introduced by Parts 3–5 of the Tribunals, Courts and Enforcement Act 2007. and places these changes in context by presenting a review of the law of enforcement. Examples are supplied to show how the reforms differ from the pre-Act position and the stated aims of previous consultations, and speculates how parts of the Act are likely to be implemented by further regulations.

Burning platform

Have your shout. If you have comments about articles in *RECOVERY* or concerns about the industry we'd like to hear from you.

Dear Sir,

Soc Gen and investment banking controls

Soc Gen is being pilloried in the press. Commentators have referred to their controls as 'abysmal'. That is a little unfair. It may be that Soc Gen's line managers and audit staff were asleep on the job to have allowed positions of this magnitude to go unchallenged. However, it is a fact that cases of investment bank staff trying to buck the systems for dishonest reasons are far from uncommon. We must realise that banks will experience fraud whatever systems they put into place to avoid it. They employ very skillful people who, on rare occasions, misuse their talents and employ them against the bank. It is possible, however, to have systems and controls that pick up irregularities swiftly before too much damage is done.

The most sophisticated electronic monitoring systems will be let down if the human beings that operate them are not assiduous in following up errors and exceptions. But in most cases the failings are much more basic and old fashioned than that. For example, the 'holiday' problem, where mismarking the book is picked up when the individual responsible finally takes a holiday and another colleague takes over the book and checks the value of the positions and the failure to be forensic enough in following up complaints and queries coming in from exchanges and counterparties. The FSA is right to regard this as a wake up call. This could easily happen again.

Angela Hayes is head of Financial Services Regulatory at Lawrence Graham LLP.

Trident reversed

In 2007 the *Trident* ruling found that council business rates should be treated as preferential creditors in an administration; insolvency experts maintained that this would put back insolvency rules by 20 years. Since then, the government has decided that *Trident* poses a risk to the rescue culture (as embodied in the 2003 Enterprise Act) and John Healey, local government minister, has announced that the ruling has been overturned. Companies in administration will now get a permanent exemption from empty property rates. (See articles on pages 10 and 15.)

The announcement was welcomed by Patricia Godfrey, president of R3 who said, 'With the effects of the credit crunch increasingly likely to be felt in the New Year, this will help administrators save businesses and jobs'.

IVA code of conduct deal

The BBA, R3 and the IS have agreed a voluntary code of conduct concerning IVAs. New guidelines that came into force in February are intended to help standardise IVA procedures, particularly in the assessment of the income and expenditure of over-indebted consumers.

Mr McFadden, minister for Employment Relations and Postal Affairs said that the new voluntary code for IVAs 'will provide greater transparency for creditors and debtors alike by using standard clauses and a consistent format'. The proposed code of conduct will include the following stipulations:

- The financial statement that debtors are asked to complete, detailing their income and outgoings, will be standardised. This will include the need for insolvency practitioners to carry out more stringent checks on income and mortgage repayments.
- There will be an agreement as to when a debtor will be deemed to have failed the IVA if he or she gets into arrears with monthly repayments.
- All previous attempts by the debtor to settle debts with their creditors will have to be disclosed in the IVA proposal. In practice, this means an insolvency practitioner will now have to tell a debtor to try for an informal agreement with creditors before recommending an IVA.
- If a lender rejects an IVA, it will now need to give a specific reason justifying that rejection.

The new code will apply only to straightforward IVAs – those where the people applying have a regular income and where they have three or more credit card debts from two or more lenders. It will not cover more complicated cases – for example, where the applicant is on state benefits.

However, Nick O'Reilly, the vice-president of R3, says there are two main sticking points to an IVA being agreeed: the hurdle rates and the fees paid to the IVA company.

'If a consumer comes to me for an IVA and we draw something up that meets this new code of conduct, it could still be turned down because of the two big sticking points', he says. 'However, we are giving this new understanding a cautious welcome, as it does mean we now agree on a lot of terms'.

Nick O'Reilly pointed out that anyone who is in serious debt would be better off talking to their card and loan providers as soon as they start running into problems. 'If you agree things informally with your creditors early enough, it is far cheaper for both the debtor and the banks than an IVA', he says.

Permacell Finesse: judgments affecting floating charge holders

When the Enterprise Act became law, the preferential status of the main government departments was dropped but, through Section 176A of the Insolvency Act 1986, a 'prescribed part' was created. This was done in an attempt to improve the chances of unsecured creditors receiving some return in larger liquidations.

In a recent judgment on the *Permacell Finesse* case the court ruled that floating charge holders should not have a further crack of the whip by sharing in the 'prescribed part'.

Bankruptcy in Wales doubles in six years

Bankruptcy orders in Wales in 2000 numbered just over 1,000 but by the end of 2006 they were over 2,000. Mark Williams, the Liberal Democrat MP for Ceredigion, said that the problem was becoming of increasing concern. 'This is a real problem and we have got to look at three particular areas', stressed Mr Williams:

- financial education
- promoting independent advice in a positive way
- the practices of loan sharks.

Bankruptcy in Scotland soars by 15 per cent

Official figures published in February show that personal bankruptcies rose by almost 15 per cent in Scotland last year; the situation may get even worse when Scottish insolvency laws are brought into line with those of England and Wales later in the year.

At present, a person declared bankrupt must wait three years before they are discharged. The change in the law will reduce this to 12 months. When this change was introduced in England and Wales there was a large rise in the number of people declaring themselves bankrupt and this is expected to be mirrored in Scotland.

However, there were 657 corporate insolvencies in Scotland in 2007; this is 2.5 per cent down from the 2006 total.

New faces at the ACCA

The ACCA has made three senior appointments recently in Wales, Scotland and Ireland. All the three men appointed will draw on their extensive business experience to develop their respective organisations.


Ben Cottam, head of ACCA Wales

Andrew Leek, head of ACCA Scotland


Kevin Kernam, head of ACCA Ireland

Financial stability and depositor protection

The chancellor has announced the publication of a consultation document outlining proposals for strengthening the framework for financial stability and depositor protection. This is a joint publication by HM Treasury, the Financial Services Authority and the Bank of England.

The document can be accessed on the HM Treasury website at **www.hmtreasury.gov.uk/consultations_and_legislation/consult_liveindex.cfm**. Comments are welcome by 23 April 2008.

Legal update

Legal update provides updates on the US Chapter 15 and COMI and on *Trident Fashions*. It also examines the ruling in the *Cheyne* case and how it could affect IPs.

US Chapter 15 and COMI

The *Basis Yield Alpha Fund* case

Since Jennifer Marshall's article on *Bear Stearns* in the winter 2007 edition of legal update, there has been a further case dealing with Chapter 15 of the US Bankruptcy Code and the concept of 'centre of main interests' (COMI). The application for summary judgment by the joint provisional liquidators (JPLs) of the *Basis Yield Alpha Fund* (*Basis Yield*) to the US Bankruptcy Court, Southern District of New York, on the issue of recognition as a foreign main proceeding was refused by Judge Gerber. It was held that:

- a court engaged in recognition proceedings is not bound by parties' failure to object;
- the court may, if so advised, consider any and all relevant facts (including facts not yet presented); and
- the circumstances in this case made further factual enquiry necessary and appropriate.

Non-US insolvency practitioners to back up COMI assertions with evidence

On the question of whether the failure to object should bind the court, Judge Gerber referred to the *Guide to Enactment of the UNCITRAL Model Law* pointing out that it does not require the presumption (that the COMI of an entity be the place of its registered office, absent evidence to the contrary) to be called into question by an interested party, rather it should be called into question by the court. Therefore, JPLs cannot rely on failure to contest proceedings because the courts will take it upon themselves to ensure they consider all relevant information. Judge Gerber agreed with the analysis of Judge Lifland in *Bear Stearns* and disagreed with the dicta in *SPhinX* that suggested that if interested parties had not objected to proceedings, recognition would be granted.

Using further analysis from *Bear Stearns*, Judge Gerber made it clear that the court will not just 'rubber-stamp' a recognition application under Chapter 15. Rather, the burden of proof is on the foreign representative to build a case with sufficient evidence and factual content for the court to determine the COMI. In *Basis Yield* the JPLs failed to provide the information necessary to show they were entitled, on undisputed facts, to summary judgment granting recognition as a *main* proceeding. Therefore, further factual enquiry is required to address the issues that would establish Basis Yield's COMI to be in the Cayman Islands.

"Using further analysis from *Bear Stearns*, Judge Gerber made it clear that the court will not just 'rubber-stamp' a recognition application under Chapter 15. Rather, the burden of proof is on the foreign representative to build a case with sufficient evidence and factual content for the court to determine the COMI."

At the time of writing, we understand that an evidentiary hearing on the matter of recognition for *Basis Yield* has been set for the earliest practical time. Also, the *Bear Stearns* appeal is scheduled for 29 February 2008. It remains to be seen whether the decision that the Bear Stearns funds did not have an 'establishment' in Cayman will be overturned.

Moving on from *Trident Fashions* – non-domestic rates in administrations

Trident Fashions decision

There have also been further developments on the thorny subject of non-domestic rates and administration expenses. Joe Bannister commented on the *Trident*[1] case in the summer 2007 edition of legal update, in which David Richards J held that:

- non-domestic rates were 'necessary disbursements' of the administrator (under Rule 2.67(1)(f)); and
- as such, non-domestic rates accruing in respect of premises occupied during the administration of Trident ranked as administration expenses payable ahead of the administrator's remuneration.

As readers will recall, the issue in *Trident* arose from an observation by the House of Lords in *Toshoku*[2] that the position as regards non-domestic rates is the same as it is for corporation tax – namely that it ranks as a liquidation expense under Rule 4.218.

>>

"The government engaged in a consultation process last year to look at exempting companies in administration from rates on unoccupied property – either on a temporary or permanent basis. This culminated in the announcement by DCLG that companies in administration are to get a permanent exemption from empty property rates, mirroring the status of companies in liquidation."

Legislative changes afoot

Following the decision in *Trident*, concerns were raised that it could discourage the use of administration by creating the anomalous situation whereby a receiver or liquidator (under the non-occupied exemption for companies in liquidation) could avoid payment of rates on non-occupied commercial property, but an administrator could not. As it was felt that this could hamper the rescue culture, the government engaged in a consultation process last year to look at exempting companies in administration from rates on unoccupied property – either on a temporary or permanent basis.

This culminated in the announcement by the Department for Communities and Local Government (DCLG) that companies in administration are to get a permanent exemption from empty property rates, mirroring the status of companies in liquidation.

John Healey, the local government minister said, 'We are committed to the promotion of a rescue culture which provides opportunities for insolvent companies that have viable underlying businesses to be rescued wherever possible. A permanent exemption will remove any potential for decisions about whether to enter administration to be distorted by difference in rates liability'.

At the time of writing it is anticipated that the relevant secondary legislation will be laid before Parliament so that the new rules can come into effect on 1 April 2008, and we understand that the new exemption will apply to companies already in administration on 6 April 2008 (though the rule will not apply retroactively). (See page 15.)

Cheyne Finance: relevance beyond the SIVs

Commercial insolvency test evolving

The recent decision in the *Cheyne Finance*[3] case has generated a degree of interest. Although the judgment was given on 17 October 2007 due to confidentiality issues it was not released until 4 December 2007.

In *Cheyne Finance*, the court was asked to consider to what extent it would be permissible for the receivers of Cheyne Finance, appointed under a trust deed (the receivers), to include contingent or future debts when applying the 'cash flow' test of insolvency (the 'future debts' question). The court was further asked to rule on the degree of confidence the receivers should have in forming the view that Cheyne Finance plc (Cheyne) was, or was about to become, unable to pay its debts as they fall due prior to their determining an insolvency event under the relevant documentation (the 'standard of proof' question).

Under the *Cheyne* master definitions agreement, 'insolvency event' means a determination by the manager or any receiver that the issuer [Cheyne] is, or is about to become, *unable to pay its debts as they fall due* to the senior creditors and any other… [priority creditors] (the Cheyne insolvency event).

This is broadly similar to the 'commercial' or 'cash flow' test of insolvency, set out under section 123(1)(e) of the Insolvency Act 1986 (the act), which states that a company is deemed unable to pay its debts (the s.123 Test) 'if it is proved to the satisfaction of the court that the company is *unable to pay its debts as they fall due*'.

Unlike the 'balance sheet' insolvency test in section 123(2) of the act, section 123(1)(e) and the Cheyne insolvency event omit the express inclusion of all 'contingent and prospective liabilities' in making a determination. The judge concluded that the commercial insolvency test in section 123(1)(b) of the act should include debts becoming due for payment in the future.

The SIVs

By way of background, Cheyne is one of a number of structured investment vehicles (SIVs) that have experienced difficulties. SIVs are investment companies that fund themselves by issuing a combination of commercial paper and medium term notes (together, 'senior debt'), subordinated capital notes and, more recently, mezzanine debt (which ranks between the senior debt and the capital notes). SIVs use this finance mainly to fund the purchase of investment-grade debt securities, and make returns based on the net spread between the yield on such securities and their own financing costs. A number of SIVs have recently been experiencing financing difficulties due to the 'credit crunch' affecting global debt markets and the consequent shortage of short-term commercial paper. (See article on page 34.)

Cheyne background

Cheyne entered into certain funding arrangements in August 2005, which included granting security pursuant to a trust deed with the Bank of New York (the trust deed). As a consequence of Cheyne breaching a net asset value covenant, as well as the broader problem it faced in refinancing its maturing commercial paper, the Bank of New York appointed Neville Kahn of Deloitte and two of his partners as receivers of the business and assets of Cheyne on 4 September 2007.

Following their appointment, the receivers applied to the court for directions regarding the application of monies coming into their hands during the period between their appointment and the occurrence of any Cheyne insolvency event. The court directed that the receivers should apply monies coming into their hands as it was received (the 'pay as you go' approach), on the assumption that a Cheyne insolvency event had not yet occurred. At the time of the first application the receivers had not yet formed the view that Cheyne was insolvent. However, following the first court application, the receivers carried out intensive analysis of the Cheyne cash flow position, which precipitated an urgent need for the meaning of a Cheyne insolvency event to be determined. They established that Cheyne would not be able to pay all of its senior debts in full, as they fell due, merely by letting its investments run to maturity and collecting the resulting cash. According to Neville Kahn's second witness statement referred to in the judgment, the receivers had a 'substantial investment portfolio of assets' with which to make repayments. However, despite this, the high level of asset sales required to continue with the pay-as-you-go approach, as directed by the court, would, in Kahn's view, require Cheyne 'selling assets for discounted prices, which would in turn deplete its balance sheet and render it unable to pay some of its late-maturing [senior] debt'.

Four parties were represented at the hearings, as follows:

- **Party A** represented senior creditors with short maturity dates who benefited from the pay-as-you-go (rather than *pari passu*) distribution then being effected by the receivers;
- **Party B** represented senior creditors with longer maturity, who would benefit from an early declaration of an insolvency event;
- **Party C** was a member of the Party B class; and
- **Party D** represented a group of holders of subordinated debt, who supported Party B.

The meaning of 'unable to pay its debts as they fall due'

The issue for determination was whether the Cheyne insolvency event and by implication the section 123 test related to liabilities payable immediately or at some time in the future.

The main arguments of Party A (all of which were rejected) were:

- When compared with section 123(2) the language of section 123(1)(e) omits, and therefore requires to be ignored, all contingent and prospective liabilities.
- Draftsmen of the insolvency legislation were perfectly capable of requiring a reference to the future when it was intended (reference was made to s123(2) ss 8 and 89 of the act and ss 173, 643 and 714 of the Companies Act 1985), the absence of specific language in s123(1)(e) to address futurity was conclusive evidence of the draftsmen's intention.
- There is nothing uncommercial in the parties to the trust deed adopting a clear and simple test of insolvency that excludes the need to look into the future of Cheyne's financial position.

The ruling of Briggs J

In the judgment of Briggs J, the effect of the alterations to the insolvency test made in 1985 and now found in section 123 of the act was to replace in the commercial insolvency test now contained in section 123(1)(e), one futurity requirement, namely to include contingent and prospective liabilities with another more flexible and sensitive requirement encapsulated in the new phrase 'as they fall due'.

In reaching his decision Briggs J was principally influenced by:

- A comprehensive analysis of Australian case law where the test is 'inability to pay debts as they become due' although there is no balance sheet test and;
- The legislative history of section 123 of the act[4], from 1907 to 1985 where there was no separate balance sheet test and a requirement to take account of contingent and perspective liabilities.

It is worth noting that of four academic writers that had considered this point, only Professor Goode shared the conclusion reached by Briggs.

The mandatory requirement to take account of contingent and prospective liabilities was, in the judgment of Briggs J, replaced with the phrase 'as they fall due'. He regarded this as the key words of futurity, which were synonymous with 'become due'. He also considered that there is a common sense requirement not to ignore the relevant future.

The standard of proof question

In looking at this question, Briggs J took into account a number of factors including the fact that the trust deed calls for what he expressed to be 'experienced professionals working in the commercial world to make the determination', and he drew a parallel with the 'cash flow' test in section 123(1), which would be resolved on a balance of probabilities (albeit by the court, rather than outside of it). He consequently dismissed an approach that would require the receivers to be satisfied that there is no reasonable prospect that Cheyne would be able to pay its debts when they fall due. Briggs J felt that the effect of delaying any decision to switch from a 'pay-as-you-go' to a *pari passu* distribution of assets realised could be of 'grave prejudice' to the late-maturing senior creditors, which would be out of proportion to the prejudice to early-maturing senior creditors by using *pari passu* distribution.

The court therefore ruled that the receivers should make their determination with a level of confidence such that 'Cheyne is or is about to become unable to pay its senior debts as they fall due on the balance of probabilities'. In other words, they must be satisfied that, having made thorough enquiry, an inability to pay is more likely than not.

Given that the facts here were assumed, Cheyne was found to be unable to pay its debts as they fell due.

Implications of the ruling

The decision in *Cheyne* is of significant importance to advisors involved with the management of distressed SIVs because it affects the assumption that a SIV could be run off within a receivership structure, without an acceleration, on a pay-as-you-go basis. Any SIV suffering the appointment of a receiver is now likely to become subject to an insolvency event, and an acceleration of all liabilities.

From a broader perspective, the ruling in *Cheyne* may be of some assistance to insolvency practitioners when considering the meaning of section 123 as referred to in section 240(2) of the act, which is applicable to transactions at an undervalue and preferences. The sufficiency of a company's working capital and liquidity will need to be considered in the context of a more extended period into the future than might otherwise have been the case. For a company that is still trading, as indeed is noted by Briggs J in his judgment, where there is a high degree of uncertainty as to the profile of its future cash flow, an appreciation that section 123(1)(e) permits a review of the future will often make little difference. □

"In the judgment of Briggs J, the effect of the alterations to the insolvency test made in 1985 and now found in section 123 of the act was to replace in the commercial insolvency test now contained in section 123(1)(e), one futurity requirement, namely to include contingent and prospective liabilities with another more flexible and sensitive requirement encapsulated in the new phrase 'as they fall due'."

1 *Exeter City Council* v. *Bairstow* and others, *Re Trident Fashions plc* [2007] EWHC 400 (CH)

2 *Re Toshoku Finance plc* [2002] 1 WLR 671

3 *Cheyne Finance PLC (in receivership)* [2007] EWHC 2402 (Ch)

4 Under the Companies Act 1985 s.518(i)(e) (which was repealed by the Insolvency Act 1986) the test was as follows: 'A company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the company is unable to pay its debts (and, in determining that question, the court shall take into account the company's

Tony Bugg is a partner and **Richard Hodgson** is a managing associate at Linklaters.

Recent case summaries

Corporate and personal insolvency update from Martin Ouwehand.

Corporate Insolvency

Re Minrealm Ltd [2007] EWHC 3078 (Morgan J)

Facts: Minrealm Ltd had five directors each of whom held an equal number of shares. A dispute arose between three of the directors on the one hand (the majority) and two of the directors on the other (the minority). The minority presented a petition under section 459 of the Companies Act 1985. The majority admitted some of the allegations including the diverting of funds. A consent order was made, which included the majority's undertaking to pay certain rental income into the company's account on an interim basis. When little was paid in, the minority applied for an order that an account be taken of the sums due under the consent order and that the majority make an interim payment of £200,000 to the company. Before the application had been determined, the majority applied under section 124 of the Insolvency Act 1986 for the company to be wound up. The principal creditor, HMRC, took a neutral position on the winding up petition and the landlord creditor opposed it.

"The decision is a good example of the court discouraging a resort to liquidation as a means of resolving shareholder disputes."

Held: The company was cash flow insolvent. However, as a matter of discretion the court decided that a winding up order should not be made because it was neither necessary nor useful; the best course was to adjourn the winding up petition until determination of the minority's application for an interim payment.

Comment: Morgan J found that in broad cash flow terms, the company had current debts of £152,000 and liquid assets of £105,000 and was therefore cash flow insolvent. If the minority paid the £274,000 they admitted as owing to the company, or if the majority paid the £283,000 said to have been diverted, then the company would be cash flow solvent. Section 125(1) gives the court an unfettered discretion as to whether to make a winding up order. Morgan J therefore weighed up the competing considerations. He placed great weight on the majority's admitted serious breach of fiduciary duty by diverting funds, the failure to comply with the undertaking in the consent order and the prospect that the sums owed under the consent order would solve the company's cash flow insolvency. In the absence of any support from creditors, these factors pointed strongly to adjourning the winding up petition to await quantification and payment of the sums due from the majority.

Ultimately, the court regarded the winding up petition as tactical and unnecessary. The decision is a good example of the court discouraging a resort to liquidation as a means of resolving shareholder disputes. Indeed the court sought to avoid a liquidation even though the company was insolvent and even though this was contrary to the wishes of the majority shareholders.

Personal Insolvency

***Haines* v. *Hill* [2007] EWCA Civ 1284 (Andrew Morritt C, Thorpe and Rix LJJ)**

Facts: A matrimonial court ordered Mr Haines to transfer his interest in the matrimonial home to his wife. Mr Haines was then made bankrupt and his trustee applied for a declaration under section 339 of the Insolvency Act 1986 that the transfer was a transaction at an undervalue. At first instance, the district judge dismissed the application but HHJ Pelling QC allowed the trustee's appeal. He held that a compromise of ancillary relief proceedings was not measurable in money terms. He also held that, in any event, an applicant for ancillary relief was not giving consideration by compromising his or her claim or having it determined. Mrs Haines appealed to the Court of Appeal.

Held: The Court of Appeal allowed the appeal. A pre-existing statutory right, such as one to ancillary relief, can be the subject of consideration in the context of section 339. As a matter of economic reality, in the absence of vitiating factors, an ancillary relief order quantified a spouse's claim by reference to the property ordered to be transferred.

Comment: This case is of considerable importance in defining the boundary between a bankrupt's creditors and the former spouse. In Thorpe LJ's words 'the decision of His Honour Judge Pelling QC… caused considerable consternation to the ancillary relief practitioners' and destroyed what had come to be understood as 'a fair balance which on the one hand protects the creditors against collusive orders in ancillary relief and on the other protects orders justly made at arms length for the protection of the applicant and the children of the family'. HHJ Pelling QC's conclusions meant, in effect, that this most commonplace of ancillary relief orders could be automatically set aside at the suit of a subsequently appointed trustee in bankruptcy.

In light of the Court of Appeal's decision, an ancillary relief order providing for the transfer of property does not involve a transfer at an undervalue because the value of the recipient's right is to be regarded as consideration equivalent in value to the property. This will be the case where the order follows either contested matrimonial proceedings or a compromise approved by the court. However, such an order is still liable to be set aside if the trustee establishes that a vitiating factor was at play. A vitiating factor means the balance sought to be struck by the order cannot be said to be a true one. Thorpe LJ observed that it would be easier to prove that a vitiating factor was at play where there was a consent order than where the order was made after a hard-fought trial. □

"The value of the recipient's right is to be regarded as consideration equivalent in value to the property."

Martin Ouwehand is a barrister at 11 Stone Buildings.

Legal voice

To get your voice heard in Legal Q&A 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

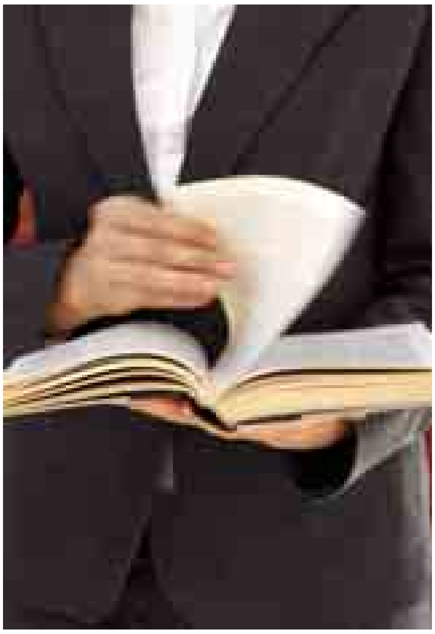
Michael Mulligan answers your insolvency queries

I am the joint liquidator of a company. I recently sent letters to all creditors whose proofs had been admitted enclosing notice of a declaration of a dividend and cheques. A few days after sending out these letters I received an application notice in the post from a creditor whose proof I had rejected. I was not aware that this application appealing my decision on proof had been issued when I sent out notice of the declaration and cheques to creditors. My solicitor advised me to immediately contact my bank and stop the cheques immediately. I also contacted creditors and informed them of my decision to defer payment until the appeal is heard. If the appeal is successful there may be no funds to pay creditors and I am worried that they will take action against me personally for non-payment of a declared dividend. What should I do?

You have sensibly followed your solicitor's advice to postpone finality. If a liquidator, having declared a dividend, paid away assets so as to defeat an appeal of proof or equivalent application, then a misfeasance claim might lie against the liquidator. On the other hand, it is likely that a court will sympathise with the difficult position you have found yourself in. Liquidators are entitled to postpone and later cancel the payment of dividends to creditors even where they had already declared those dividends and provided the cheques in circumstances where they became aware of a pending application by another creditor (see *Lomax Leisure Ltd* (In Liquidation) v. (1) *Nicholas John Miller and* (2) *Timothy James Bramston* (2007)). Rule 11.5 Insolvency Rules 1986 provides for the declaration of a dividend but does not impose a duty to pay it over and above the overriding duty of a liquidator under r.4.180(1). A liquidator is not personally responsible to pay a dividend and there is no relationship of debtor and creditor between the liquidator and any creditor.

"Rule 11.5 Insolvency Rules 1986 provides for the declaration of a dividend but does not impose a duty to pay it over and above the overriding duty of a liquidator under r.4.180(1)."

It is open to a liquidator to postpone or cancel a dividend at any time prior to payment of monies to creditors so long as they do so within the relevant four-month time limit.



I am the administrator of a company having been appointed out of court by the directors. Soon after my appointment I was contacted by the Financial Services Authority (FSA) who advised me that they considered the company to be a collective investment scheme within the meaning of section 235 of the Financial Services and Markets Act 2000 (FSMA). Since the company had not been authorised by the FSA to operate a collective investment scheme it was carrying out a regulated activity illegally in breach of the general prohibition set out in section 19 of FSMA. The FSA further advised me that they considered my appointment to have been in breach of section 362A(2) of FSMA, and therefore it was invalid.

The company can no longer trade and I am concerned that my appointment as administrator may be void. Can I seek retrospective approval for my appointment from the FSA or the court? Am I personally liable in any way?

As you will be aware, the directors of a company or the company itself may appoint an administrator without recourse to the court pursuant to paragraph 22 of Schedule B1 to the Insolvency Act 1986. However, there is a restriction on the appointment of an administrator by reason of section 362A(2) of FSMA. This prevents the appointment of an administrator by the company or its directors out of court without the consent of the FSA where a regulated activity has been carried on in contravention of the general prohibition. Such consent must be in writing and filed with the notice of intention to appoint under paragraph 27 of Schedule B1.

If the FSA is correct, and the company has carried on an unauthorised, regulated activity, then your appointment out of court as administrator is invalid. I am not aware of any provision that allows for the ratification of an invalid appointment so it is irrelevant that you may now have the FSA's consent to your appointment.

"If the FSA is correct, and the company has carried on an unauthorised, regulated activity, then your appointment out of court as administrator is invalid."

You should be aware that if the 'administrator' acts under what turns out to be an invalid appointment he or she is a trespasser in respect of the company's assets and undertaking and may find him- or herself subject to a personal claim. The court of course does have the power pursuant to paragraph 34 of Schedule B1 to order the directors or company to indemnify the 'administrator' against liability that arises solely as a result of the appointment's invalidity.

You will need to get yourself properly appointed. The best way to achieve this end is to apply to court for an administration order pursuant to paragraph 12 of Schedule B1 of the Insolvency Act 1986 for a declaration that your initial appointment was invalid and for the registration of the same to be removed. It is an unfortunate situation you have found yourself in, but you should be prepared for the court to be fairly unsympathetic on the question of costs. □

Michael Mulligan is a corporate recovery and litigation partner at Halliwells LLP London office.

Technical update

Richard Heis on topical technical developments.

Pre-packs – a new SIP

Members will not need reminding that pre-packs remain a hot topic that has given rise to a considerable amount of debate. The Insolvency Practices Council expressed some concerns about pre-packs in its annual report for 2006, while acknowledging that they can be a useful tool in the right circumstances. Many members will also be aware of the research into the use of pre-packs undertaken on behalf of R3 by Dr Sandra Frisby of Nottingham University.

There is no doubt that if the conditions are appropriate a pre-pack can be advantageous for all concerned, and can be the best way of extracting value from a bad situation. On the other hand, there is clearly a problem with perception and lack of transparency. This appears most starkly in the case of administrations where, according to Dr Frisby, there has been an increasing use of pre-packs in recent years. Normally in an administration the creditors would have the opportunity to consider and approve the administrator's proposals. However, the courts have held that where the circumstances of the case warrant it, the administrator has the power to sell assets without the approval of the creditors or the permission of the court. Where this happens, and the creditors are effectively presented with a *fait accompli*, it is clearly important that they are provided with a detailed explanation and justification of why a pre-pack was undertaken, so that they can be satisfied that the administrator has acted in their best interests.

“In the light of the discussion surrounding pre-packs, the Joint Insolvency Committee has come to the view that there is a need for guidance to be issued to the profession in this area, and the General Technical Committee has produced a draft statement of insolvency practice, which at the time of writing is with the regulatory bodies for review.”

According to Dr Frisby, the reports that she studied for the purposes of her research varied greatly in the quality and quantity of information provided to creditors where there had been a pre-pack. A very few were ‘woefully inadequate’, only mentioning that a pre-arranged sale of the business had already taken place. Others were ‘absolutely exemplary’, giving details of the decision process leading to the sale, the identity of the purchaser, the consideration and how it was apportioned, among many other things.

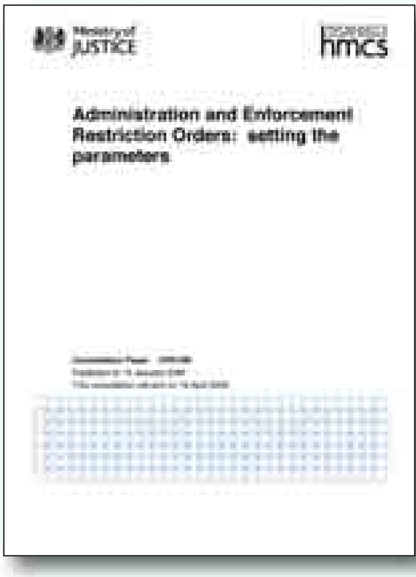
In the light of the discussion surrounding pre-packs, the Joint Insolvency Committee has come to the view that there is a need for guidance to be issued to the profession in this area, and the General Technical Committee has produced a draft statement of insolvency practice, which at the time of writing is with the regulatory bodies for review. The draft SIP is concerned with transparency rather than commerciality. It does not attempt to prescribe when a pre-pack is or is not justifiable, but seeks to set out a minimum level of information that should be provided to creditors so that they can be properly informed about the transaction and can form a view as to whether it is in their interests.

Rates in administrations

Good news from the Department for Communities and Local Government. The department has announced that companies in administration are to get a permanent exemption from empty property rates. This follows the consultation carried out earlier this year, which I wrote about in the summer edition of *RECOVERY*. In its response to the consultation R3 argued strongly that, in view of the effects of the decision in *Trident Fashions*, companies in administration should have the same exemption from empty property rates as companies in liquidation, and our arguments have evidently won the day. Announcing the move, the Minister said:

'We are committed to the promotion of a rescue culture which provides opportunities for insolvent companies that have viable underlying businesses to be rescued wherever possible. A permanent exemption will remove any potential for decisions about whether to enter administration to be distorted by differences in rates liability.' (See article on page 10.)

We have also written to the department arguing that the same relief should apply to partnerships and limited liability partnerships that are in administration. It is aimed to bring these new provisions into effect on 1 April 2008. Equivalent provisions will also be introduced in Scotland.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Administration and Enforcement Restriction Orders: setting the parameters

More on tackling over-indebtedness

There has recently been a sudden resurgence of interest in some of the personal debt relief measures introduced by the Tribunal Courts and Enforcement Act 2007. This seems to have been prompted by the recently issued Ministry of Justice consultation document entitled *Administration and Enforcement Restriction Orders: setting the parameters*. This was picked up by some of the newspapers as though it was a new development. In fact it is a secondary consultation on changes that have their origins as far back as July 2004, when the DTI and Department for Work and Pensions, with the support of the Treasury and Department for Constitutional Affairs, launched their *Action Plan for Tackling Over-Indebtedness*. During 2004 the Department for Constitutional Affairs launched its own *Debt Programme*, which seemed to share essentially the same objectives as those set out in the DTI Action Plan. As part of this programme the DCA issued a consultation paper, *A Choice of Paths*, in July 2004, setting out various proposals for debt relief. The proposals set out in that paper were eventually incorporated into the Tribunal Courts and Enforcement Act. In summary they provide for:

- a revised county court administration order procedure;
- enforcement restriction orders, which would give debtors temporary relief from enforcement measures;
- debt relief orders to be administered by official receivers; and
- procedures for establishing formalised debt management plans that would include compulsory creditor participation and discharge of debts.

The proposed scheme for debt relief orders administered by official receivers was the subject of a separate consultation exercise by the Insolvency Service in March 2005.

We wrote about these proposals in the summer 2005 edition of *RECOVERY*, and they now look like becoming a reality. The current consultation is about the 'parameters' of the new administration and enforcement restriction orders, ie who they should apply to, what debts they should cover and what monetary limits should apply. The formalised statutory debt management plans were originally going to be left until more information had been collected on how current plans operate and what the statutory ones might look like, but the rumour is that these might now be moved up the agenda. Further developments are awaited, but if you thought that a statutory scheme involving the composition of debts and compulsory binding of creditors operated by a regulated person looks a lot like an IVA by another name, you would not be alone.

"In its response to the 'Choice of Paths' consultation, R3 argued against the proliferation of new procedures for dealing with debt, and suggested a simple but flexible system based on existing procedures that could apply to all debtors whatever their circumstances."

In its response to the *Choice of Paths* consultation, R3 argued against the proliferation of new procedures for dealing with debt, and suggested a simple but flexible system based on existing procedures that could apply to all debtors whatever their circumstances. Unfortunately our suggestion was not adopted so it looks as though we are heading for further unnecessary complication of our personal insolvency regime, and a confusing array of competing options for those facing pressing debt problems. Do debtors, and those who advise them, really need this?

The current consultation is available on the Ministry of Justice website at: **www.justice.gov.uk/publications/cp0108.htm** and is open for comment until 16 April 2008. □

Technical Bulletin

Technical Bulletin 81 was issued in December 2007. Its contents included:

- Winding-up resolutions – important changes
- Substantial property transactions involving directors
- Directors' duties under the Companies Act 2006
- Practice direction on insolvency proceedings
- Consultation on proposed redundancies
- Undervalue transactions and matrimonial proceedings – Court of Appeal decision in *Hill* v. *Haines*.

Technical Bulletin 82 was issued in March 2008. Its contents included:

- Employment Rights Act – increases in limits
- Companies Act 2006 – revised small company limits
- The prescribed part – floating charge holder not entitled to participate
- Receivers' liability for costs – recent decision
- Conditional fee agreements in bankruptcy proceedings
- Protective awards – recent decisions
- Directors as employees – recent EAT decision.

Richard Heis is a partner in KPMG Restructuring.

Customer deposits (in the twilight zone)

Trusts for customers can be fragile and care needs to be taken establishing the entitlement of beneficiaries, but Daniel Redstone still thinks they're worth it.

Many businesses in the retail and leisure sectors take customer deposits and other payments in advance on a daily basis, whether they are selling furniture, computers, holidays or, as in the case of Sendo International[1], mobile phones. Often this does not sit well with the current restructuring trend of pre-packs and accelerated M&A and it can give rise to all sorts of problems.

The problem with 'business as usual'

For a pre-pack to work, it must appear to be 'business as usual' to the outside world while the restructuring is being put together. However, 'business as usual' will often mean continuing to incur liabilities and taking payments, including deposits in advance. Generally speaking, directors' duties and wrongful trading legislation dictate that in this period a business ought not to incur liabilities that are not going to be met. While this sort of restructuring can often save the business and reduce losses to (usually the secured) creditors, advice to directors is generally that this should not come at the expense of customers and other unsuspecting third parties.

Trusts can be fragile

So, trusts are often set up to ringfence monies received in the twilight period prior to an anticipated insolvency to protect customers and suppliers. They are also set up by boards of directors keen to ensure that they are complying with their fiduciary duties and to protect themselves from any allegations of wrongful trading. The idea is that debts incurred in this period will be matched by funds placed on trust so that the position of creditors is not made worse while the restructuring is sorted out. The trouble with such trusts is that they are notoriously fragile and often fail for lack of certainty; they are often put together in haste and can be costly to administer.

Establishing the entitlements of actual or prospective beneficiaries to the trust funds can be complex. Subject to the amounts in question and the number of beneficiaries, the costs of determining how to distribute the available funds can deplete the funds disproportionately to the detriment of all beneficiaries so it should be asked in each case whether setting up such trusts is appropriate. There may also be a conflict of interest for an administrator who may wish to challenge the trust's validity in order to make the monies held under it available to his creditors but who, on appointment, effectively assumes the trustee role and is saddled with all the trustee's duties that go with it.

> **"Trusts are often set up to ringfence monies received in the twilight period prior to an anticipated insolvency to protect customers and suppliers."**

Re Sendo: The importance of a clear trust document

The recent *Sendo* case has highlighted some of the problems. Sendo International was a mobile phone manufacturer and distributor. The company's major supplier (who was also a secured creditor and source of finance) made arrangements to allow the company to continue to trade to facilitate a sale of the business and, during that pre-sale period, two trusts were set up. The administrators applied for directions concerning the distribution of funds held in those trusts. The business was sold but there was a shortfall on both trust accounts, with insufficient funds to meet the claims of those listed in the relevant schedule as beneficiaries.

In essence, the application was about how to assess beneficiaries' entitlements: should that be done by reference to what in fact became owed to each beneficiary in the trust period or by reference to what was actually put in trust for them?

On the facts, it was held that the 'plain intention' of the trust deed was that sums equal to the debts set out on the schedule should be released from the security to which those monies would otherwise be caught (they would otherwise have been caught by the supplier's charge) and that it was those amounts that defined the extent of each creditor's interest in the overall fund.

What of those who were left off the schedule for whatever reason or whose debt is determined (by reference to the schedule) to be much less than the actual amounts incurred to them in the relevant period? Their pro rata share of the fund would be either nothing or less than it should have been.

One supplier had agreed to continue supplying the company having relied on assurances from the company that its claims would be met out of the trust funds. It was argued that this gave rise to an estoppel preventing the trust from denying the supplier's claims. This argument was rejected on the basis that such assurances could only affect the company and not the trust's beneficiaries. Bad luck for that supplier but good news for the beneficiaries whose pro rata share was not depleted.

World of Leather

Might directors lay themselves open to allegations of wrongful trading where they incur liabilities in this period but fail to settle sufficient sums on trust to meet them? In the *World of Leather*[2] case (which was a director disqualification case as opposed to wrongful trading, so not directly on the point) the directors did not attempt to set up trust accounts. However, on the facts it was held the directors had acted appropriately in seeking additional funding and had taken every step that could have been expected of them in those particular circumstances. Each case, of course, will turn on its facts.

There is no 'one size fits all' solution other than to take the utmost care in the drafting of trust deeds and the setting up and operation of trust accounts. Identifying the beneficiaries in a schedule may address the need for certainty although anyone missed off the list will miss out. Better to have a trust that works for some than one that fails completely. ☐

1 Sendo International Ltd (In Administration), Re [2006] EWHC 2935 (Ch); [2007] B.C.C. 491; [2007] 1 B.C.L.C. 141

2 *Re Uno plc and World of Leather* [2004] EWHC 933

Daniel Redstone is a partner in the Business Support and Restructuring team at Addleshaw Goddard.

London & Edinburgh Swallow Group: achieving value through administration

Angela Swarbrick explains how the administrators in the LESG case had their eye on the long game and achieved the best result for all by employing a range of solutions.

Following phenomenal growth fuelled by acquisitions over a number of years, London & Edinburgh Swallow Group (LESG) collapsed in September 2006. While some industry commentators were not surprised, the speed and scale of the collapse invoked the usual questions of how, why and who was responsible.

The shortcomings of LESG's portfolio

Prior to its collapse, LESG managed or controlled through tenants, the operations of 835 hotels and pubs throughout the UK, employing over 8,000 staff. The portfolio had been built over a ten-year period, the largest acquisition being 252 pubs from Punch Taverns in late 2003. Also in 2003, LESG acquired the Swallow brand and 13 hotels from Whitbread. The last acquisition prior to the collapse of LESG was of the Carnoustie Hotel, Golf Resort & Spa in March 2006.

Our investigations showed that while LESG had a large portfolio, it did not own the freeholds. Instead, in the majority of cases, the freeholds of the properties acquired were purchased by a joint venture partner. The properties were then leased back to LESG at full market rents. On a subsequent disposal of the freehold by the joint venture partner, any profit would be shared with LESG.

Industry commentators had already questioned the ability of LESG to continue its pace of growth. How would it deal with the integration issues arising from the scale of the acquisitions and achieve the cost savings over such a diverse portfolio necessary in order to drive the operating performance to allow it to pay its lease obligations? What became apparent was that LESG's overall fortunes were based upon profits generated from the sale of the freeholds by the joint venture partner, which were in turn founded upon the operating covenant of LESG. In reality, that operating covenant was questionable as the pub and hotel operations of LESG had made significant losses since incorporation. Once the operating covenant was challenged, the ability to sell on the freeholds dried up, exposing LESG to substantial operating losses, which were unable to be offset by the profits from the freehold disposals, and a cash need far in excess of its available bank facilities.

> “Prior to its collapse, LESG managed or controlled through tenants, the operations of 835 hotels and pubs throughout the UK, employing over 8,000 staff.”

Administrators appointed

By August 2006, LESG was faced with a short-term cash need that was significantly in excess of available funds. While a restructuring may have yielded material cost savings, neither time nor cash were available with which to achieve it. LESG's poor and non-consolidated record keeping generally, coupled with the defections of key senior operational management and accounting personnel, all contributed to the primary operating companies filing for administration in September 2006 with Roy Bailey, Angela Swarbrick and Alan Bloom from Ernst & Young being appointed as joint administrators. On our appointment we took control of 152 hotels, 128 managed pubs and 554 tenanted pubs. The decision to enter into administration as opposed to liquidation was a finely balanced one. LESG owned no freehold property, having occupied its pubs and hotels on high rental operating leases over a 25–35 year term and it was not possible, due to the poor state of record keeping at the time, to even determine the level of debtors and creditors on a consolidated basis. LESG's trading operations indicated losses were being incurred pre rent at a number of sites and, in any event, LESG had no cash or facilities available with which to continue trading.

“ 42 sale transactions over four months covering 320 pubs and hotels, together with debtor realisations, have generated over £10 million of value and saved 6,700 jobs. ”

We concluded that we would nevertheless employ our traditional commercial skills and fielded a UK-wide and experienced team in order to take control of accounting, trading and cash so as to pursue the required cost and job savings and ultimately to achieve value.

The administrations were unfunded and we continually reviewed our decision to continue trading the various sites. Our decision was based on the trading figures from individual sites together with our expectation of going concern sales for those sites. In a number of instances we continued to trade loss-making sites for a period of time in order to achieve going concern sales of those sites.

Disposal of the business

42 sale transactions over four months covering 320 pubs and hotels, together with debtor realisations, have generated over £10 million of value and saved 6,700 jobs. Another 420 pubs have migrated to a sub-tenant or landlord relationship and unfortunately a further 95 were closed.

We faced all the usual commercial and practical difficulties that arise on trading a large, geographically diverse portfolio. An immediate issue we faced was the need to apply for premises licences for over 835 pubs and hotels in a seven-day timeframe. In Tom Withyman's accompanying article (see page 20), he outlines the issue in more detail and the steps required to ensure we continued to operate the premises in compliance with the Licensing Act 2003. I am sure that when the new licensing laws came into effect in November 2005, the legislators had not envisaged or taken into account the failure of a large pub and hotel group and the practical challenge of ensuring continuity of premise licences.

Bookings and deposits honoured

Prior to our appointment, members of the public had paid deposits for functions they had booked in the pubs and hotels and the deposits had been treated a normal trading cash-flow. During the period in which we traded the various premises, we honoured the bookings and deposits that had been paid and, as and when we sold sites, the purchasers agreed to honour the future bookings and deposits that we were aware of.

“ We proposed that the exit from the administrations would be liquidation of the companies, once we had achieved the purpose of the administrations. ”

Tenanted pubs

The group operated a significant tenanted pub estate, which, on appointment, comprised some 554 units. The tenants held sub-leases from the relevant company in administration and paid the group monthly rents in advance. With minimal interest in the tenanted estate, except for 134 tenanted pubs that we were able to sell within days of our appointment, and as a result of the considerable trading difficulties, on 28 September we took the decision to effectively walk away from the remainder of the tenanted estate. The primary driver behind this was the need to pay the landlords their rent, while the tenants were refusing to pay theirs in lieu of unsecured rental deposit balances. We wrote to all tenanted estate landlords indicating our inability to pay the rent and our intention to no longer be in beneficial occupation of the units, while at the same time advising landlords to contact sub-tenants directly.

Liquidation

We proposed that the exit from the administrations would be liquidation of the companies, once we had achieved the purpose of the administrations. The timing of the *Trident* decision in March 2007, influenced the timing of the exit from administration. We had a number of properties where leases had been surrendered but landlords had not confirmed their acceptance of the surrender. We wanted to avoid incurring the burden of the rates payment without any benefit. As a result, it was in the interests in the creditors as a whole to seek to place the group companies into liquidation such that the liquidator could disclaim the leases. The companies were placed into liquidation in April 2007.

While the liquidations will continue for some time, it is a fact that the administration process has been very successfully employed in this instance. It has generated real value, provided a platform for restructuring a number of operations in order to achieve sales to third parties and saved thousands of jobs in the run up to Christmas in areas where unemployment would have hit hard. A fine line was trod over protecting the interests of creditors generally, and accommodating the specific interests of residents, customer deposits, weddings (45 on one Saturday at one site), funerals, charitable and retirement club events etc.

IPs need to employ a range of solutions

What of the future? The 'market' and attitudes continue to evolve but we believe that there is considerable merit in the argument that no single solution can be employed to solve every situation. The current economic climate, brings with it an increased anticipation that there will be a sustained demand for restructuring skills. Those professionals experienced and able to employ the full range of solutions will be well placed to deal with them. ☐

Angela Swarbrick is a director at Ernst & Young.

Licences in administration

Tom Withyman explains that time is of the essence in an administration when applying for the reinstatement of a licence – in order to maintain the ability to trade and the underlying value of the business.

Monitoring the sector

Amidst the recent predictions of difficult times ahead for the UK economy, one particular leisure sector is often singled out – the pub, restaurant and hotel market. The administration of the London & Edinburgh Swallow Group (LESG) and the receivership of Provence coupled with the administrations of Sports Cafe and the Massive Group in January, mean that in recent years, it is an area being closely monitored by recovery bankers and IPs at present.

There are a number of factors contributing to this.

> "If a business involves the sale of alcohol then the premises licence must state on it who the designated premises supervisor (DPS) is and the DPS must hold a valid personal licence."

Despite the news stories of teenage binge drinking, year on year as a nation we are drinking less. 'Staying in' has become the 'new going out' and with less disposable income available to consumers, 2008 does not promise to reverse this trend.

The smoking ban has hit pubs and restaurants hard particularly those without beer gardens or who struggle to diversify into food revenues.

Extended drinking hours, with us for two years now, have not noticeably increased trade. According to Licensing Minister, Gerry Sutcliffe, most premises only extended their hours for a single hour and only three per cent of licensed premises in the UK are reported to be open for 24 hours (of which two thirds are hotels).

There is over supply to the market generally, with many operators failing to deliver a distinctive brand or product.

Property prices for new entrants and the acquisitive have been comparatively high. According to the Fleurets annual price survey, pub prices increased only two per cent in 2007 but this followed a series of high annual increases, including 12 per cent in 2006. Many in the industry believe that the prices of pubs in particular have reached unsustainable levels.

A feature in common with LESG and Provence was that they were both groups structured to take advantage of the increasing strength of the commercial property investment market. The basic LESG model of a sale of one of its freehold units to a related party followed by a lease-back at an inflated rent relied upon that freehold being turned quickly into the investment market and LESG receiving a share of the uplift. Once the investment market for LESG's properties softened, its revenues fell and the flaw in the model ultimately led to its collapse. While other operators may not be so tied to the strength of the commercial property investment market, there remains a vulnerability to a downturn in commercial property prices.

For these reasons, the licensed retail market is likely to become a busier area for IPs and offers a number of challenges to practitioners. One of these, where an operator is to be traded in an insolvency process, is the impact of the Licensing Act 2003.

Licensing

The Licensing Act 2003 came into force in November 2005 and radically changed the licensing structure. The main changes it introduced were that:

- Local Authorities replaced magistrates as being responsible for granting licences.
- A dual licence regime replaced a single Justices' licence. Premises are now required to have their own specific premises licence and, if alcohol is to be sold on those premises, an individual will also need to hold a personal licence.

It is important to distinguish between the two types of licence.

> "Given the importance of reinstating the premises licence, it is unfortunate that the 2003 Act provides that any application to reinstate be made within seven days, otherwise the licence will lapse absolutely."

Premises licence

A premises licence is required by any individual or company that is carrying on a business involving a licensable activity. Licensable activities include:

- the retail sale of alcohol (for example, in a shop or supermarket);
- the supply of alcohol by/or on behalf of a club;
- the provision of regulated entertainments (including cinemas, theatres and sporting events); and
- the provision of late-night refreshment: shops, petrol stations, restaurants and takeaways.

Personal licence

If a business involves the sale of alcohol then the premises licence must state on it who the designated premises supervisor (DPS) is and the DPS must hold a valid personal licence.

The 2003 Act provides that a licensing register is to be maintained by each Local Authority and that this may be inspected free of charge. When an IP is appointed, it is now possible to obtain a copy of the relevant section of the register that will set out what premises licences are held, what conditions are attached to the licences and what notices and applications have been issued in relation to the licences.

Effect of insolvency

Under the 2003 Act, if the holder of a premises licence enters an insolvency process, then the premises licence will lapse automatically. Unless the procedures for reinstatement can be used, the loss of a licence will impact both on the ability to trade the premises in the short term and on the value of the underlying business in the medium term.

Given the importance of reinstating the premises licence, it is unfortunate that the 2003 Act provides that any application to reinstate be made within seven days, otherwise the licence will lapse absolutely. Once the application to reinstate is made, the business can be traded on a temporary basis until the application has been heard. Difficulties can occur, as we found when acting for Ernst & Young in the LESG administrations, where an IP has just seven days to make applications in respect of a large number of premises (835 pubs and hotels), with only limited information available. The risk in the LESG administrations was that the applications to reinstate would not be made in time and hundreds of pubs and hotels would have had to cease trading.

Reinstating a licence

There are two ways in which the licence can be reinstated in these circumstances:

1) Interim authority

This involves an application being made for trading to continue under the terms of the old licence for a period of up to two months. In part as a result of the limited time period and in part because it is likely to be the IP personally who becomes the licence holder, this type of application will not be attractive to IPs.

2) Transfer of the licence

This involves transferring the licence to a third party and as such there is more scope as to who the new licence holder may be. This option is generally preferred by IPs. Where the insolvency is a trading one, the application is generally made by a special purpose vehicle (SPV) under the control of the insolvent company. In this way, if a purchaser is found for the business, the purchaser may acquire the shares in the SPV and obtain the benefit of the licence immediately. An SPV might be used for individual premises or a larger portfolio of units but this route will be less attractive on larger assignments like LESG. Here there was no alternative but to arrange for a second transfer of the relevant licences from the one SPV used to a purchaser.

Once a licence lapses and is not reinstated in this way, any application for a new licence is treated by Local Authorities as a new application, with the potential for added cost, delays and objections impacting on the prospects of realising the unit.

If an operator has a well organised licensing team and updated database or has subcontracted out the function to one of a number of specialists in this area, then the task of reinstating the licences may be relatively straightforward. If, however, this is not the case, seven days is a short period to find the necessary paperwork and information and make the application. Each application is in a prescribed form and should be accompanied by a request that the transfer take place with immediate effect. The application is only effective once the Local Authority receives a correctly completed application plus the required fee. Notice is also to be given to the DPS of each premises and the local Chief of Police.

Checklist for IPs

At the outset of an assignment, an IP should ask:

- Who holds the premises licence?
- What is the scope and what are the conditions attached to the premises licence?
- Has the company complied with the terms of the licence?
- Who is the designated premises supervisor?
- Is he or she on site?
- Does the business need to continue carrying out licensable activities if it goes into an insolvency process?
- What advance planning is necessary to ensure the licences can be reinstated within the seven-day period?

Surrender of a licence

With the LESG units being leasehold, a significant number failed to attract a buyer and it was therefore necessary for trading to cease and the premises licence to be surrendered. This involves writing to the Local Authority, sending it the original premises licence (or a copy of it) and giving written notice to the DPS. It is important that all licences are ultimately assigned or surrendered to prevent the SPV continuing to incur annual licensing fees.

The current licensing regime on insolvency under the 2003 Act is far from satisfactory for IPs. The short deadline for reinstatement of the premises licence and the huge inconsistency of approach from Local Authorities mean that a period of planning pre-insolvency in this area, if available, can be very helpful. ☐

Tom Withyman is a partner at Lawrence Graham LLP.

Half full or half empty?

Shay Bannon explores the restaurant sector – and considers what's on the menu for IPs.

The UK restaurant sector has prospered over the past few years, but it remains a high-risk area. There are long-term grounds for confidence, but also short-term challenges. Which will dominate?

It's no exaggeration to say that Britons are in love with eating out. In today's cash-rich, time-poor society, many are disinclined to shop for, prepare and cook their own food. A third of all food and drink spending now goes on meals out, and 66 per cent of adults eat out at least once a month.

Women have a key role. They tend to care more than men about what they eat, where they go for their meals, and how often they dine out. Demographics are a factor: 16–24 year olds eat out most often, but the 50–65 age group spends more; families without children eat out more than their child-rearing counterparts. There's also a geographic split, with spending considerably higher in London and the South East than in other regions. Government figures from the Office of National Statistics (ONS) show that Londoners spend 60 per cent more on eating out than those in the North East.

The UK eating-out market is worth over £30 billion, distributed across a range of outlets. At the top is fine dining: the tasting menu at a three Michelin-starred restaurant could come to over £300 for two without wine. At the bottom is fast food, where a meal can be bought with change from a five-pound note. In between are pub restaurants, sandwich shops, bar meals, self-service and other outlets. Fast-food outlets and pubs account for 50 per cent of the total spend on eating out.

Positive factors

Eating out in this country has boomed. UK consumers are Europe's biggest spenders in this area and food sales outside the home have shot up in the last decade.

One of the fastest-growing segments of the market is casual dining, with brands such as Nando's, Café Rouge and Wagamama. These are popular with women and young people and have a more middle-class profile. Research by the Peach Factory in July 2007 showed that casual dining restaurants are the top choice in London, with 72 per cent of Londoners visiting at least once every three months.

Smoke and mirrors

Some short-term consequences turn out to be less significant than anticipated. When the smoking ban came into force last year Tragus CEO, Graham Turner, described it as 'the biggest thing to hit pub customers for a couple of hundred years'.

Smoking in Britain is now at its lowest ever level. According to ONS research published in January 2008, just 22 per cent of Britons now smoke, down from 27 per cent at the end of the 1990s. The research also found that four-fifths of drinkers felt the ban did not affect their pub-going habits, while 15 per cent said it made them more likely to drink in a bar.

Analysis of trading performance since the ban was introduced would suggest that pubs with a strong food offering are gaining business at the expense of those that have wet-led sales.

> **"A third of all food and drink spending now goes on meals out, and 66 per cent of adults eat out at least once a month."**

The other fast riser is the coffee shop, again a favourite with women. Twenty-seven per cent of women frequent a coffee shop at least once a month compared with 18 per cent of men.

In the longer term, the prospects for the sector look good. Eating out is now such an ingrained habit for so many that it's likely this pattern will persist. According to one estimate the market will be worth nearly £37 billion by 2012 – a rise of 23 per cent in just six years.

However, a word of caution: this figure was arrived at before the recent financial downturn. The sector faces a number of short-term challenges in today's less favourable economic climate.

Storm clouds

Other changes are likely to be more pronounced. My firm predicts a UK GDP growth rate of just 1.8 per cent in 2008. This compares with actual GDP growth of 3.1 per cent in 2007. Fears of recession brought on by the sub-prime mortgage crisis will cause people to rein in their spending. The leisure market will be one of the first to feel the effects.

The so-called wealth effect of rising property values has seemingly halted, at least for the time being. The Council of

Mortgage Lenders forecasts just one per cent house price inflation in 2008, compared with seven per cent in 2007. At the same time, rising mortgage costs are adding to the gloom as over 1.4 million fixed-rate mortgages come to an end and need to be replaced by more costly alternatives.

Customers are already cutting back on eating out: by dining less frequently, by reducing their spend per visit – or both. Meanwhile restaurants face rising food and utility prices.

This will lead to overcapacity that results in price competition between restaurants. Combined with rising costs, this will lead to a narrowing of margins, particularly for restaurants in the mid-market sector. We may see a higher rate of failures in 2008.

Restaurants, and restaurant groups, will have to work harder in this more challenging climate. There is no room for complacency. Any decline in food quality, hygiene or service standards could be catastrophic.

So how do they respond to the competition – and can they do anything about it?

They certainly cannot afford to stand still. The market is continually evolving, with more contemporary offerings outperforming old-fashioned outlets. The Subway sandwich chain, for instance, opened its one-thousandth UK store last year. Wetherspoon's pubs are now more popular as an eating-out destination than Burger King and KFC.

“ A common theme in the failure of many restaurant groups is a lack of control over capital expenditure. Cost overruns on fit-out of new premises or refurbishment of existing units can result in the additional funding requirement being sourced from working capital. ”

Warning signs

Aside from such shifts in consumer taste, some restaurants face particular problems. These can include a lack of timely and accurate management information that is suitable for purpose, or failing to meet key performance indicators such as reduced numbers of covers, reduced spend per head and ratio of wages to sales.

High staff turnover, particularly for key personnel such as front of house or senior chefs, is a warning sign, as is high capital expenditure, especially high-cost premises fit-outs without a commensurate return.

A common theme in the failure of many restaurant groups is a lack of control over capital expenditure. Cost overruns on fit-out of new premises or refurbishment of existing units can result in the additional funding requirement being sourced from working capital. This can lead to severe cash constraints on the business causing creditor stretch and subsequent failure.

Management that is resistant to change may also be a cause for concern in more straitened circumstances. The more innovative restaurants have been able to stay ahead of the game.

The much-maligned McDonalds, whose profits collapsed in 2005 by almost two-thirds to £36.9 million, has been quietly reinventing itself: extending opening hours, improving core foods and adding more ‘gourmet’ choices, adding freshly ground coffee and using only British organic milk. It is also adopting a new image in its stores – sleek, green and modern. As a result, the chain is now selling more burgers than at any time since it came to the UK in 1974.

Greene King is trialling Coffee Republic-branded coffee in 26 of its pubs; Geronimo Inns switched to local suppliers and tailored each pub to its locality. It increased demand and won *The Publican*'s ‘Pub Category of the Year Award’ for the 10–99 managed outlets category.

Others are embracing change by expanding overseas. Gordon Ramsay is planning to open a restaurant in Prague; Tiffinbites is looking for expansion in Dubai, while Wagamama is eyeing the US market. For those unwilling or unable to enhance their demand, though, the short-term future may be difficult.

There will inevitably be winners and losers in the UK eating-out market over the next few years. The health of the sector as a whole will depend most of all on the economy. Resilient and robust outlets should continue to thrive, albeit on reduced margins. Those with poor procedures in place, low staff morale and high turnover, and those unable or unwilling to adapt to more demanding conditions, may find themselves facing difficulties and ultimately even insolvency. □

Managing restaurant sector insolvencies

What factors should IPs consider in insolvency situations? Here are some specifics.

- Staff retention: a particular issue for top-end restaurants. Additional payments to retain key personnel should be considered.
- Cash business: mainly for the lower end of the market. Are proper cash handling and security controls in place? Is insurance cover adequate?
- Premises/location: premises are likely to be leasehold, so negotiation with the landlord will be required.
- Key suppliers: top-end restaurants tend to have a limited number of suppliers, with the chef usually handling the professional relationship. Goodwill needs to be maintained with both. Duress payments may be required.
- Regulations: health and safety standards must be maintained. For restaurants with an alcohol licence, the premises must be licensed, usually by the company. Sale of alcohol must be supervised by a licensee with a personal licence. On insolvency, the licence will lapse and a new one must be applied for. The licence is required to trade, so it would be necessary either to keep on the current licensee or appoint an agent with the necessary licence.
- Most restaurants operate a tronc system to distribute tips to staff. It is controlled by the tronc master. Do not make this individual redundant unless there is another employee able to fulfil this essential role!

Shay Bannon is a partner at BDO Stoy Hayward LLP.

Leeds United: fact and fantasy

Gerald Krasner gives us the edited highlights of his battle to save Leeds United.

There is a saying in sport that football lives in a world of its own, but every now and then, it gets a dose of reality. If ever a football club has had a dose of reality in the last five years, then that club must be Leeds United.

From riches to rags

At the turn of the millennium the club was playing football in the European Championship; it is now fighting for promotion from what used to be the third division.

> "In view of the heavy mortgage on the football ground, in an administration it was highly likely that the ground would be sold to a property developer. It could only be retained for football if the offer by a proposed purchaser was higher than that of a developer."

In the intervening period there have been two administrations, one failed CVA, a possible liquidation to come and a 15 point penalty for the current season. It has been a wonderful case study for IPs in general but for me in particular it became a way of life for a twelve-month period between 2004 and 2005.

In the early part of 2004, Leeds United was languishing at the bottom of the Premiership division with debts of over £100 million built up during the Ridsdale era. The day of reckoning had started some two years earlier and, for the last 12 months of the period, the club had been 'nursed' by Trevor Birch (an IP in his own right).

In January 2004, I was approached by a client, who asked what would happen if Leeds United went into administration. The local newspapers were full of prophecies of doom and gloom and I explained that, in view of the heavy mortgage on the football ground, in an administration it was highly likely that the ground would be sold to a property developer. It could only be retained for football if the offer by a proposed purchaser was higher than that of a developer. If the club lost its ground, the future of both Leeds United as a football club and the city of Leeds would take a decade to recover. On being asked if there was any other solution, my instant answer was, 'You find the money and I will find a way of dealing with it'. Little did I know that within six weeks the whole deal would have been completed and that I would be faced with the problem of solving the football club's finances.

The problems

The initial problems can be summarised as follows:

- £60 million was due to a group of American bondholders secured on the stadium and training ground. As a result of negotiations, there was an initial payment of some £12 million, with structured payments in the future that depended on results. There was also a write off of at least 50 per cent of the debt, and possibly more.
- Some £22 million was secured on certain players under leasing arrangements. Due to the way in which the security had been drafted it appeared that in administration the security was not going to be valid and there would be no recovery. In view of this, there was a one-off nominal payment to these creditors, though approximately 90 per cent of the debt was written off.

- £10 million was owed to H M Revenue & Customs. An initial discussion with them indicated that, if there was no formal insolvency event, they would insist on payment in full in order not to set a precedent for other football clubs. They would, however, consider taking scheduled payments over a number of years, and this is ultimately what was agreed.
- £10 million was due to players and former football managers – 'the football creditors'. The general football creditors had to be paid in full immediately for the club to continue.
- Another £5 million was owed to general creditors.

Business planning

As part of our initial strategy we had to consider three different business scenarios and prepare business plans for them.

1) Remaining in the Premiership for the foreseeable future.
2) Being relegated to the Championship but then promoted back within two seasons and before the parachute payment of £5 million for each of the next two seasons ran out.*
3) Relegation and no quick promotion to the Premiership.

The biggest problem for the strategy we planned was the level of wages, which were some £40 million plus at the time of acquisition, despite initial pruning by Trevor Birch. Whereas, the average wages in the Championship were of the order of £8 million, and sometimes even less. Because of the nature of football contracts it was almost impossible to reduce it to this low figure within one season and, despite the sale of many of the well-known Leeds United players, the wage bill in our first season following relegation was still some £18 million (this included £3 million for two players who, due to injury, played less than two matches in the whole season).

The last part of our strategy, and the one part that did not work out as we had planned, was the sale of debentures to fans. We were hoping to raise some £9 million to £10 million from the sale of 3,000 debentures. This was based on the fact that debenture holders would acquire a seat for twenty years for a sum equal to ten times the current season ticket price. The average cost for this would be about £3,000. Unfortunately, we were only able to raise £1 million, which put quite a bit of pressure on the cash flow.

Acquiring the club

At the time of acquisition, the club was owned by Leeds United plc, which had 22,000 shareholders. It was not feasible to hold a shareholders' meeting to approve the sale so it was agreed that the plc would go into administration and the administrators would then immediately sell the football club to our consortium for a nominal sum. In addition to the other debt acquired we also had to repay the plc's creditors £500,000 (a fairly small sum bearing in mind the other liabilities).

Cutting the wage bill

Following our acquisition, Leeds United won its next match and climbed off the bottom rung of the Premiership ladder but unfortunately it soon became apparent that the club would not escape relegation. The close season was spent selling very many of the club's top-class players in order to maximise realisations and reduce the wage bill for the forthcoming season. Dealing with football agents brought a whole new meaning to the art of negotiation and, more than once, I wondered just in whose interests they were acting. By the new season, the wage bill was down to £18 million, which was manageable, but not as low as we would have liked.

Due to the lack of success of the debenture issue, a further £5 million was realised from the sale of an option on some land that the club held. This was acquired by a major casino group that hoped to redevelop the site. Shortly afterwards, the government changed its view on the expansion of casinos but by that time we had already banked the money.

Media interest

The interest of both the media and fans was phenomenal. Leeds' supporters are renowned throughout the country for their enthusiasm and the club had a substantial fan base. Gates of between 25,000 and 30,000 were regularly achieved, which was more than some of the other clubs in the Premiership league were obtaining, and this level of support assisted the ongoing cash flow. As regards the media, the interest was just as intense and, between Thursday and Sunday, one-third of my time was spent on the telephone dealing with media enquiries. As a matter of policy, I always spoke to the media, even when times were hard, otherwise they would just print a story, often more fantasy than fact. As I explained to the fans, the problem with media reports was that they fell into three categories: the factually correct, the factually incorrect and a mixture of fact and fantasy. The trouble was identifying which category you were reading.

Tight cash flow

Following relegation, we had appointed a new manager for the season, Kevin Blackwell. Early results showed some promise but it soon became obvious that we were unlikely to win an automatic promotion slot, although our target by way of minimum achievement was to finish in the top half of the league. During the six-month period to December 2004, there was a lot of media speculation and interest from third parties who wanted to invest in the business, but this came to nothing. There were three distinct offers from a member of the Sainsbury family representing various consortia but they were unable to meet fully our requests for proof of funds. By December 2004, although we realised that we could continue to trade, cash flow was becoming tight and the payments to H M Revenue & Customs, which had been kept up to date to that time, had to be re-negotiated by agreement. We had, however, reduced the liability from some £10 million to under £4 million.

“ The close season was spent selling very many of the club's top-class players in order to maximise realisations and reduce the wage bill for the forthcoming season. ”

Ken Bates takes over

In January 2005, a meeting was held with Ken Bates who expressed an interest in taking over the club and investing substantial monies in it. Negotiations took approximately one week and in January 2005 the club changed hands yet again. Mr Bates was kind enough to praise our work in reducing the club's debts from over £100 million to just over £20 million within the previous year.

Unfortunately, since this change in ownership, things have not improved and the club has been relegated again to League Division 1. It would take another article to cover the events since that time, which include administration, a failed CVA and the 15-point penalty. These events have ensured that Leeds has remained high in the media focus during this period, although not always on the sports pages.

A dose of reality

To summarise, the year I was involved with the club was an emotional experience. As an IP, I had to put into practice the advice I had given directors over the last twenty years. As a football fan, I had to divest myself of as much emotion as possible in order to concentrate on the objective, namely, to correct the club's finances and put them on a stable footing. This meant that both I and Leeds United experienced a dose of reality! ☐

* When a football club was relegated from the Premiership to the Championship, the Premiership would make a £5 million payment to the relegated club for each of the next two seasons. This was to assist the club with the reduction in the wages bill that would be necessary. This was known as a parachute payment. (The amount and method of payment has since changed.)

Gerald Krasner is a partner at Begbies Traynor.

Heard about the revolution?

The digital revolution in the music industry is having a major effect on traditional 'bricks and mortar' retail music outlets. What is their future?

The music industry is currently undergoing a commercial, technological and legal revolution. This is being fuelled by internet technology, particularly digital distribution systems and increasing broadband growth, which creates issues such as illegal downloading and file sharing that have had a material effect on the industry.

> "The digital revolution is changing everything. It has brought the ability to distribute a digital file, both legitimately and illegitimately, across an increasing number of platforms and constantly expanding worldwide boundaries."

Discs and DVDs

The music industry has come a long way since the 'glory days' for wholesalers and retailers, where high margins could be made by those involved in the distribution chain of records and subsequently CDs and DVDs. Although record labels took risks in advancing (loaning) money to artists, many of whom did not succeed, the potential rewards from successful artists were huge. Driven by single and album charts and marketing through radio and television, singles and the more profitable albums could sell in the millions – initially in vinyl and later in CD and DVD format.

Throughout the 1970s and 1980s huge record sales led to the growth of major multiple-retailers and independent record shops. Competition was limited as there were few other alternative entertainment products to purchase.

The digital revolution

The digital revolution is changing everything. It has brought the ability to distribute a digital file, both legitimately and illegitimately, across an increasing number of platforms and constantly expanding worldwide boundaries. This, combined with the growth of alternative entertainment offerings such as computer games, social networks and chatrooms (note in particular the huge amount of time and energy devoted to platforms such as Facebook, MySpace and MSN chatrooms) provides a major alternative to physical record sales. Traditional retailers also face competition from online retailers whose overheads are considerably lower.

The amount of physical goods (CDs and DVDs) sold, except perhaps for the recent increase in giveaway cover mounts and promotional CDs, is in sharp decline. This is threatening the very existence of physical music retailing. Although the music industry as a whole is beginning to derive alternative revenue streams from live performances (at gigs and festivals), the increase in sales of legitimate downloads and the commercialisation of user-generated content poses significant challenges for the traditional music retailer. While live music at successful venues such as the O2 and festivals like Glastonbury is generating revenues these are not shared by traditional retail outlets.

Online music distributors on the up

Some US commentators have gone so far as to suggest that the traditional world of music retailing is coming to an end and that online music distributors will take over that role. Recent research by the International Federation of the Phonographic Industry (IFPI) has shown that illegal file sharing was a key contributor to the 22 per cent decline in the recording industry's sales between 1999 and 2004. A study conducted in the UK in July 2005 concluded that 'on average nine potential CD purchases per single 'buyer' are lost to piracy each year, with this figure rising to 20 among teenagers'. In Europe, research has concluded that 'digital piracy' was responsible for about 35–40 per cent of the reduction in size of the global music market in 2006. And US research published recently by Edison Media Research stated that 'CD purchases fell by 61 per cent in 2006' among those who also purchased digital files.

Recent figures from the British Phonographic Institute (BPI) showed that UK album sales dropped by 10.8 per cent in 2007. Singles have sometimes been seen as loss leaders for the sale of high-margin albums in the increasingly crowded retail shelf space. However, album sales are under pressure from the consumer's desire and ability to buy one or several tracks by an artist through legitimate digital distributors, particularly the omnipresent iTunes. In addition, the global nature of the internet has made it easier for artists to sell their music digitally with less reliance on retail outlets. The growth in legitimate downloads is reflected in figures recently released by the BPI and the Official Chart Company. These showed that during Christmas week 2007 music download sales were just under three million, the largest one-week sales tally recorded to date in the UK, and more than double of that in the corresponding week in 2006. Music download sales throughout 2007 were in excess of 77 million, again a 50 per cent increase on 2006. However, it was recorded in *Music Week* that key players across the UK music industry insist that there is cause for optimism in 2008 despite the massive year-on-year fall in album sales.

"Nowhere are the shifting sands of the music industry more apparent than at EMI, which, unlike the other major record labels, was not part of a broader media group and relied on revenues from recorded music and music publishing."

Growth in 'lifestyle' music

The music industry is making great strides towards meeting the new market. For example, music is becoming more of a lifestyle product and being used increasingly in association with brands, computer games and social networks, etc. Labels are offering what are known as '360 deals' where the artist and the label form what is in effect a joint venture where revenues are shared from all forms of music exploitation including touring and merchandising. Revenues from live performances and merchandising were traditionally the preserve of artists and promoters. Although there are many different forms of 360 deals and different opinions on how good the deals are for artists and labels, the likelihood is that very little of this revenue will filter through to the traditional music retailer.

EMI

Nowhere are the shifting sands of the music industry more apparent than at EMI, which, unlike the other major record labels, was not part of a broader media group and relied on revenues from recorded music and music publishing. EMI's acquisition in 2007 by Terra Firma prompted a four-month review by its new owners. This culminated in major restructuring plans being announced in mid-January 2007 that included an overhaul of EMI's internal operations and a substantial redundancy programme. Guy Hands, the owner of Terra Firma stated, 'We have spent a long time looking intensively at EMI and the problem faced by its recorded music division which, like the rest of the industry, has been struggling to respond to the challenges posed by the digital environment… we believe we have devised a new, revolutionary structure for the group that will improve every area of the business.' He focused on three key areas that would be changed: repositioning EMI's numerous record labels, developing new partnerships with artists and opening new income streams (such as enhanced digital services and corporate sponsorship arrangements). This is certainly radical and responsive to the changing music market but where does it leave record retailers?

Digital rights management

The traditional music industry model with its multi-territorial licensing and defensive copyright legislation is facing serious challenges from the worldwide nature of online physical and digital sales. Much has been said recently about digital rights management (DRM), particularly in the UK where there is currently no private copying exemption (ie unless authorised by the copyright owner, the consumer is not allowed to make personal copies of digital or physical records). This is not mirrored in most of the developed world where copying for purely personal use is allowed. In the UK, copyright owners and distributors have often imposed conditions on downloads (for example restricting the number of CDs that can be burnt from a download), although a number of record labels have announced that they are relaxing DRM restrictions (which would also enable digital files to be played on a number of different hardware formats). One such instance is the latest confirmation by BMG that it is dropping DRM to add its catalogue to Amazon's MP3 store in the US. This follows Napster's announcement early in January 2008 that it will adopt the DRM-free MP3. The government recently asked Andrew Gowers, head of corporate communications at Lehman Brothers and ex-editor of the *Financial Times*, to review the state of copyright law in the UK. Following the publication of his report last year, the government is now considering allowing the copying of music and other products for personal, private use – possibly creating a new exception to copyright law for private copying or format shifting such as the copying of a purchased CD to an MP3 player. This may place additional pressure on retail outlets as it might reduce further the sales of different formats of records.

In-store downloading

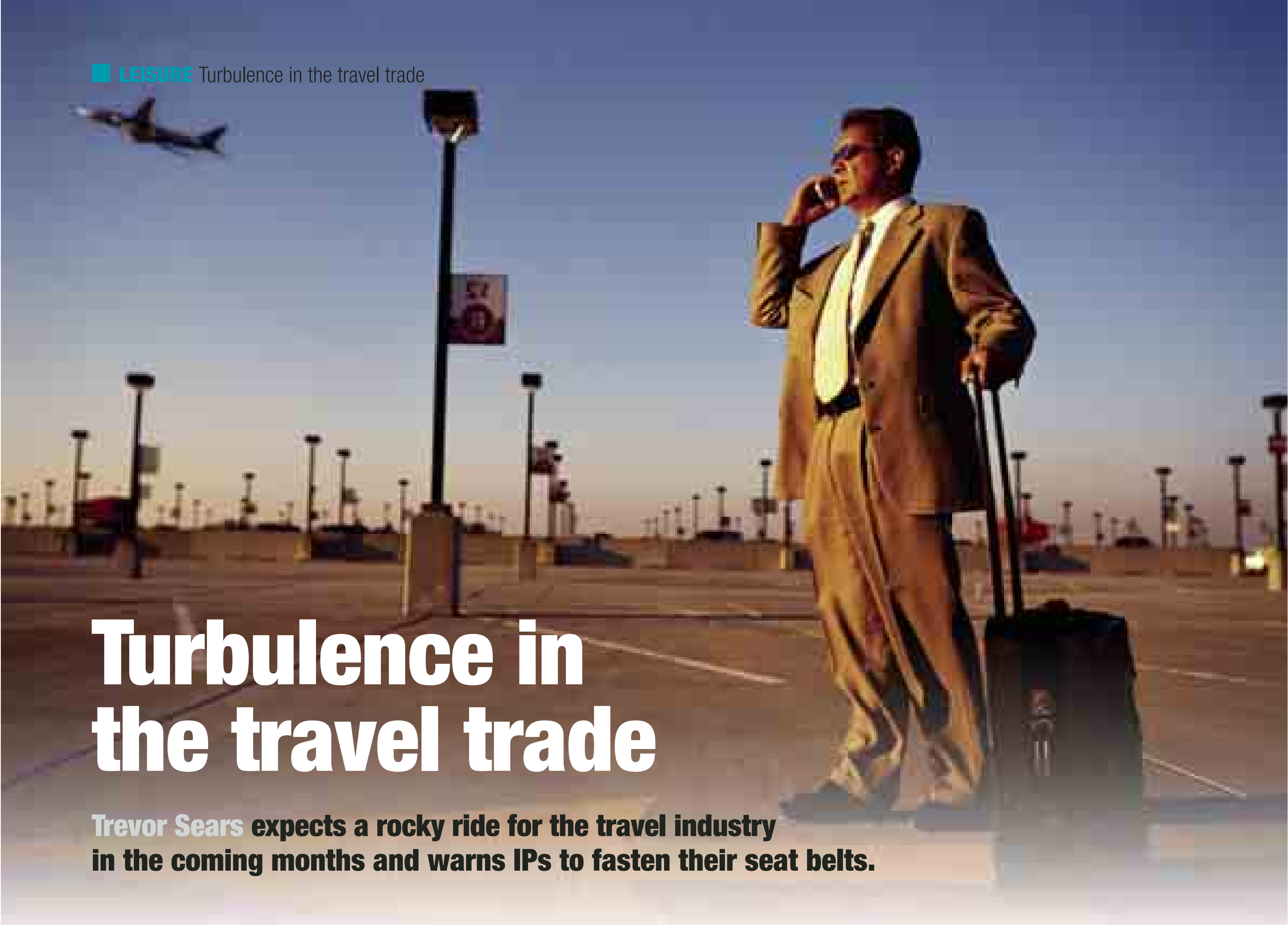
In a response to current conditions, retailers have started to introduce in-store downloading facilities. This is an effort to bring themselves in line with the ease of digital downloading through personal computers and mobile phones. In the UK, it was recently announced that Borders, the book, CD and DVD retailer, is exploring the possibility of launching an MP3 download store as part of its new focus on generating digital sales. However, the extent to which consumers will deliberately travel to a retail outlet to download or buy records remains to be seen, no matter how good the coffee.

The growth of the digital revolution has put unsustainable pressure on music retailers. This has led to a number of insolvencies including Tower Records, which cited heavy debt (incurred during its aggressive expansion in the 1990s), growing competition from mass discounters and internet piracy as contributory factors in its downfall. Other retailers noticeably absent from the high street include Impulse, Music Zone and Fopp. Although retailers are diversifying their product offering (you are now just as likely to find computer games, film DVDs and download stores in retail outlets as records) broadband penetration is becoming increasingly prevalent and faster. The weekly trip to the record store is becoming a thing of the past.

Where is the final frontier?

It is difficult to assess where the traditional 'bricks and mortar' music and entertainment product retail market will end up. What is clear, however, is that it (together with the music industry) is facing a revolution during which there will undoubtedly be even greater pressure on music retailers. ☐

Paul Williams is a partner at Menzies Corporate Restructuring and **Nigel Davies** is a partner at Davenport Lyons.



Turbulence in the travel trade

Trevor Sears expects a rocky ride for the travel industry in the coming months and warns IPs to fasten their seat belts.

The few weeks before Christmas and over the New Year saw the collapse of Maxjet Airways, a business-class airline flying from Stansted, and Travelscope, a tour operator specialising in escorted tours and cruises. Many thousands of holidaymakers were booked to travel over this period with some 30,000 more booked for travel during 2008.

Protection schemes

Travel-related insolvency affects both the industry and the public at large. By way of contrast with the ordinary unsecured creditors in a typical insolvency, travel passengers are afforded many ways of protecting either their holiday or their money through arrangements made with tour operators or travel agencies who are properly accredited and bonded by the likes of the Civil Aviation Authority (ATOL Bonding), the Association of British Travel Agents (ABTA) and the International Air Transport Association (IATA).

> **“If the agent becomes insolvent without paying the carrier, the carrier will be bound to carry the passenger or refund monies to that passenger.”**

Additional to this protection will be the usual safeguards given to consumers under the Package Holiday Regulations and under Section 75 of the Consumer Credit Act where they have paid using a credit card and where the service is not provided.

The practical result of this protection for passengers will be that they will not form the bulk of unsecured creditors in a travel insolvency; but rather the bulk will be trade creditors and those who provide the bonding protection for the organisations referred to above.

ABTA, ATOL and IATA

A member of the public paying money to an ABTA-registered operator or travel agent, which subsequently fails to provide the holiday contracted for, will be covered by the bonding arrangement put in place by ABTA.

Similarly, the ATOL Bonding Protection Scheme will also safeguard passengers in the event of a collapse of a tour operator or agent and will enable the repatriation of holidaymakers abroad or the recovery of monies paid for a cancelled holiday.

IATA travel agents are licensed by IATA on behalf of the IATA member airlines (most of the airlines of the world) to issue tickets on behalf of those airlines. The travel agent acts as a true agent for the airline on whose behalf it issues the ticket, and holds monies paid or payable for such tickets on trust for the airlines.

The legal effect of a payment being made to an IATA agent for a specific airline flight is that the payment to the agent constitutes payment to the principal. If the agent becomes insolvent without paying the carrier, the carrier will be bound to carry the passenger or refund monies to that passenger.

The position will be otherwise for passengers who have paid monies to a non-IATA agent, who in turn buys the passenger's ticket from an IATA agent. In this case there will not exist a direct contractual nexus between passenger and IATA agent (and therefore carrier) and, in those circumstances, a carrier will be unlikely to carry the passenger or return monies paid. Carriers may demand proof from passengers at check-in that they have indeed paid the IATA agent rather than an entity not approved by IATA.

Travelscope

It was due in no small way to the very prompt actions of the administrators appointed to Travelscope that contact was made with all of these organisations with a view to safeguarding and limiting the exposure of travellers facing cancellation of their holidays. Acknowledgement should also be given to the bonding companies standing behind the organisations who were prepared to take a view and allow passengers to travel, thereby limiting the bonding exposure because of arrangements put in place at short notice by all concerned.

The IP will be keen to see whether a buyer might exist for the business, but that potential buyer may well need approval from the bodies mentioned before the sale can take place. For example, you cannot sell an ABTA or IATA licence, or transfer either without approval of the new owner by the authorities.

Data protection

The IP involved with selling assets in a travel-related insolvency will often be faced with a sale not only of the goodwill, booking systems and forward bookings but also of the customer data. Data protection problems might arise from the terms under which the tour operator or agent acquired such database information, which could include many thousands of potential customers.

The IATA Trust

One of the most significant legal and practical financial issues for any IP involved in travel insolvency is the relationship between airlines and IATA travel agents. This is governed by a Passenger Sales Agency Agreement, in common form throughout the world, which contains an express trust whereby proceeds of sale of member airline tickets are trust monies to be held by the agent on trust for and accounted to the airlines through the auspices of IATA.

“ A director may also find himself on the receiving end of a claim under the principles of accessory liability established in Royal *Brunei Airlines* v. *Tan*. ”

IPs faced with a travel insolvency will meet a number of problems specific to travel. The IP will urgently need to contact those organisations mentioned above if there are travel arrangements in place for the future, or existing at the time of the insolvency of the company. The bodies concerned will move quickly to switch off ticketing systems, effectively cutting off the lifeblood of the business. The bodies may also take the decision to call in bond monies to provide refunds, thus seriously affecting any ultimate distribution of the company's assets. Contact with the organisations, as Travelscope demonstrates, could result in negotiations benefiting both passengers and other creditors of the company.

What might therefore appear to any IP as an asset of the business, be it monies standing to the credit of the bank account of the operator or book debtors, may in fact not be the property of the agent and may indeed merely be trust money properly belonging to the IATA member airlines.

The major banks are all aware of the efficacy of the IATA Trust and will provide for a write-down of debts when assessing the credit risk posed by a travel agent customer and the value of balance sheet items such as debtors. IPs must be careful not to deal with a sale of assets to which the company may not have title.

The position of the bank

And what is the position of a bank holding a charge over cash at bank or receivables? Insofar as these monies are proceeds of sale of member airline tickets during the requisite period prior to insolvency, they will be trust monies belonging to the airlines and not to the agent, and not therefore caught under the terms of the charge.

Changes of ownership within travel agencies

IPs must also be aware of the effect of changes of ownership within travel agencies. Having mentioned above that it is often a requirement for any new owner to be approved by ABTA or IATA, it is sadly commonplace for the sale of a travel agency to take place with the ownership of the shares not being transferred until the final tranche of the sale monies has been received by the seller from the buyer. This is to avoid having to seek approval of the sale because of the bonding requirements, which might be triggered by the change of ownership, especially where the buyer is using his acquisition as a vehicle for fraud. The seller, who will have taken an increasingly less active part in the running of the business over the months following the partial handover of the business, will be left holding the baby when the buyer commits the fraud. The seller will find himself on the end of a claim from the authorities because his name will remain on the original documentation that has never been changed.

A director may also find himself on the receiving end of a claim under the principles of accessory liability established in *Royal Brunei Airlines* v. *Tan* in that he may have assisted in the breach of trust by permitting the payment away of trust monies (being the proceeds of sale of the airline tickets) for which the company eventually fails to account.

Robbing Peter to pay Paul

Airline tickets, being in some cases better than cash because of their negotiability over a period of at least one year, may often be used by outgoing directors or shareholders as a means of payment to outside creditors when insolvency looms. This is in effect no better than robbing Peter to pay Paul, but in this case Peter, on whose behalf the tickets are issued, and who is the beneficial owner of the proceeds of sale of those tickets, will inevitably take steps to cancel tickets issued in such circumstances where an applicable fare has not been paid. Passengers will be stopped at check-in and asked for proof of payment.

The case of the 'international businessman'

The writer recently had cause to interview someone describing himself as an 'international businessman' who had paid £15,000 in cash at Victoria Station to a person he had never previously met for airline tickets with a face value in excess of £80,000.

When questioned, the 'international businessman' asserted that it was quite normal practice amongst the international business community for such transactions to take place. When it was pointed out that carriers had a right to refuse carriage to persons who had not paid 'an applicable fare' he demanded that the airlines repay him the money he had paid.

Needless to say he had no receipt, neither did he have any proof of payment. On continuing to argue the writer was both happy to tell him that if not an 'international businessman', he was certainly an international 'something', and that a very nice gentleman from the Fraud Squad would be more than happy to meet him to discuss his problem. Suddenly the telephone line was clear.

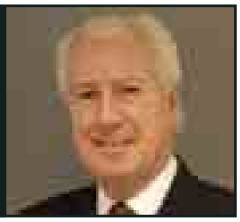
Watchstream Limited

A travel case from many years ago has an impact in many insolvency-related situations, not merely travel. Section 349 of the Companies Act 1985 is a seemingly innocuous section about a company's name having to appear accurately in legible characters on documentation and it provides, as do many Companies Act provisions, for a fine in the event of transgression.

Section 349(4), however, provides as follows 'If an officer of a company or a person on its behalf signs or authorises to be signed on behalf of the company any bill of exchange… cheque or order for money or goods in which the company's name is not mentioned as required, he is liable to a fine, *and he is further personally liable to the holder of the bill of exchange, cheque or other order for goods for the amount of it unless it is paid by the company*'.

A travel agency named Watchstream Limited issued a cheque in favour of British Airways. The company went into insolvent liquidation. The usual information was on the cheque, however, the name of the company omitted the word 'Limited'. Beside the name of the signatory, a Mr Parish, there appeared the description 'director'. Mr Parish was found personally liable to repay the amount of the cheque to the airline because of a failure to observe Section 349 (then Section 108 CA 1948), and the Court of Appeal upheld the decision (*British Airways Board* v. *Parish 1979 CA*).

The writer anticipates a number of significant travel failures during the course of 2008. These will be due partly to further consolidation within the industry, increasing fuel charges and the continuing inability of some directors of corporations to understand what is their own property and what belongs to their company, despite their position as the main or only shareholder. □



Trevor Sears is a partner at Davenport Lyons.

Can a court appointed receiver secure assets held overseas?

Manoeuvring some yachts out of deep water proved a tricky business. David Wood explains.

Court appointed receivers are about as rare as hens' teeth but a recent case showed that this procedure can be used to good effect to gain control of assets held overseas when all other avenues look doomed to fail.

Racing yachts

A wealthy American family (the claimants) had invested significant funds in a yacht charter business being run by an English yacht captain entrepreneur (the defendant). The yachts were to be chartered to a global tobacco company to provide off-shore racing experience for its corporate guests. The yachts in question were two 80-foot Maxi race yachts and a 49-foot high-speed power boat of a type associated with the Miami Vice TV series. There had been a fourth yacht but by the time of our involvement this had been wrecked and become the subject of a disputed insurance claim.

The claimants became disillusioned when the business venture never got off the ground but the defendant continued to enjoy a flamboyant lifestyle while living in Dubai courtesy of the claimants' investment. Eventually the claimants obtained judgment against the defendant in the High Court in London for a figure in excess of $2 million and set about recovering their money.

We were approached by the claimants' London-based lawyers through an East coast yacht consultant. The scene was set with the only other salient facts being that the defendant had no known assets in the UK. His only known assets were the three yachts, all of which were British registered in the name of the defendant. These were berthed in separate locations around the UAE and, with no reciprocal treaty, the UAE Courts were unlikely to recognise an order made in a London court… and so the High Court in London appointed one of my partners as court appointed receiver over the three yachts.

Recovery of the assets

The recovery of the yachts was to be far from straightforward. The power boat had been seized by a local creditor and was being held by him ashore at an undisclosed location in Dubai. Later it emerged that it had undergone a 'change of identity' and had disappeared, presumed sold. Of the two Maxi race yachts, one was found to be in a poor state of repair and we concluded it would be uneconomic to recover the vessel.

Our efforts focused on the remaining Maxi yacht, which was known to be the most valuable of the three. This was berthed in Abu Dhabi with no known encumbrances. We decided to move the vessel to the Mediterranean where we could secure it and where there is an established market for this type of yacht. Easier said than done!

The harbourmaster in Abu Dhabi did not recognise the receiver's authority and would not allow the yacht to be moved without the express authority of the defendant. We had to obtain a Power of Attorney from the defendant who was prepared to co-operate because otherwise he risked being held in contempt of the High Court.

> "To avoid a charge for VAT on the sale, it was conducted in international waters at least 12 miles offshore with photographic evidence of the vessel's GPS position."

Moving the yacht

Essential repairs were carried out, outstanding berthing fees and duties paid, an experienced crew mustered and the yacht was ready to sail for the Mediterranean – but only after the customary inducements, including the provision of the latest style Nokia phone for one local official.

Ten days later the yacht arrived in Malta where further repairs were carried out before being moved on to Palma, Majorca.

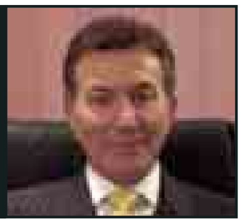
We then received notice of a propriety claim for a 50 per cent interest in the yacht from a third party. This necessitated further action in the High Court that led to the claim being set aside.

Yachts that operate internationally are rarely VAT paid and can be subject to a charge for local duty if they enter and remain in a European port for a prolonged period. To avoid this, the yacht was moved to North Africa for a short period before returning to Majorca.

X marks the spot

The yacht was extensively marketed but in the end the best offer received was from the claimants and, in accordance with an order from the High Court, the sale was finally effected some 31 months after the appointment. Again, in order to avoid a charge for VAT on the sale, it was conducted in international waters at least 12 miles offshore with photographic evidence of the vessel's GPS position.

In this case we found the court appointed receivership an effective tool to recover assets held overseas under the control of a UK national who wished to avoid being held in contempt of court for



David Wood is a partner of **McTear Williams & Wood.**

The role of IPs in Spain

Our series looking at the work of IPs around the world continues by examining practice in Spain.

Types of insolvency appointments in Spain

In Spain, only the courts are competent to handle distressed business situations where these are tantamount to insolvency. The current 'Concurso' Law entered into force in September 2004 and offers a whole host of restructuring tools drawn from other countries, such as Germany and France. It also provides tools that are very similar to those found in business reorganisation legislation in English-speaking legal systems. The Concurso Law provides for two types of court proceeding to handle corporate insolvency:

1) **Ordinary concurso proceedings** designed for all debtors with initial liabilities estimated to be in excess of €1,000,000;
2) **Expedited concurso proceedings**, designed for all debtors with initial liabilities estimated to be less than €1,000,000. Unless otherwise indicated, our comments refer to ordinary concurso proceedings.

Who takes up the insolvency appointments in Spain?

Three IPs must be appointed from among the following persons: (i) a lawyer with over five years' practising experience in a firm within the jurisdiction of the court handling the insolvency proceeding; (ii) an auditor or economist meeting the same requirements as in (i); (iii) a creditor of the insolvent company, holding an unsecured claim.

Should the company adjudged to be insolvent be a 'special entity' (for example, a securities issuer or an investment services firm), the position of auditor or economist must be filled by a member of the technical staff of the Spanish National Securities Market Commission. Should the insolvent company be a credit institution, the relevant deposit guarantee fund will be appointed instead of the creditor.

Who appoints the insolvency practitioner?

This power falls exclusively to the commercial judge hearing the concurso proceeding. The power is exercised on a discretionary basis: a commercial judge is free to appoint such IPs as he or she chooses, provided the appointments meet the requirements indicated above. The creditor who has been appointed by the judge may nominate an IP to discharge the post on his behalf.

Which practitioner does the court appoint?

The commercial judge appoints the professional IPs (lawyers, auditors or economists) from the lists provided annually by their respective professional associations. The appointment takes place following verification that such persons fulfil the other requirements. Appointment does not oblige the professional to accept the position immediately, as he or she may cite any of the incapacities, incompatibilities or prohibitions provided for by law. Should any of these exist, the appointee cannot hold office (eg if he or she has been disqualified from practising his profession in a final judgment, or has worked for the insolvent company within the three previous years). Moreover, the same person cannot be appointed as an IP if he or she has so acted in three proceedings before the same court in the previous two years. Lastly, in the case of creditors (see above section 'Who takes up the insolvency appointments in Spain'), a person who is a competitor of the debtor or forms part of the same group cannot be an IP.

> "Spanish insolvency practitioners feel that the new Concurso Law has introduced a much more sensible system, which reflects the current economic and social reality."

The IP's remuneration

The fees of IPs are calculated by using certain mathematical rules set forth in Royal Decree 1860/2004, of 6 September, 2004, which establishes the fee scale for IPs. Essentially, each IP receives fees on an individual basis depending on, among other factors, the size of the debtor's assets and liabilities. In addition, the Decree provides for an uplift in fees in particular complex cases (termination of employment contracts, several work places, early approval of the arrangement with creditors, etc).

The IP and out-of-court restructurings

In Spain, there is no legal framework regulating the involvement of IPs in out-of-court restructurings. However, these are increasingly common and a very important role is played in them by certain prominent 'boutique' firms of IPs, large law firms and even professionals (former CFOs) who are very used to working in distress situations. Although their functions may vary hugely, the most common are: the preparation of cash-flow analyses, business plans, asset divestiture plans; the drafting and negotiation of bank debt refinancing agreements; taking the lead in negotiations with secured debtors, etc.

Corporate rescue culture

Spanish IPs feel that the new Concurso Law has introduced a much more sensible system. The possibility of anticipating severe insolvency means that the measures the company needs to adopt can be much more effective for turnaround purposes; and it means better solutions for creditors and other stakeholders. The Concurso Law rewards diligence, mitigating possible liabilities associated with insolvency situations. Since September 2004, all these factors have contributed to the creation of a new 'corporate rescue' culture.

Chief restructuring officers (CROs) and Spanish turnaround professionals

The role of CROs has been increasing in Spain with the emergence of a new corporate rescue mindset. Sometimes, it is the secured creditors who, as part of a debt refinancing operation, assign a CRO to the company in financial difficulty as a way of ensuring the smooth flow of information, the presence of someone with an independent opinion, or the fulfilment of covenants by the debtor. At other times, a CRO is appointed by the struggling company itself in order to maximise the value of its assets, implement a business plan, or even to prepare sales memorandums for assets that are investment targets. Over the past year, turnaround professionals have been particularly active in Spain, so much so that they have even formed professional associations to raise the profile of their work and knowledge in the market. □

Antonio Fernandez is a partner and head of the Insolvency Group at Garrigues and **Juan Verdugo** is an associate in the Group.

Structured Investment Vehicles: just a financial cold or the start of an epidemic?

Will the germs from the US sub-prime continue to disrupt the financial sector and also move into the 'real' world?

It's August 2007 and like most IPs we're enjoying a well earned break in the sun. Dreams of an impending retail collapse drift away but then the call comes:
'We need to pitch for a SIV.'
'A what?'
'You know, a Structured Investment Vehicle.'
'Which is what?'
'Not sure, you'd better come back.'

And so began a six-month excursion into the world of structured finance where acronyms are king: SIVs, ABS, RMBS, CMBS, CDO, CLO, CBO to name but a few. In this article we will share a little of what we've learned.

What are Structured Investment Vehicles (SIVs)?

SIVs are funds that are designed to profit from borrowing 'cheaply' by issuing highly rated short-term debt and then investing those funds in longer-term and higher paying, high-grade assets. At their peak, total assets held by the 29 SIVs were some $400 billion with the largest single SIV holding in excess of $50 billion in investments.

A typical SIV (Diagram 1) is launched by a financial institution that will usually invest in the most junior of capital notes. It may also contract with the SIV to provide liquidity, which can be where the liability for the 'sponsor', at least legally, ends.

The vehicles themselves are structured as bankruptcy remote SPVs, have limited recourse provisions throughout the structure and are usually registered in tax efficient jurisdictions. They are generally governed by English or New York law.

The SIV will issue multiple tranches of debt including junior, mezzanine and senior capital notes, all of which are subordinated to the equally ranking short- (three to six months) and medium-term (six to 13 months) senior debt, otherwise known as commercial paper (CP) and medium term notes (MTN) respectively. Gearing is high, usually in the region of 10 to15 times. Unlike many structured finance models SIVs are open ended, intending to stay in business indefinitely by replacing maturing assets with new assets and continually refinancing the CP and MTN as it falls due.

> "SIVs are funds that are designed to profit from borrowing 'cheaply' by issuing highly rated short-term debt and then investing those funds in longer-term and higher-paying high grade assets."

On the asset side, the investment manager will be permitted to invest in only high-grade assets (AAA or AA) and investments are typically a combination of bank debt or structured finance securities. It is here that the minefield of acronyms really starts to kick in. Asset classes include: ABS – asset backed securities, subsets of which include RMBS – residential mortgage backed securities (which include 'sub-prime') and CMBS – commercial mortgage backed securities; CDOs – collateralised debt obligations including CDOs of ABS and other securitisations.

Who's involved?

There are numerous stakeholders including sponsor banks, liquidity providers, rating agencies, an administrator (who performs day-to-day valuations, covenant tests and rating agency reports), a security trustee, an investment manager, corporate service providers and directors. All are bound by a plethora of legal documentation that may (or in many cases may not) have been reviewed by the investors.

Investors include financial institutions, government bodies and corporate treasurers – but may be anyone with a substantial surplus of cash to invest and who views SIVs as a low- or no-risk investment. Individual investments range from, say, $2m to in excess of $500m.

Rating agencies are critical to the successful launch and ongoing operations of a SIV. Without AAA ratings for their senior debt and high ratings for their mezzanine and even junior notes, SIVs could not obtain cheap enough financing to make the model viable. In return for their high ratings the agencies impose certain conditions and covenants, one of which is the net asset value or NAV test (the amount by which the market value of assets exceeds the senior debt, divided by the capital). This test has been a key factor in the difficulty faced by SIVs.

So what went wrong?

The causes of the 'credit crunch' have been widely reported. A US housing bubble was created from an environment of low interest rates combined with a relaxation of lending standards. A subsequent rise in interest rates combined with the end of low 'teaser' rates and a fall in house prices burst

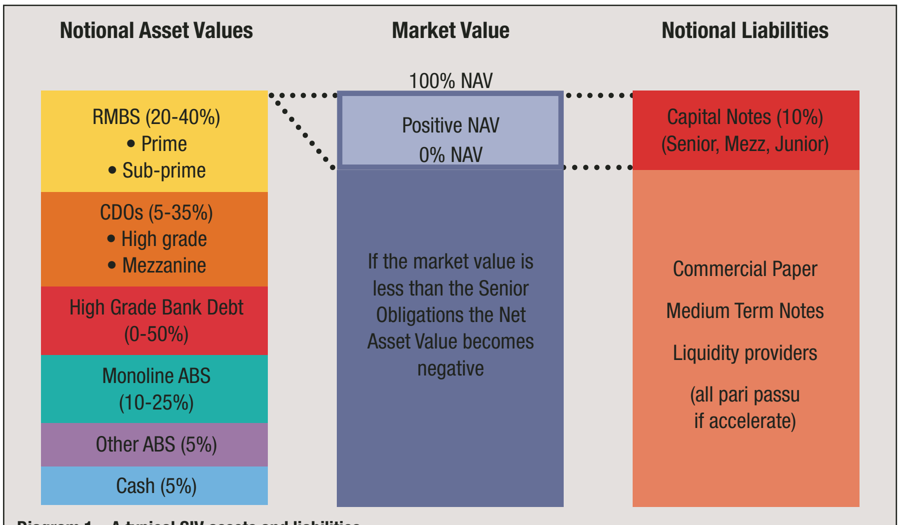


Diagram 1 – A typical SIV assets and liabilities the bubble in 2006 and prices have fallen ever since. Foreclosures have risen dramatically and the loans most at risk were those in the 'sub-prime' category.

But why were SIVs impacted?

Until mid 2007 SIVs had existed for some time without incident. A large part of the problem was that the SIVs had significant sub-prime exposure held either through RMBS assets or as tranches of CDOs. In terms of the sub-prime RMBS, these were mainly AAA rated (well at least on purchase). However, through the 'slicing and dicing' of risk the mezzanine CDOs were able to use BBB sub-prime RMBS assets as collateral and magically turn them into AAA CDO tranches (Diagram 2). As SIVs are required to invest in mainly AAA rated assets they had no problem in investing in the subordinated A2 and A3 CDO tranches (all AAA rated). But with the sub-prime crisis the value of the BBB RMBS collapsed, resulting in limited value for any of the mezzanine CDO investors – and especially those that were subordinated behind the 'super senior' A1 class. Hence with the knowledge that SIVs did have exposure to US sub-prime and at a time of limited liquidity across the globe, CP and MTN investment in SIVs dried up overnight.

This presented a fundamental issue for many SIVs, as large chunks of CP continued to fall due and needed to be repaid or the vehicle would immediately be in default. In the first instance, they could call upon specific liquidity facilities but these were not designed and not sufficient to cope with the closure of the CP market and only provide limited breathing space. The next step was to sell assets, but a forced seller in a panicked market is never going to get best value and sales below book value crystallise losses for the SIV. Other options included entering repo arrangements or selling vertical slices of assets but these only solved the liquidity issue for a period of time.

At the same time, asset prices started to fall forcing the SIVs to further mark down those assets they had retained.

These factors drive down the NAV of the SIVs and as it falls the vehicle is forced into more and more restrictive operating states until ultimately it reaches enforcement (typically when NAV falls below 50 per cent).

What happens next?

This very much depends on the legal documentation. In the case of *Cheyne Finance plc* and Rhinebridge plc the legal documentation resulted in English receivers being appointed once NAV tests were breached. Ordinarily one would expect the appointment of a receiver to accelerate all liabilities and therefore to stop any payments to creditors being made. However, in SIV land this only occurs if an 'insolvency event' is called and although this is drawn from section 123 of the Insolvency Act it's not exactly the same and therefore there was room for debate as to what 'insolvency' meant. On Rhinebridge it didn't matter as the liabilities had accelerated pre-appointment. However, on *Cheyne* the receiver continued to pay the CP as it fell due with some $315 million being paid out in the first week. An insolvency event was subsequently called towards the end of October after a court directions' hearing where the interests of all parties were heard.

The other key area that the receivers and their legal advisors, Lovells, have been grappling with is to achieve a refinancing solution taking account of the legal, stakeholder, market and practical issues. In both instances the receivers' power of sale may be an important tool in achieving a successful execution of a refinancing transaction.

What is the impact so far?

SIVs themselves are considered by many commentators to be dead as a model. Any mention of the word SIV sends most investors running for the hills and the PR implications for a financial institution to set up a new SIV in the current climate make it highly unlikely. Since August 2007 four SIVs have entered enforcement: *Cheyne*, Rhinebridge, Axon and Orion with others on the brink. Around 15 others are now back on balance sheet and should asset prices continue to degrade it is possible that the remaining 10 or so SIVs will need support from a sponsor bank or face enforcement.

The coming months

We are in rapidly changing times and much of what has been written in this article may already be out of date by the time it comes to print. There is obvious potential for further fallout, particularly if the cold caught by the US sub-prime sector spreads into other asset classes or even crosses borders to the UK or Europe.

We are now seeing issues for the 'monolines', the companies who insure or 'wrap' asset backed securities, and over the coming months some may restructure, go into run-off, be purchased or potentially go bust (absent any political fix). It is not clear what the exact impact may be, but with a huge amount of 'wrapped' assets the holders of wrapped investments are likely to see further writedowns.

The key question for all of us is whether we will begin to see an impact in the 'real' world from what to date has largely been a financial sector problem. The signs do not look good, equity markets are falling in fear of a US recession that, depending on who you listen to, is already here. No doubt central banks will take steps to intervene, but whether rate cuts will provide sufficient stimulus to prevent a wider slowdown is questionable and, on balance, we believe it's likely to be a busy year for restructuring professionals! (See article on page 9–11.) ☐

"Since August 2007 four SIVs have entered enforcement: Cheyne, Rhinebridge, Axon and Orion with others on the brink."

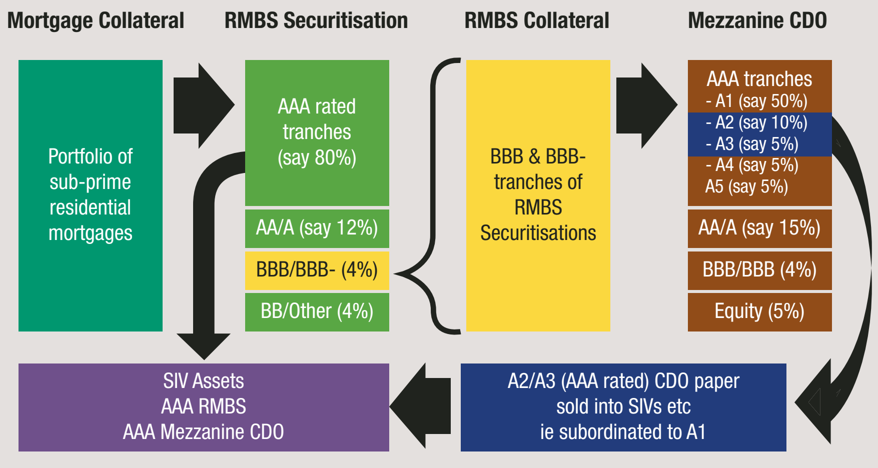


Diagram 2 – Application of ratings and risk transfer

Acronyms at a glance

SIV	structured investment vehicles
ABS	asset backed securities
RMBS	residential mortgage backed securities
CMBS	commercial mortgage backed securities
CDO	collateralised debt obligations
CLO	collateralised loan obligation
CBO	collateralised bond obligation


Phil Dowers (left) is a director and **Ian Wormleighton (right)** is an assistant director of the Reorganisation Services team at Deloitte.

Pensions: another ticking time bomb for insolvency practitioners

Darren Toms looks at a growing problem that creates what is known as an 'orphan pension scheme' – a scheme with no employer and sometimes no trustee.

Recent pension scheme legislation has made life somewhat burdensome for insolvency practitioners (IPs) who may, by virtue of their appointment, take over as trustees to company schemes. However, have you ever stopped to think what might happen to a pension scheme if you were unable to find its details during an insolvency or took no action to wind it up in line with the trust deed and scheme rules?

How a scheme can become 'orphaned'

An employer often sets up a company pension scheme as a trust-based arrangement, whereby a trustee is appointed as custodian to the assets and liabilities. During liquidation or in administration, the IP automatically takes over where the principal employer was trustee, and control is taken away from the company directors.

But often, during an insolvency appointment, it can be difficult for the appointed practitioner to locate scheme details. Where this happens, or where the practitioner fails to wind-up the scheme prior to closing the insolvency appointment, then it loses both its employer *and* trustee, and so becomes 'orphaned'.

The duties of an IP

When a practitioner becomes a trustee they have a duty and a moral obligation to act in the best interest of scheme members. Ultimately this involves the practitioner settling benefits with members in line with the trust deed and rules and any overriding pension legislation at that time. All of this needs to be completed prior to closing the insolvency appointment.

It is a practitioner's duty to submit an S120 notice to the Pensions Regulator, the Pension Protection Fund (PPF) and the trustees within 14 days of their insolvency appointment or within 14 days of finding each company pension scheme. An S120 notice can be downloaded from the PPF website at **www.pensionprotectionfund.co.uk**.

A ticking time bomb

The orphaned scheme represents a ticking time bomb for IPs, as any member of the scheme wanting to receive their retirement benefits can only do so with the signature of the trustee. If the pension scheme loses its trustee when the company is dissolved, then it is only a matter of time before an aggrieved member prompts the question 'Why was the pension scheme never found or, more importantly, never dealt with during the insolvency appointment?'

The Pensions Regulator, together with the PPF, is well aware of this growing problem and the low number of S120 notices that it has received since the introduction of the Pensions Act 2004. In the first year of the legislation (6 April 2005 to 5 April 2006) the Pensions Regulator received only 881 S120 notices from all IPs in the UK. Consequently, the PPF has expressed its concern to professional bodies about the failure of some IPs to comply with their statutory notification obligations. It has also questioned why it is taking some IPs so long to unearth occupational schemes.

The Pension Protection Fund has indicated that from 1 January 2008 it will be prepared to report IPs to their recognised professional body for failure to submit an S120 notice within the statutory 14-day deadline or for not seeking out company pension schemes.

> **"The Pension Protection Fund has indicated that from 1 January 2008 it will be prepared to report IPs to their recognised professional body for failure to submit an S120 notice within the statutory 14-day deadline or for not seeking out company pension schemes."**

Points to check

Since April 2005, the Pensions Regulator has had to appoint a large number of trustees – the vast majority of which were to orphaned pension schemes. In light of this, it is vital that IPs have correct pension scheme procedures in place. The following simple steps should assist:

1) Ask the right pension scheme questions of the company directors prior to an insolvency taking place – a procedure often likened to drawing blood from a stone!
2) Check company accounts for mentions of a pension scheme or even employee wage slips for pension deductions.
3) Submit an S120 notice for each company pension scheme found.
4) Establish, via the trust deed and governing documents of the pension scheme, who the trustees are.
5) If the principal employer was the trustee of the company pension scheme then you need to wind-up the scheme before closing your insolvency appointment.

These are the absolute minimum steps that any practitioner should be undertaking when it comes to company pension schemes but do they go far enough? There will undoubtedly be schemes that slip through the net as practitioners inevitably encounter difficulties locating them from day one. So is there an answer to the orphaned pension scheme problem?

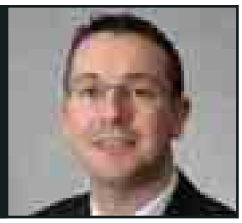
A dilemma for IPs

At the moment, the Pensions Regulator holds details of all registered company schemes in the UK. During a recent visit to the regulator, this very issue was discussed; they confirmed that their pension scheme database holds restricted information that cannot be circulated in the public domain. The regulator stressed that under no circumstances should practitioners write to them to ask whether a company scheme exists for every insolvency appointment taken. A real dilemma for all concerned but clearly not one that can continue forever! ☐

Key actions for IPs

- Ask the right questions
- Complete and send off your S120 notices within 14 days of your appointment
- Wind-up the pension scheme where you become the trustee.

Darren Toms is a consultant at Alexander Forbes Trustee Services Limited.



Employee rights in a restructuring

Richard Nicolle outlines the position of employees during an administration.

Employees will often have no prior notice that their employer may be facing an insolvency situation. While employees may have a general indication that their employer may be facing a downturn in business, it would be contrary to a company's commercial best interests to provide any indication to employees that it may be necessary to enter administration. Indeed, while redundancies will inevitably be a possibility for a business that may be declared insolvent, it would be extremely unlikely that any form of redundancy consultation would take place prior to administrators being appointed.

Status of service contracts

During administration, the identity of the employer remains the same (Paragraph 69, Schedule B1, Insolvency Act 1986 (IA)). The employees' service contracts therefore remain on the same terms.

An administrator is effectively given respite by being prevented from adopting any service contracts during the first 14 days of his appointment (Paragraph 99, Schedule B1, IA). Even when contracts are adopted, the administrator's liabilities are limited to qualifying liabilities, such as 'wages or salary' (defined in Paragraphs 99(5)(c) and 99(6), Schedule B1, IA) incurred after the adoption of the contract. These liabilities take precedence over the administrator's remuneration and general expenses. The following are not 'wages or salary', but can be claimed as unsecured debt, equal with all other unsecured creditors:

- redundancy payments and payments for unfair dismissal
- protective awards
- damages for wrongful dismissal.

The recent High Court decision in *Day* v. *Haine* [2007] EWHC 2691 (Ch), however, now precludes employees, who become entitled to a protective award after the onset of liquidation, from claiming against their employer or its liquidator, even as an ordinary creditor. The only remedy available is against the Secretary of State for BERR under the Employment Rights Act 1996.

What else can the employee claim for?

Employees generally do not have any rights pre-administration, although they may be able to recover certain pre-administration liabilities as preferential debts in an administration. Preferential debts that employees may seek to recover include salary owed during the four months before insolvency (including holiday and sick pay), contractual commission or bonus and overtime payments (Section 386, Category 5, Schedule 6, IA.). Preferential debt is capped at £800 per employee, but accrued holiday pay is not included in this cap. Any moneys owed that are above the £800 cap will rank as an ordinary unsecured debt.

What if the company cannot repay the employees?

The Secretary of State will step in and ensure that some of the debt owed to employees (whether preferential or unsecured) will be recoverable from the National Insurance Fund (NIF).

Employees can apply for moneys directly to the Secretary of State, once their employment has been terminated and their employer is formally insolvent. But the amount payable during the employees' notice periods will be reduced if the employee has other earnings or receives benefits from the state during the period of notice. The Secretary of State then has a subrogated claim against the insolvent company and assumes the rights of each employee to whom payment was made.

Any moneys not capable of being recovered from the NIF will remain unsecured claims from the company employer. Employees will frequently only be able to recover a small proportion of such claims and in many instances nothing at all.

Can employees file claims against the company during administration?

During the moratorium imposed in an administration, no legal process can be instituted or continued against the company without the consent of administrator or court (Paragraph 43(6), Schedule B1, IA). However, the courts have decided that consent should only be refused in rare cases for unfair dismissal and redundancy claims (*Carr* v. *British International Helicopters* [1993] BCC 855).

The stay on proceedings must be lifted before an employee receives compensation from the NIF for an unfair dismissal claim (as liability must be established before compensation is paid). Administrators should therefore seek an undertaking from claimants that they will not seek to enforce any award (including costs) against the company or its administrators.

Employees will usually find it is not cost effective to bring a claim for wrongful dismissal (consent will ordinarily not be granted). The costs of bringing a claim may outweigh the financial benefits, as it will be an unsecured claim in the final exit route or against the company where it survives.

The NIF will guarantee payments of:

- up to eight weeks' arrears of pay, subject to a limit of £330 per week
- up to six weeks' holiday pay, with a limit of £330 per week, accrued during the 12 months before insolvency
- statutory notice pay, subject to the statutory maximum of £330 per week
- unpaid contributions to an occupational or personal pension scheme
- the basic award for unfair dismissal (to claim this the employee would need to seek a lifting of the automatic stay on proceedings)
- up to eight weeks at a maximum of £330 per week of a protective award
- statutory redundancy pay.

(Part XII ERA)

Consultation

The legal requirement to undertake collective consultation in relation to both redundancies and a possible TUPE transfer applies regardless of the employer having entered administration. However, administrators will frequently not be in a position to retain employees for an additional period of up to 90 days to facilitate full compliance with consultation obligations. While the legislation provides for a 'special circumstances' defence for a failure to carry out full consultation, this does not automatically apply in an insolvency and the tribunals and courts are so reluctant to accept its existence that it has arguably become obsolete.

Following the decision of the Court of Appeal in the case of *Susie Radin Ltd* v. *GMB* [2004] IRLR 400 the starting point for protective awards (regardless of whether the minimum consultation requirement is 30 or 90 days) is 90 days' pay and the onus is on the respondent to demonstrate why the maximum award should be reduced to reflect mitigating circumstances. Therefore, if a failure to carry out consultation will have a deleterious effect on creditors, administrators should undertake as much consultation as is possible in the hope that this will assist arguments regarding mitigation. ☐

Richard Nicolle is a partner at Denton Wilde Sapte LLP.

Driving the impossible: the 2007 Peking to Paris Endurance Rally

Mike Pink gives a whole new meaning to the notion of 'recovery'.

In 1907 five crews of adventurers – 'the mad motorists' – set off on what was to be the precursor to modern motor rallies: the first Peking to Paris raid. The challenge was set by *Le Matin* newspaper and sought to prove that there was nowhere a 'modern' automobile could not go. The journey, the farthest distance on a single land mass between two capital cities, ran through Northern China, the Gobi Desert, Siberia and finished in Paris. The RAC Club declared the event 'so daft' and 'so ludicrous' that 'no Englishman could possibly contemplate [it]'.

Last summer, to mark the 100th anniversary of that event, a classic car endurance rally was staged following the original route. I was lucky enough to be able to take part in it, in the only 4 x 4 in the event – a 1955 Series One SWB Land Rover.

How I got involved

In late 2005, a work colleague, Nigel Challis, mentioned he was entering a centenary event in his Land Rover. With more wishful thinking than expectation I offered to be his co-driver 'if ever [his] regular navigator dropped out'. In April 2006, my phone went – I had one of the biggest decisions of my life to make. I leaped at it!

Twelve months later the Landie was shipped to China by sea and we flew out to Beijing to meet it, the other 130 crews and the organisers. Prior to this I had to take a GPS navigation course and get all the necessary vaccinations, protective clothing and insurances. I also had to get fit enough to cope with the physical strains of being bounced around inside the Land Rover for over ten hours a day.

We're off!

I was fascinated by the amassed collection of 131 classic cars. There was everything from a 1903 Mercedes to a 1969 Aston Martin and probably the largest collection of pre-war Bentleys I had ever seen!

The rally started at the Great Wall, just north of Beijing. The cars set off at one minute intervals and took over two hours to get away. On Day 1 we drove 260 miles to the mining city of Datong. Now my navigational skills became as important as the driving.

For the first three days we went west, then north to the Mongolian border. As we got further from Beijing the scenery became more arid. Driving conditions were hot and dusty and made worse by several sets of major road works that diverted the cars off the highways onto the fields and gullies alongside. Fortunately we avoided any serious mishaps or damage (unlike others) and got to the Mongolian border in fourth place. We were feeling increasingly confident – a serious mistake!

Into the Gobi desert

Day 4 took us into the Gobi desert, which is unlike those with rolling dunes of soft sand. It is about 3,000 feet above sea level and is a relatively cold desert of gravel and compacted sand. For half the year it is largely frozen; the other half it is baked dry and sets like concrete. Most of the roads are akin to farm tracks. To give us a feel for what the 1907 pioneers endured the rally route took us away from the main tracks across uncharted plateau and basins and through boulder-laden dry river beds. Large stretches of ground had set hard with corrugations (caused by weathering), creating a washboard-like surface that set off terrible vibrations in the cars. Nonetheless, this rough terrain was where the Land Rover had an advantage over the rest of the field.

At first all went well. Although it was hot, dusty and physically challenging we bounced our way across the desert towards each of the route's GPS waypoints. We made good progress and passed several other struggling vehicles. Then disaster struck – at about 30 mph the left rear wheel, complete with its drive shaft, flew off into the desert. At the time we assumed that the wheel bearing (a known weak point) had simply failed. We carried a spare half-shaft complete with bearings, so set about rebuilding the rear axle.

Running repairs

Fitting the replacement shaft proved difficult. To cap it all a major sandstorm had blown up, making it difficult to breath, see or do anything. Nonetheless, we pressed on but in less than 20 km it became clear that the rear axle repair had not worked – there was a terrible noise and the rear wheels became extremely hot. We had to stop.

The storm prevented us from pitching our tent so we had no choice but to sit out the night in the cramped cab and seek rescue in the morning. I had a satellite phone, so reported our position to the organisers and discussed 'recovery' options. We needed to get a lift to somewhere that could fix our axle. I began to worry about letting down all those people who had sponsored us and helped to raise over £60,000 for charity; surely our rally wouldn't end on Day 4?

By the next morning the storm had subsided, but we were cold, tired and covered in dust as the Landie wasn't air tight. It took until 4.30 pm for a 'recovery' lorry to arrive. The vehicle was a flatbed truck with no special equipment for recovering cars so loading ramps were improvised using two of the lorry's side-boards. Unfortunately the ramps weren't secured and as the front wheels reached the top one of the ramps collapsed, dumping the Landie on its rear with a crash and leaving it hanging precariously with one

Mongolian herdsman

wheel still on the back of the lorry. Luckily we were able to get the car secured on the lorry by 7.30 pm.

Some 21 hours later the lorry arrived at a repair yard in Ulaan Bataar, Mongolia's capital. The yard was packed full of broken rally cars – at least 35 (25 per cent of the field was in one garage!) – so the mechanics were already fully occupied. We could strip the rear axle down, but could we fix it? Here the skill and ingenuity of the Mongolians came to the fore and by nightfall on Day 6 we were ready. Unfortunately, the rally was now a full day ahead of us.

Playing catch-up

To avoid having to test the repairs during darkness we decided to rest and set off early the next day and drive 450 miles cross-country to catch the rally up. This also meant going into the wilderness, away from trade routes, alone without back-up. A gamble, but we were more determined than ever to finish.

Thankfully our navigating and driving went smoothly and we caught the tail-enders by late afternoon – a mammoth 13 hours in the car. The drive, while filled with angst about the reliability of the repairs and quite hot, was surprisingly pleasant as the scenery west of Ulaan was truly spectacular.

Stepping out

For the next five days, we drove across the Steppes – vast barren plains between snow-capped mountain ranges. It got colder but slightly greener as we climbed higher into the mountains and approached Siberia. Occasionally we came across a Mongolian family either at their Yurt (tent) or out shepherding their mixed herd of sheep, goats, cows and horses. We were still in very desert-like conditions and frequently saw the remains of dead animals along the way – reminding us of the risks of breaking down out here.

By the time we reached the Russian border the rally was down to a field of around 80, mostly 'walking wounded', cars. The border crossing was surprisingly easy. However, the bigger surprise was the dramatic change in environment – within 20 miles of the border we found ourselves driving through Alpine-like scenery! We wound up and down tarmac roads through very green, pine tree-clad valleys; it was not the Siberia I had imagined. We were all very glad to have left Mongolia behind.

Back in the USSR

Unfortunately, our good mood in Russia didn't last. The roads were long and boring, and we had to cover 400 plus miles a day. The weather changed to heavy rain and the road works returned, acting as unwanted markers for our route.

> **"I began to worry about letting down all those people who had sponsored us and helped to raise over £60,000 for charity; surely our rally wouldn't end on Day 4?"**

Stopping to assist an early Riley by a stream on Monglia's steppes.

We were able to rest each night in hotels, which was, theoretically, better than camping in Mongolia. But many of the hotels in Siberia turned out to be far worse! It wasn't until we left Russia that the accommodation (and the food) really started to improve.

West of the Urals the police were operating an unexpectedly efficient form of 'private enterprise' and relieved many drivers of cash for minor or made-up misdemeanours.

When we had first crossed into Siberia we felt uplifted, particularly by the scenery; but by the time we had travelled the huge distance to Moscow and St Petersburg our view had changed – sadly, for the worse.

The Baltic States

By contrast, the following week in the Baltic States was fantastic, combining great scenery and very friendly people with interesting, timed 'special stages' in each of Estonia, Latvia, Lithuania and Poland.

Our last major mishap occurred in Estonia when, on a special stage running on gravel tracks in a forest, we pulled over slightly to let another car by. The side of the track turned out to be unstable and the weight of the Landie caused it to collapse, dropping two wheels into a ditch. Before we could brake a small tree forced a rather abrupt stop and we were left hanging at a precarious angle. We needed help to get out of this position without rolling the Landie completely but that wasn't possible until the special stage had been completed by all participants – three hours later. The damage appeared superficial (later, in Gdansk, we discovered a broken leaf spring), so we drove on, but were now definitely out of contention.

While there were plenty of reasonable tarmac roads in this region, the rally organisers directed us off these roads and onto unmade minor ones. The scenery was tremendous, but for many it didn't compensate for the additional damage these surfaces caused to their already battered cars. Even over the last 1,000 miles cars were still suffering catastrophic mechanical problems – sheared shock mounts, broken radiators and wheel bearings. You still couldn't guarantee finishing.

Mission impossible – completed

The final complete change of environment occurred when we reached the German border with Poland and we were on improving autobahns. The Landie was pretty much a back-marker in these conditions with a top speed that even cars from the 1920s could exceed, although there were several more road works that held up the faster cars.

The final few days were uneventful as we wound our way through Germany and France, though we were a bit concerned about the broken front leaf spring and what might happen under heavy braking. We were delighted to reach the finishing line at Place Vendome in Paris on time. Nine countries; 35 days; 8,000 miles later we had done it. We'd driven *'The Impossible'*. □

Mike Pink is director, City & International Group, Restructuring at KPMG.

The Abilene paradox: the dangers of groupthink

There is a paradoxical tendency for members of a group to take a route that none of them wants. Find out how to spot the warning signs and ensure your business keeps on track.

It was a particularly hot July afternoon in Coleman, Texas. The family was sitting on the back porch of the house enjoying the breeze from the fan, sipping cold lemonade and playing a game of dominoes. Out of the blue, a member of the family suggests a fifty-mile trip to Abilene and a meal at the diner there. The rest of the family agree and they set off. The heat is crushing, the food in the diner execrable. Four hours later, the family return to Coleman, hot and exhausted. A post mortem ensues. The truth slowly emerges that no one actually wanted to go to Abilene and everyone would have preferred to have remained on the porch drinking cold lemonade and playing dominoes. It is not long before mutual recriminations break out among the family.

The Abilene paradox

The story of the family outing to Abilene is the creation of Jerry Harvey, a former professor of management science in the US. It gave rise to the famous expression 'The Abilene paradox', ie the paradoxical tendency for groups to embark on ventures that no group member wants. Harvey noticed, however, that the paradoxical tendency was not limited to a domestic or social setting but applied in business organisations as well. The proposition here is that when organisations blunder into the Abilene paradox, they take actions that are the opposite of what they want to do and defeat the organisation's objectives.

> "The sense of the paradoxical is heightened when it is appreciated that the underlying problem is not, as most of us would imagine, managing conflict within the organisation, but the *inability to manage agreement.*"

It is immediately obvious that embarking on trips to Abilene has much more serious consequences in a business than in a domestic setting. Indeed, some businesses never make it back to Coleman, ie they become insolvent and fail. The sense of the paradoxical is heightened when it is appreciated that the underlying problem is not, as most of us would imagine, managing conflict within the organisation, but the *inability to manage agreement*. The Abilene paradox is also more likely to affect organisations with a flat management hierarchy supporting a consensual leadership style, ie friendly people who want to be nice to each other and avoid and fear conflict.

Failure to manage agreement

Harvey identifies six characteristics of businesses failing to manage agreement effectively and hence on a trip to Abilene. We have changed the slightly outdated terminology used by Harvey. References to 'team' below are either to a team or any group in a business charged with formulating strategy and its implementation eg the board of directors in a limited company.

1) Team members agree individually and privately the situation or problem facing the business. (In the story, members of the family agreed that they enjoyed sitting on the porch drinking lemonade and playing dominoes).
2) Team members agree individually and privately what steps are required to cope with the situation or problem. (In the story, stay in Coleman and continue drinking lemonade and playing dominoes).
3) Team members fail to communicate their desires and beliefs to one another accurately or even at all. In fact, they do the exact opposite.
4) On the basis of invalid and inaccurate information, team members make collective decisions that are contrary to what they want to do and they achieve results that are counterproductive to the objectives of the business.
5) As a result of taking counterproductive actions, anger and frustration break out among members of the team causing sub-groups to form, which blame other sub-groups and authority figures.
6) For teams that do not deal with the underlying systemic issue of the inability to manage agreement, the cycle repeats itself with greater intensity. (This does not actually happen in the story. The family realised what had happened.)

Abilene 2008: Southern Sands

What would these characteristics look like in a modern business setting? Harvey wrote his book over twenty years ago at a time when the world was just on the cusp of the internet and global terrorism. The reader must judge for him- or herself the extent to which the paradox still prevails. In the writers' view, the huge technological advances of the last two decades have singularly failed to address how individuals and teams can communicate better.

To answer this question, we take the example of the Southern Sands Building Society plc (Southern Sands). All references to individuals and institutions whether current or past, alive or dead, are entirely coincidental.

Southern Sands has its headquarters in Exeter and is regarded as the financial beacon of the West Country. Its shareholders, depositors and customers are also largely based in the West Country. Many of its customers are farmers who have mortgage loans approaching or even exceeding the value of their holdings. The board of Southern Sands formed a bullish view of the agricultural economy some years ago. The financial support extended to the farmers was much appreciated.

Members of the board are also proud of their West Country origins and come from 'good farming stock'. The board sponsors philanthropic objectives in the local community, viz. football teams, cider-making competitions etc.

In recent years, the board has implemented and pursued an aggressive expansion plan and the mortgage book is now valued conservatively in excess of £50 billion. To do this, the decision was taken to lend over a long term to the farmers and fund the expansion of the mortgage book by borrowing short term in the wholesale money markets. For several years, this policy worked well to the delight of Southern Sands shareholders, the football teams, cider makers and other recipients of Southern Sands' philanthropic bounty.

Will Southern Sands sink?

We all know what happens next. The collapse of the sub-prime market in the US and credit squeeze resulted in an acute liquidity crisis for Southern Sands. To add to the misery, outbreaks of bird flu, worm

Editor: recovery@r3.org.uk

infestation of the cider apples of the dreaded Brownius Darling strain and other vicissitudes of country life have all put in jeopardy the value of the mortgage book. All this is nothing compared to the recriminations as to the sorry state Southern Sands now finds itself in. Everyone from the government, select committee, FSA, CEO, board members and institutional investors to the depositing shareholders and farmers throw blame on the others. The birds of prey, aka hedge funds, who only acquired equity stakes after the problems emerged clearly also relish joining in the recriminations.

The cardinal business failing of Southern Sands was of course to adopt the economic model of 'lend long, borrow short'. But how could the problems have happened? The CEO and other board members of Southern Sands were not country bumpkins and had both financial experience and expertise.

Several years later, a remarkable discovery is made. The BERR[1] inspectors appointed[2] to investigate the Southern Sands debacle headed by Sir George Jeffreys, the notoriously irascible retired Court of Appeal judge, have ascertained from private examinations[3] of executives of Southern Sands that each of them believed that this was a dangerous and potentially lethal economic model to pursue. How was it though that they had failed to communicate this belief to each other?

Similar internal dialogues go on in the heads of the CEO and deputy chairman. It is all part of the paradox.

2) **Negative fantasies**

These are the pessimistic imaginings team members experience about acting congruently with their beliefs and values. Negative fantasies feed action anxiety. The executives of Southern Sands feared loss of status and their job as the outcome of confronting the very issues about which they believed, incorrectly, that they disagreed. Importantly, they provide the individual with the excuse that frees him psychologically from the responsibility of having to solve the problems of the organisation.

The reader who has persevered with this article so far will probably be asking him- or herself questions along the lines of, 'Is my business on a trip to Abilene and if so, what can I do about it?'

"The cardinal business failing of Southern Sands was of course to adopt the economic model of 'lend long, borrow short'. But how could the problems have happened?"

But why?

Harvey offers a number of explanations for the phenomenon of the Abilene paradox. Reasons of space oblige us to mention only a couple.

1) **Action anxiety**

Here, team members take actions directly opposite to their understanding of the problems or situation of the business because thinking about acting according to their beliefs makes them extremely anxious. To avoid such anxiety, a team member or decision maker chooses to endure the negative economic and professional consequences of their decisions.

Harvey sees an analogy in the famous soliloquy of Hamlet and the action anxiety expressed there. We transpose Hamlet's soliloquy into the thought processes of the CFO of Southern Sands as she reflects on her forthcoming report to the finance committee. It might go like this:

'To maintain my sense of integrity and self worth or compromise it, that is the question. Whether 'tis nobler in the mind to suffer the ignominy of managing an economic business model that is bound to fail or the fear and anxiety that come from making a report the CEO and the deputy chairman may not like to hear.'

How to avoid a trip to Abilene

To answer this, we would suggest purchasing Professor Harvey's book. It is short at 137 pages and available at modest cost through Amazon and larger book stores. The book does indeed contain an 'Organisation Diagnostic Survey' to ascertain whether your business is on a trip to Abilene.

As to possible solutions to the pernicious and perverse nature of the paradox, we offer our own views that overlap partially with those of Professor Harvey.

Few companies in this situation possess their own psychological maps that correspond accurately with the reality of the terrain they occupy. Indeed, the solutions that they work out for dealing with that reality are often the problem. Like the executives of Southern Sands, they too are not immune from negative fantasies. Time, space and the safety of confidential dialogue are required to bring beliefs and values into conscious awareness. From these, options and plans of action can be formulated.

It is helpful if the executive can connect at an emotional level and not just cognitively. This means following up the gut feeling that 'something isn't right'. Such is the pace of life that we do not allow our awareness to develop the gut feeling to the point where we both recognise and express it. It is possible to think one thing and at the same time feel something completely different[4]. We need to work out why this should be so if we are to avoid making trips to Abilene.

We agree with Professor Harvey that confrontation of the paradox is likely to involve real moral courage on the part of the individual. It is no use tackling the problem through sub-groups of trusted friends over a drink after work in the pub. That only seems to perpetuate the paradox. The whole group needs to be addressed and with it the acceptance of the existential challenge of being given the sack as a boat rocker or closet whistle-blower.

On the other hand, there is the possibility of being acclaimed as a hero as realisation finally dawns for other members of the team. There may still be time for the car to turn back to Coleman and jugs of refreshing cold lemonade for everyone. □

1 Department of Business Enterprise and Regulatory Reform (formerly DTI).

2 Under section 431 Companies Act 1985.

3 Under section 434(3) ibid. An inspector may for the purposes of the investigation examine any person on oath.

4 For further reading, see Graham Lee, *Leadership Coaching, CIPD*, 2006 (Reprint) London. For the importance of emotional intelligence, see Daniel Goleman, *Emotional Intelligence. Why it can matter more than IQ*, Bloomsbury Publishing, 1996 London and Guy Claxton, *Hare Brain, Tortoise Mind. Why intelligence increases when you think less*, Fourth Estate, 1998 London. The literature on emotional intelligence has increased exponentially since Goleman's first book appeared in 1995.

Jeremy Hamer (left) and **David Griffiths (right)** are partners in Westminster Coaching LLP.

Due diligence: seek and you shall find

Due diligence is vital for both buyers *and* sellers. Christopher Parr explains why.

Due diligence is the equivalent of examining a used car by kicking the tyres, lifting the bonnet, examining the bodywork and checking its service history, whereas an independent accountant's report is comparable with getting a car overhauled by the RAC! Normally, there is no test drive until after the deal is completed. However, that may not be the case in a 'pre-pack' or an MBO because the buyer might already have been 'driving' the business.

Due diligence is vital for both buyers and sellers. For IPs, because of their legal responsibilities, the exercise is more important than normal. Failure to discover something vital and valuable may lead to allegations of negligence. It's a case of 'seller beware'.

Seller beware

Although it is expected that a potential buyer will perform due diligence, it is less typical for a seller to think in these terms. However, unless the seller has performed due diligence, at least to the same extent as will be allowed to the potential buyer, he or she runs the risk of being caught out in the deal negotiations. A large piece of value (tangible or intangible) might be missed and thus give the buyer a windfall or, perhaps even worse, a material problem might be overlooked that will kill the deal.

> "It would be damaging to fail to realise that an unacquired asset is vital to the operation of the acquired assets. This is a particular concern in the case of intellectual property."

IPs' due diligence

When an insolvency practitioner (IP) takes over an ailing company, the first question is, 'What have I got?' This requires due diligence that focuses on the facts and the reality of the current state of things.

In this context, a company is a finite entity. There are limits to what flows into it, what is inside at any given time, and what flows out of it. These limits might be blurred but they exist. Therefore, the IP must set about gathering all the information available and marshalling it into a manageable and understandable state. The company is fluid so the 'as is' position will change constantly but with proper due diligence the IP will be able to monitor the company's state as it alters and predict its future circumstances.

The second question an IP may ask, and which is perhaps more important than the first, is, 'What can be done with the

company?' The IP must use due diligence to find the value of the company and be alert to any aspects that might enhance its worth. For example, if due diligence brings to light some un- (or under) exploited intellectual property, then that must be factored into the IP's decisions about what to do with the company.

IPs should check the cupboards

The objective of the IP's (as the seller) due diligence is to find out as much as possible about the company: to uncover all the flaws in the business and ensure that all skeletons in all cupboards are, at least, accounted for, understood and explicable. The seller's nightmare is that the buyer finds an unknown cupboard containing an unidentified skeleton. At best, this will damage the price but it might scupper the deal altogether.

Buyers should evaluate all assets carefully

Normally, an IP sale is of assets only, whereas the buyer has the advantage of being able to 'cherry pick' his or her acquisition. This means that the buyer's due diligence can be more focused. However, it is not simply a matter of running through the asset list and deleting unwanted items. If a buyer is assuming an acquisition as a going concern, he or she must understand how the assets work together in the business. It would be damaging to fail to realise that an unacquired asset is vital to the operation of the acquired assets. This is a particular concern in the case of intellectual property. The failure to acquire the right to a certain piece of technology could render the acquired hard assets useless.

Where representations and warranties are being given, due diligence disclosure can be replaced or supported by a representation that something exists, or that it is 'just so'. However, the buyer should remember that, in IP sales, seller representations and warranties will be minimal. In addition, once payment is made, it is likely to be swallowed by creditors. This combination of points means that the buyer will have little or no meaningful recourse if the acquisition goes sour. Therefore, the buyer must do all he or she can to protect him- or herself by verifying as much as possible before completion.

A double-edged sword

There are inherent dilemmas in due diligence. In the seller's efforts to attract buyers, he or she risks showing so much of the business that an acquisition becomes unnecessary. The potential buyer (often a competitor) can learn so much that he or she has no need to buy the business. Similarly, because (normally) all potential buyers see the same information in the due diligence process, the eventual buyer will know that his or her competitors now know considerably more than they should about the business, even if they are bound by confidentiality agreements.

Information on packages

Dealing with these issues requires careful analysis of the due diligence information and the process by which it is delivered. It is usual for such information to be divided into packages of increasing depth. In the first round of due diligence, only high-level information will be disclosed. Enough must be shown to allow reviewers to decide whether to bid but not so much as to 'give away the store'. As bidders drop out more can be shown. Ultimately, the final due diligence disclosures may not be made until just before, or even after, completion. □

Christopher Parr is a partner at Collyer Bristow LLP.

STP Focus

Turnaround! It's a perfect storm.
Christine Elliott reports the shipping news.

In October 1991, an unprecedented set of weather circumstances combined to form a killer storm in the North Atlantic. Although the US National Weather Service was warning of a massive storm, while the sun shone on New England, there was scepticism about the forecast's accuracy. A monstrous time bomb was impending in the shape of a storm of epic proportions. Meanwhile, the crew in a fishing boat called the *Andrea Gail* had been taken unaware. With a commercially valuable swordfish cargo on board after a sparse season, the captain had to decide whether to head home or to sit out the storm and lose the catch. Fuelled by a dying hurricane Grace, whose immense tropical energy completed the conflagration, a monstrous storm packing 150 miles per hour winds and 70 foot waves raged for six days. The *Andrea Gail* never came back.

Recession or depression?

That storm might look fairly mild now, given the gathering tempest in the UK economy. 'Tighter credit conditions… will bear down on demand' and inflation will be pushed northwards by rising energy, food and import prices, according to the Bank of England, whose quarterly inflation report is forecasting a deeper and more persistent turnaround than did the Bank's assessment at the end of last year. The governor Mervyn King has cautioned against using the word 'recession'. BASF's chief executive, head of one of the world's biggest manufacturers, has accused the financial industry of a 'panicking approach' about the economic impact of the credit crunch and has assured us that the US is unlikely to suffer a recession 'this' year. It is true that in some manufacturing industries, order books are healthy. However, the 32nd President of the US, Harry S Truman coined a phrase, 'It's a recession when your neighbour loses his job; it's a depression when you lose yours.'

> President of the US, Harry S Truman coined a phrase, 'It's a recession when your neighbour loses his job; it's a depression when you lose yours.'

Banks choose healthier diet

The adverse indications have been there since before I took the helm at STP for those who wanted to see, and we have rehearsed them in these columns. Last autumn's liquidity constraints have eased but (except perhaps in the government's dealings with Northern Rock) heightened risk awareness is having a knock-on effect in the 'real' economy. Banks' creditworthiness has taken a tumble and estimated credit premiums, a good indicator of a lender's possible insolvency, have risen in sharp contrast to other bank lending rates' fall. Lenders' capital is therefore more likely to be rationed and costly, and if businesses and households have difficulty borrowing the economy will be squeezed. Banks have lost their appetite for funding 'credit-impaired' borrowers, which now seem like the markets' junk food and they have made New Year resolutions for a diet rich in high-protein prime mortgage products – when they can be obtained.

Stormy weather

There is a growing, yet incomplete understanding of how the fallout from complex securitised lending will pollute the domestic environment. Mervyn King places the onus on banks not only to reveal losses, but also to recapitalise to preserve liquidity. The *Financial Times* reports stellar hedge fund manager Philip Jabre as being categorical that a ten-year credit orgy is at an end, propelling Britain and the US into 'a very severe recession'; also being predicted by Merrill Lynch economists. PwC's chief executive Samuel DiPiazza says that spectacular losses are not confined to Wall Street banks – we will see them in write-downs across annual reports from non-financial institutions. One example in the UK is the now notorious hedge disaster at Mitchells & Butler, certain to culminate in ownership and management change.

In the centre of the perfect storm is its eye, a deceptive oasis of comparative calm. The turnaround forecast for 2008 portends tricky seas on all sides. Turnaround panels and networks continue to build capability and they are starting to deploy it. Asset based lenders have made unprecedented loans. Private equity and hedge funds are targeting problem cases, where the results will make the difference to unclosed funds. They and other captains of storm-buffeted assets will have to decide whether to 'sit it out' or make a dash for land. There will be litigation, litigation, litigation. Turnaround navigators expect that by Quarter 3, the winds of change will once again be unleashed. □

STP News


Andrew Marr, Iain Lynam (STP Chairman), Christine Elliott and Sir Stuart Rose.

Europe's Top Turnaround Awards

Awards, sponsors Deloitte, AlixPartners, Rutland and Lloyds TSB glowed in the achievements of the outstanding winners honoured. Full details from the STP website and the date this year is 1 December. We will call for nominations shortly, so don't keep lights under bushels!


Sir Stuart Rose.

Sir Stuart Rose: Honorary Fellow

Stuart, now 'Sir' accepted the chairman's Special Award and an Honorary Fellowship. He will be delivering the first STP Annual Lecture on June 18.

Peter Cooper, Baker Tilly National Head of Turnaround, Christine Elliott, STP CEO & Simon Bower, Baker Tilly, National Head of Banking.

New sponsors

Baker Tilly and Lloyds TSB have committed support to STP and are most welcome.

Christine Elliott is the chief executive of the Society of Turnaround Professionals.

R3 contacts

Staff R3, 8th Floor, 120 Aldersgate Street, London EC1A 4JQ
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President .... Patricia Godfrey *e-mail:* p.godfrey@nabarro.com
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Accounts and administration officer .... Beate Wirbs *e-mail:* bwirbs@stp.org.uk
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For more information on R3 membership, please contact Cynthia Matthews on 0207 566 4200 or e-mail **membership@r3.org.uk**.

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Law firm Edwin Coe LLP is delighted to announce the expansion of its insolvency practice with the appointment of a new partner.

Simeon Gilchrist (above) was previously a partner at Druces & Attlee. He has both contentious and transactional insolvency expertise, advising insolvency practitioners, banks, distressed companies and individuals in a wide range of both corporate and personal insolvency matters. Simeon Gilchrist complements the existing practices of Chris Berry, Robert Tateossian and Ali Zaidi.

PRESS RELEASE **GOINDUSTRY STRENGTHENS LONDON TEAM**

Andrew Dunbar has joined GoIndustry in London. Andrew has over 14 years experience gained in the invoice and trade finance industry, mainly in business development, with the last 6 years spent at UPS Capital where he was responsible for developing their supply chain finance business in the UK & Europe. Andrew will be responsible for delivering GoIndustry appraisal & valuation services to the Asset Based Lending, Private Equity and Corporate Finance market in London and the South East of England.

Andrew's contact details at GoIndustry: Phone: +44 (0)20 7098 3782 Mobile: +44 (0)7825 663470 Email: andrew.dunbar@goindustry.com

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Smith & Williamson

Promotion at Smith & Williamson's Maidstone office

The Restructuring & Recovery team at Smith & Williamson is pleased to announce Adrian Dante's promotion to associate director.

Adrian, who has worked in corporate recovery and personal insolvency for the past 17 years, manages the professional team in Maidstone. He works on a varied portfolio of cases and is active in giving pre-insolvency advice to directors, individuals and clients of solicitors and accountants.

Adrian Dante
01622 604 511
adrian.dante@smith.williamson.co.uk

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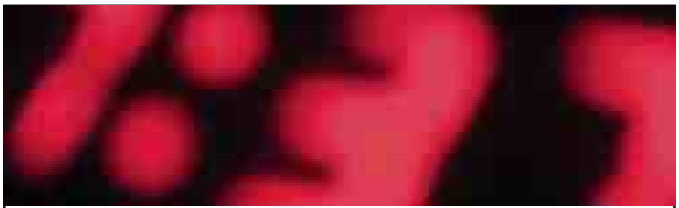

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Senior Administrator
Kent £25-35,000 + Benefits

Friendly local recovery practice is seeking to recruit an experienced administrator with between one and five years experience. Great working environment and no commute.

Corporate Restructuring Manager
Melbourne Aus $ Competitive

Exciting opportunity for a Chartered Accountant to join a leading international Corporate Restructuring team. You will be responsible for analysing the financial and operational influence of underperforming businesses and establishing valuable strategies to recover and re-establish successful company performance. The role is likely to suit a Chartered Accountant with a sound knowledge of Corporate Restructuring in a strategic advisory manner.

Corporate Recovery Manager
Reading £50-55,000 + Car

International firm with an expanding Recovery presence seeks a qualified accountant and / or JIEB with at least 2 years relevant post qualification experience to specialise in a full range of corporate assignments.

Corporate Recovery Assistant Manager
Brisbane Aus $ Competitive

Excellent opportunity for a newly or recently qualified Chartered Accountant with at least 1 year's Corporate Recovery experience to join an international firm on the Gold Coast of Australia.

Corporate Recovery Senior
Ipswich £ Flexible

Leading professional firm offers a qualified accountant / CPI / JIEB the chance to work on a wide range of Corporate Recovery and Insolvency work and assignments including Receiverships, Liquidations, Administrations and Investigation work as well as the opportunity to become involved in marketing work.

'Big 4' Restructuring / Recovery Opportunities Manager to Director Level
London/South East
£45,000 – Substantial 6 Figures

Our client, a 'Big 4' firm, is experiencing significant growth in its Recovery and Restructuring practice and is consequently looking to make a number of key appointments to its team in London and the South East. They are interested in talking to dedicated specialists at all levels from Manager to Director. At Manager levels ideal candidates will be qualified accountants, JIEBs or equivalent with a strong grounding in Recovery and Restructuring assignments. Senior Managers and Directors will need 5-10 years of directly related experience and should be able to demonstrate a wide range of skills across the discipline, together with strong management and business development ability.

Corporate Recovery Director
South East England
Negotiable £6 Figure Package

Outstanding 'Big 4' opportunity for an ambitious Restructuring/Recovery specialist to 'make a name' for themselves in a 'Big 4' office in the South East of England. You are likely to be a qualified accountant and JIEB with at least 7 years post qualification experience and a specialist background in Recovery and Restructuring work, particularly for mid-market clients. You will need a strong history of successful delivery and a proven business development record. This role represents a great opportunity to be part of a growing national team.

Directors & Assistant Directors Mixed Advisory and Formal
London £85,000–6 Figures

Recovery department of this leading international firm can offer challenging and rewarding careers to qualified accountants and/or JIEBs with a strong mix of advisory and formal insolvency experience. You are likely to be operating at a similar level in a Big 4, Top 20 or large boutique environment and should be able to add value to the existing team via e.g. an industry sector or service line specialism or strong contacts with work referrers. Good onward career prospects.

Investigation Senior Managers and Managers
London £60-90,000

The Corporate Recovery department of this leading international firm is seeking a number of Managers and Senior Managers to join its busy and expanding Investigations team. Ideal candidates will be qualified accountants, JIEBs or equivalent who can supervise and direct a team of staff on investigation assignments. The work will involve analysing historic trading performance and understanding the key drivers of business performance and operations, understanding the impact of current and projected trading and cash flow on the position and security of key financial stakeholders, preparing detailed assessment of management and their capabilities and coordinating the fieldwork and subsequent report writing on investigation assignments.

Recovery / Restructuring Manager
Southampton £ Flexible + Car

One of the national market leaders seeks a qualified accountant with at least 18 months post qualification experience in Recovery and Restructuring work. You will rapidly be able to develop your experience working on a wide range of mid market corporate assignments and career prospects are excellent.

Corporate Recovery Seniors / AMs
Edinburgh & Glasgow £ Competitive

Expanding Recovery team of an international practice can offer a challenging mix of Corporate Recovery work to qualified accountants who will ideally already have some relevant experience. You will rapidly develop your experience on a broad range of case management and pre-insolvency reviews.

Corporate Recovery Senior
Cambridge £ Competitive

Great opportunity for a qualified ACA, ACCA or equivalent with a good professional services training to join an international firm specialising in turnaround, investigation and restructuring work. Some previous relevant experience would be useful and, in any event, you will need a strong appreciation and commercial understanding of the skills required for advising underperforming businesses.

'Big 4' Restructuring / Recovery Opportunities Senior Managers, Managers and Assistant Managers
Birmingham £40-80,000

Due to its success this 'Big 4' firm's Restructuring and Recovery team has a number of opportunities available for qualified accountants, JIEBs or equivalent in its Birmingham office. They are able to offer a high element of advisory work though staff are encouraged to participate in a wide range of Restructuring and Recovery activities. Applications will be considered from top level corporate administrators through to Assistant Managers, Managers and up to experienced Senior Manager level. Excellent range of experience and career prospects in a vibrant department.

53 Chandos Place, Covent Garden, London WC2N 4HS. Tel: 020 7812 6688

Interview with Garth Calow

Garth Calow is chair of the R3 Regional Committee in Northern Ireland. In a small community his role, and that of the IPs who work in the area, is an important element in the success of the local economy.

What was your career path?

I joined Price Waterhouse as a trainee accountant in 1985 and moved to Cork Gully, the insolvency division of Coopers & Lybrand, four years later. At that time, thanks to high-profile failures in Northern Ireland (notably DeLorean and Lear Fan) the insolvency industry was an interesting work place. New legislation was changing the role of the practitioner, with the principles of a 'rescue culture' embodied in a new Insolvency (Northern Ireland) Order introduced in 1991.

Initially, I worked mainly in insolvency gaining valuable experience dealing with failed companies. Today my focus is mainly on protecting, preserving and realising value through more broadly based business recovery services in relation to the company that is facing financial difficulties.

I was seconded to the European operations of the National Australian Bank in June 1998. As a principal advisor in Ireland I helped to establish asset structuring units and provide assistance with key accounts in Northern Bank and National Irish Bank (both now owned by Danske). Working with the bank credit structures, as well as with customers in various stages of underperformance and distress, provided further practical lessons in operating a recovery culture.

As a partner within Pricewaterhouse-Coopers I have been responsible for business recovery services in Northern Ireland, but now also have managerial responsibility for corporate finance and recovery within our advisory practice. In addition to my role as chair of R3 in Northern Ireland, I also sit on the Insolvency Technical Committee (North) and the Insolvency Licensing Committee of the Institute of Chartered Accountants in Ireland.

> "There are so few large businesses in NI that if one collapses it impacts throughout the community. That puts pressure on business recovery specialists to identify firms with potential and to ensure that they have the funds and environment in which to grow and prosper and become internationally competitive."

How important is R3 in Northern Ireland?

R3 gives focus to the insolvency and restructuring community in Northern Ireland. We work closely with the Institute of Chartered Accountants in Ireland, the Law Society and the local Department of Enterprise, Trade and Investment (DETI) in the region to enhance the brand and provide suitable forums for education, networking and debate.

What jurisdiction do you operate under?

Northern Ireland is a region of the UK and tends to follow the law in GB, with some minor differences. For instance, in NI the insolvency funds are managed by the insolvency practitioner.

With the workings of government in NI there can be some lag in enacting legislation – the Insolvency Act of 1985 in GB was reflected in the Insolvency (Northern Ireland) Order introduced in 1991; but things have improved as the Enterprise Act, introduced in GB in 2005, came into place here in 2006.

What are the key challenges facing the sector in Northern Ireland?

Historically, political power lay with successive Secretaries of State, but since devolution in May 2007, power has been devolved to NI. And, with power comes the responsibility to manage and regenerate the local economy.

Northern Ireland's public sector accounts for around a third of all employment, with another third indirectly dependent on it. And, with nearly 90 per cent of all private businesses employing fewer than ten people, we have an unhealthy dependence on the public sector.

Nevertheless, increased stability has improved business confidence and thanks to the public sector and growth in the service industry, particularly retail and hospitality, unemployment is well below the UK average. Traditional industries like manufacturing and agriculture are declining and major retailers are moving in – Ikea has recently opened a megastore and the House of Fraser will open here soon.

This new prosperity has also galvanised our traditionally low-priced property sector and house prices grew by 26 per cent in 2007 – the fastest growth in Europe.

But global competition is also taking its toll on the local manufacturing sector, so we have seen some high-profile closures and appointments in the past couple of years. That challenges business recovery professionals to help companies to safeguard and maintain values as they wrestle with market pressures. There are so few large businesses in NI that if one collapses it impacts throughout the community. That puts pressure on business recovery specialists to identify firms with potential and to ensure that they have the funds and environment in which to grow and prosper and become internationally competitive.

A good example of this recently was in the case of Thermomax Limited, a local manufacturer of domestic solar panels. Using an administration process, this company was kept alive using emergency funding from a government agency, Invest NI, to protect an international customer base and seek a suitable purchaser to exploit the potential. The company was ultimately sold to an Irish-based plc with employment safeguarded and business value preserved.

What are your outside interests?

A sociable game of golf or walk on the beach is the ideal way to unwind. However, my wife and I spend most of our time involved with our three children's activities. As these are mainly sporting I have discovered that life on the touchline, or edge of the court, is much harder than

Garth Calow was interviewed by **Sarah Houghton**, the publishing manager of ***RECOVERY***.