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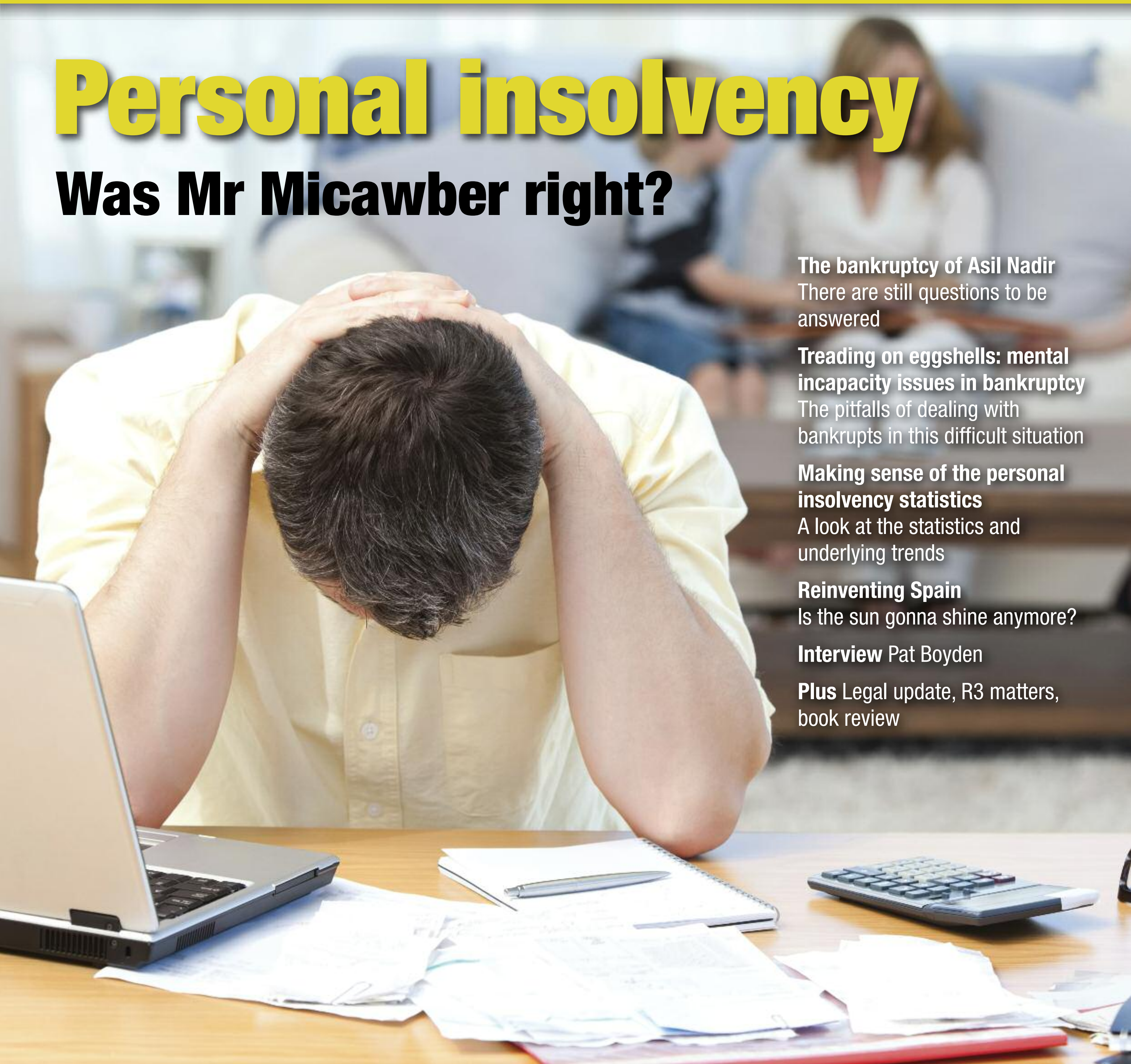
Winter 2012

RECOVERY



Personal insolvency

Was Mr Micawber right?

The bankruptcy of Asil Nadir
There are still questions to be answered

Treading on eggshells: mental incapacity issues in bankruptcy
The pitfalls of dealing with bankrupts in this difficult situation

Making sense of the personal insolvency statistics
A look at the statistics and underlying trends

Reinventing Spain
Is the sun gonna shine anymore?

Interview Pat Boyden

Plus Legal update, R3 matters, book review

What do you think?

Readers' views are welcome. Got an opinion about a burning issue? Want to comment on articles or *RECOVERY* itself?

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

From the editor

After seven years of giving tremendous support to the editorial board as *RECOVERY*'s publishing manager, Sarah Houghton is retiring. Her final interview (with Pat Boyden) is, appropriately, at the end of this issue. We are grateful for all she has done in developing *RECOVERY* and we wish Sarah a long and happy retirement. We are delighted that Sandra Kessell, whom we introduce briefly on page 6, is joining the team.

Richard Hopwood expresses a valuable opinion on page 4 about HMRC's use of insolvency powers to prevent and tackle fraud and marketed avoidance. He notes that HMRC is an involuntary creditor in almost every insolvency. It is critical to the proper functioning of the insolvency regime that HMRC plays its full part as the major creditor, always taking an active role in insolvencies where the IP seeks creditor input. Creditor participation is, after all, at the heart of the Enterprise Act and supporting the rescue culture in this way would be a fine example of joined-up government.

Claire Sharp's answers to the questions raised in our legal Q&As this month (on page 14) are well worth considering. The challenges of dealing with potential defendants buying an insolvency claim and the TUPE consequences of dismissing staff in order to continue trading can be tricky.

The Asil Nadir story, from the perspective of his bankruptcy trustee, makes interesting reading on pages 18 and 19. This issue, however, contains much more commentary on personal insolvency, for example its interaction with divorce and the impact of mental incapacity as well as the Scottish perspective and a look at COMI tourism.

Finally, the on-going debate between landlords and IPs about CVAs is explored by Vernon Dennis on pages 32 and 33. Much has been learned about how best to structure retail CVAs over the last few years (and much has been written about the subject in the pages of *RECOVERY*) but it remains an area of contention. Understanding creditors' perspectives is crucial for IPs, as is convincing stakeholders that the solution being applied is in the best interest of the estate but not unfairly prejudicial to any individual creditor. However, it would be a real step forward if we could get rid of the Goldacre and Luminar anomalies!

C. Laughton

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

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RECOVERY

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HMRC is being proactive to ensure revenue is collected

Richard Hopwood outlines how the department is using insolvency powers to prevent and tackle fraud and marketed avoidance.

Insolvency is a big issue for HM Revenue and Customs:

- most of the individuals and companies involved are our customers
- we are an involuntary creditor who cannot choose which customers to deal with
- the taxes we collect are the foundation of public services.

Where individuals attempt to avoid or evade their tax liabilities, for example through abusing limited liability companies, HMRC will act. While HMRC works with insolvency practitioners at a variety of levels, this article concentrates on how we are using insolvency powers to prevent and tackle fraud and the strategies we are developing in relation to marketed avoidance.

> "The Companies Act 2006 has codified many of the previous common law duties upon directors. There is a rich seam of recoveries that IPs could and should be mined for the benefit of creditors, where it can be proven directors have breached those duties."

HMRC is being proactive

HMRC's attendance at liquidation creditors' meetings will be familiar to most readers and this can be useful for us to gather information and also to support the IP in their investigations. But we are increasingly moving into other more proactive areas. These include:

- stopping clearly fraudulent businesses from continuing to trade by our own interventions such as petitioning for winding up and provisional liquidation;
- taking action directly where insolvency law allows it, such as imposing personal liability for re-use of company names or following bankruptcy;
- similarly, making full use of tax powers as part of our approach to insolvent companies, eg personal liability of directors for PAYE and NICs and transferring penalties for deliberately false returns to directors; and
- raising awareness of the duties upon directors, and actions that can be taken if those duties are breached while companies are still trading.

In this last area, our view is that now the Companies Act 2006 has codified many of the previous common law duties upon directors, there is a rich seam of recoveries that IPs could and should be mining for the benefit of creditors, where it can be proven directors have breached those duties. These are in part 10 of the Act and include:

- section 171 – directors must act within their powers and for a proper purpose
- section 172 – directors must promote the long term success of the company (rather than their own interests)
- section 174 – directors must exercise reasonable care, skill and diligence, this being an objective standard, ie there is a minimum level of skill and if directors fall below it they are liable should creditors lose as a result
- section 175 – directors must avoid conflicts of interest
- all of the above can be pursued via section 212 Insolvency Act 1986.

Avoiding tax liabilities

Marketed avoidance is headline news and high on the political agenda at present. Companies and individuals may seek to reduce tax liabilities by participating in marketed avoidance schemes. It is HMRC's view that many of these schemes frequently involve contrived and artificial transactions. The tax avoidance disclosure regime allows us to tackle them.

A common situation is that a company will enter into a marketed avoidance scheme that seeks to lessen PAYE/NICs liability. The scheme will be notified to HMRC as an avoidance scheme. HMRC may begin enquiries and issue assessments in the amounts it believes to be the true liability; the company may appeal and the outcome may be determined at a tribunal. This can take months or even years. During the period the company continues to trade, interest is accruing on the contingent debt and penalties may ultimately be charged. If HMRC wins, it is not uncommon for the company to declare itself insolvent and HMRC gets nothing.

Directors' liabilities

In these situations we are looking at making directors aware while they continue to trade that they must have regard to the company's long-term interests. If they have not considered how the company will meet its tax bill should the avoidance scheme be proven not to work then they may have failed to exercise reasonable skill and so be in breach of their duties. Often the directors will be major beneficiaries personally from the scheme and so there may also be misfeasance through a conflict of interest. This could lead to personal liability.

> "Marketed avoidance is headline news and high on the political agenda at present."

By writing to trading directors and making them aware of their liabilities we are helping any subsequently appointed IP to question directors intelligently on their actions and decisions by our disclosure of such correspondence and facts to the IP.

We want to work with IPs and solicitors who have experience and enthusiasm for tackling this kind of investigative work. We know it's not for everyone but where insolvency professionals have the necessary skills and knowledge, plus the willingness to work on a contingent fee basis, then we will be fully behind them – ready to provide information and, potentially, funding and indemnities in the right cases. □

RICHARD HOPWOOD is an insolvency consultant in HMRC's Specialist Investigations Directorate and a former insolvency practitioner.

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President's column

Lee Manning updates members on recent R3 activity.

Long winter nights... Guy Fawkes... Halloween... the perfect time for zombie businesses to completely take over the media agenda. We have been debating this issue for a while, but when I was asked to discuss the matter over breakfast with the BBC's chief economics correspondent, Hugh Pym, I knew this was one buzzword that wasn't going to die.

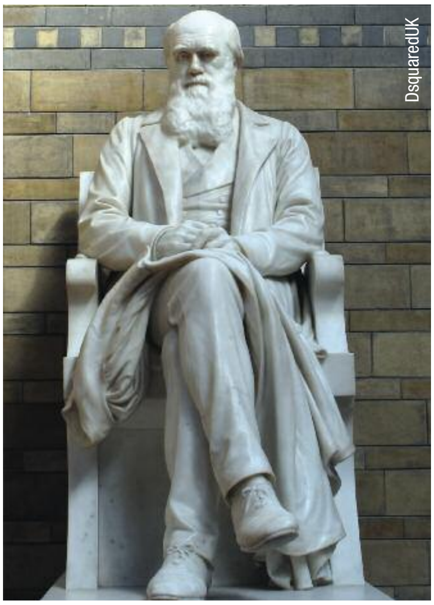
The evolution of zombies

What does a 'zombie business' mean, and is the term being over used and abused? After all, it's hardly a technical definition. R3 has carried out its own research into zombie businesses by asking businesses directly how many of them are barely able to service the interest on their debt. The replies indicate there could be up to 146,000 zombie businesses out there. Clearly, this is not a phenomenon that has suddenly sprung to life as there have always been many businesses with no well thought out turnaround strategy that have taken up a disproportionate amount of time for the business support teams of the main lenders. Their numbers appear to be swelling, while no clear out takes place. I personally know of companies that have continued to survive with inadequate working capital and with little prospect of being able to repay their term debt. These companies typically have

> "The challenge with a CVA is judging the capacity of the business emerging post-CVA to return to financial health."

enjoyed a long-term relationship with their lenders, which adds weight to forbearance but rarely leads to additional capital being provided. If zombie businesses truly exist, they cannot be easily pigeonholed.

It isn't appropriate for us as practitioners to advocate a cull of zombie businesses, as it will be seen as self-serving. However, venture capitalists like Jon Moulton are at liberty to point out the benefits of a 'clear out' of these zombie businesses. He has highlighted the point that some of the lowest corporate insolvency rates are in stricken economies such as Italy and Spain; while in Japan, near zero interest rates exist where two-thirds of companies are not profitable. Tying-up good assets and people in failing companies is dragging growth down, and he calls for a 'Darwinian process' to be allowed to operate here in the UK. We continue to engage in the



discussion and advise directors when it's right to break out of the zombie cycle, even if the final outcome is unappealing.

The future of CVAs

Recently, I appeared at the Insolvency Today conference as part of a panel discussion on retail and rent. I was pleased that the whole debate over rent issues, CVAs and pre-packs has moved forward and a collaborative dialogue exists between us, the British Property Federation and other stakeholders. In the face of cynicism about the success rate of CVAs, I stated we need to judge them in the context in which they were initiated. The challenge with a CVA is judging the capacity of the business emerging post-CVA to return to financial health. Even if it is fair to say that, on average, directors are too optimistic about the prospects of their restructured business, no-one could have predicted how long this recession would drag on. Many CVAs have worked, but I highlighted that management often lacks objectivity and is too aspirational when reshaping its business in a CVA. For a retailer, post-CVA, the main problem can be that they haven't cut deep enough when restructuring their store portfolios.

Government liaison

I paid a flying visit to the Conservative conference in Birmingham, where I had meetings with Eric Ollerenshaw MP and Justin Tomlinson MP about some of R3's concerns with the Enterprise and Regulatory Reform Bill and what we see as a missed opportunity to enhance the business rescue culture in the UK, and improve the disqualification rates for delinquent directors. Both MPs were interested in R3's policy proposals and, following the meeting, Justin Tomlinson mentioned R3's 'Holding Rescue to Ransom' campaign in a debate on the Bill.

A few weeks ago, the government announced that they would not be seeking to introduce reforms to creditor petitions for bankruptcy and winding-up orders, but they will press ahead with the simplification of debtor petitions. R3 was particularly concerned about removing the court's role to adjudicate on creditor petitions for bankruptcies; so overall this is viewed as a good outcome.

Football creditors' rule

I have just been to R3's football finance lunch, where I was joined by football insolvency experts and 15 enthusiastic MPs and peers, including members of the Culture, Media and Sport Select Committee and the shadow minister for sport, to discuss the football creditors' rule. R3's latest membership survey highlighted that over 90 per cent of the membership think the football creditors' rule should be abolished. The purpose of the lunch was, therefore, to discuss some possible legislative and non-legislative routes to amend the rule beneficially.

> "R3 will be writing a report on the [football finance] meeting and hope to table this issue with the sports minister, Hugh Robertson MP."

Mark Phillips QC, who represented the Football League in the recent case against HMRC, highlighted some of the legal hurdles involved with trying to introduce legislation to remove the rule. The group had a lively debate about some of the wider issues surrounding the governance of football, such as the 'fit and proper' test for football club owners and whether the football governing bodies should have a regulatory oversight role. R3 will be writing a report on the meeting and hope to table this issue with the sports minister, Hugh Robertson MP. So plenty to get to grips with this winter; let's hope the frost kills off some of those zombie headlines. Have a great Christmas and a successful New Year. □

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

Insolvency petition reform

Jo Swinson MP, minister for employment relations, consumer and postal affairs at the Department for Business, Innovation and Skills placed the following response statement in both Houses of Parliament on 9 October.

'At the end of last year the Government consulted on proposals to reform court processes for entry into bankruptcy and compulsory winding up.

These built upon earlier proposals consulted on by the previous administration to reform the debtor bankruptcy petition process: that is where the indebted individual is petitioning for their own bankruptcy. The consultation also proposed to replace the courts in the order-making process in creditor-petition bankruptcy and certain company winding-up petitions with a new administrative process.

Responses to our consultation showed that there is still general support for reform of the debtor petition bankruptcy process. Many concerns were expressed, however, about the proposals for introducing an administrative regime to remove courts from the order-making process in creditor petition bankruptcy and company winding-up proceedings.

Having considered the consultation responses, the Government has decided to take forward changes just to the process for dealing with debtor bankruptcy applications and has today included the measure as a proposed new clause in the Enterprise and Regulatory Reform Bill. Instead of applying to the court for a bankruptcy order, individuals will instead make a bankruptcy application to an Adjudicator, which would be a new office based within The Insolvency Service.

Taking courts out of the process of considering bankruptcy petitions presented by debtors will free up court resources to deal with matters which require judicial input and provide scope for the introduction of a modern, electronic application process.'

Sandra Kessell

Sandra Kessell (below) has joined GTI Media as a senior editor and has taken over from Sarah Houghton, long-time publishing manager of *RECOVERY*, who has retired.

Sandra is a highly experienced writer and journalist who has been editor of the *Eastern Daily Press Norfolk Magazine*, editor of *Oxfordshire Life* and has extensive freelance experience of interviewing senior figures in a variety of sectors.

If you have ideas for articles, please give her a ring on 01491 828939.

Archant/Simon Lunt

Higher costs for IPs

A Supreme Court judgment has been handed down that will increase the complexity and cost added to international collapses.

IPs had been hoping that they could make one legal application for funds in cross-border cases, which would be enforced universally and reduce costs. The ruling on two cases, joined together in one appeal, involved David Rubin & Partners, using a ruling in a US bankruptcy court to pursue funds in the UK, and Mayer Brown, using a ruling to pursue funds owed from entities in Australia.

As a result of the decision, liquidators conducting insolvencies of multinational groups may need to issue claw-back proceedings in a number of different jurisdictions, rather than being able to litigate the claims together in the insolvent's home jurisdiction against international defendants. No doubt we will hear more of this.

Themes for *RECOVERY* 2013

Spring	Environmental change and the economy *Plus*: Careers and professional development – supplement
Summer	The insolvency industry
Autumn	Property and construction
Winter	Litigation from an insolvency perspective

R3 CEO Graham Rumney, director of communications Victoria Jonson and communications manager Will Black collecting the award in London

Employment prospects decline

A study from member-based advisory firm, CEB, has found that 35 per cent of executives expect headcount to shrink in the next 12 months. Meanwhile, the percentage anticipating revenue growth fell from 69 per cent to 59 per cent, faced with Eurozone pressures and slowing emerging markets.

Executive sentiment about consumer confidence fell to the second lowest reading in Q3 – only 20 per cent of executives expect consumer confidence to improve in the next year (down from 38 per cent in Q2).

On a global level, confidence among US executives remains significantly higher than that of their counterparts in Asia and Europe. Business sentiment in the US was over 10 per cent higher than in Europe.

However, executive concern about commodity and labour costs has significantly declined.

R3 Communications win awards

The communications team at R3 has just brought home two PRCA (Public Relations Consultants Association) awards for their work campaigning on payday loans and debt concerns. For the first, the 'Corporate, Financial and Investor Relations' award, R3 was shortlisted against Santander and the Co-operative Bank. They also won 'Campaign of the Year' which considered all the campaigns shortlisted. These awards are in recognition of the significant, positive press coverage R3 and IPs received last year on our concerns over payday loans. In this case the team were responding to members, who regard the misuse of payday loans as an issue. Given that most of R3's press work is on corporate issues, this topic was an ideal vehicle to position R3 and IPs as problem solvers, and providing assistance to those with debt problems.

New LinkedIn group for 'YIPL'

Henry Page and Tom Guthrie, from the Restructuring & Insolvency team at Mercer & Hole have set up a new LinkedIn group for Young Insolvency Professionals London (YIPL) to provide a forum in which to share practical experiences, technical tips, seek guidance and arrange get togethers.

Please post into the group's discussions and start up any threads you think are interesting to the group.

IRM issues guidance on risk culture

The Institute of Risk Management (IRM) has issued two guidance documents on the topical subject of risk culture. The work looks at whether different aspects of culture make it harder or easier to manage risk and also, if you're not happy with the culture you've got within your firm, what you can do to change it.

One of the two guidance documents is aimed at boards who want to understand the issues surrounding risk culture within their organisation; the other is a detailed resource document for risk practitioners setting out the background research and some practical models, tools and techniques that can usefully be applied. These are available at **http://theirm.org/RiskCulture.html**.

- **Edition** Fourth
- **Authors** Richard Floyd; Simon Knight; Frank Brumby, 2012
- **Publisher** Sweet & Maxwell
- **ISBN** 978-0-4140-2269-0
- **PRICE** £180.00

Personal Insolvency: A Practical Guide

This is, as its title indicates, a highly practical guide to all forms of personal insolvency, written by, and very much from the point of view of, insolvency practitioners. That said, the opening remarks of chapter one provide food for thought for any individual who may be considering either embarking on a business venture, or simply obtaining credit.

This is the fourth edition of this publication, the third being published in 1997. There has been a vast amount of legislative change since then, primarily, of course, the Enterprise Act 2002, thus the current edition provides a welcome update. It is written in a style that usefully and seamlessly mixes technical with practical, and provides a concise commentary on each area under consideration.

Although reference is made to all areas of personal insolvency, including some remedies that are now seldom used, the majority of the content focuses understandably on bankruptcy. Appropriate weight is given to the areas that are, perhaps, most important to the IP, such as the impact of changes brought about by the Enterprise Act 2002 on a trustee's ability to realise the interest in the matrimonial home. The content is fully up to date, and indeed includes reference to case law on pensions that was handed down as recently as April 2012. The authors have also rightly taken the opportunity to voice their opinions in a number of potentially controversial areas including regulation and remuneration and most IPs will wholeheartedly echo their sentiments.

Some aspects of personal insolvency have traditionally been encountered less frequently, but are becoming increasingly prevalent. Consequently, IPs have the need for a concise reference document to assist in the understanding and practical application of the relevant law. Examples of such areas are partnerships, deceased insolvents and cross-border issues, and these subjects (and others) are fully and expertly analysed.

This publication is an essential tool for IPs, particularly those who do not practice personal insolvency as their primary offering. It is also a highly useful aid for those training or studying for the JIEB personal insolvency examination.

Finally, a word of thanks to whoever provided the anecdotal quotes at the beginning of each chapter. In works such as this, where by necessity the content may sometimes be 'legalistic' to the eye of the humble IP, these quotes made this reviewer smile, which is no mean feat!

TIM HEWSON is a specialist personal insolvency appointment taker at Mazars LLP.

Overseas companies: championing the use of the English Scheme of Arrangement for international restructuring

Dealing with cross-border insolvencies is always complex but English Schemes of Arrangement have proved useful and flexible tools.

A Scheme of Arrangement (a scheme or schemes) is a contractual arrangement entered into between a company and its creditors (or any class of creditors) pursuant to the Companies Act 2006 (CA 2006).

While a scheme is not a formal insolvency procedure, it is very flexible in that almost any type of compromise or arrangement may be proposed. In recent years, an ever increasing number of foreign companies have sought sanction for a scheme from the English courts to restructure their debts. It is seen as a favourable option as, once approved, a scheme is binding on all creditors affected, including dissenting and secured creditors. This article:

- summarises the procedure and key features of a scheme;
- reflects on some recent judicial commentary;
- considers the practice of forum shopping by foreign companies;
- reviews the legislation in play; and
- considers possible future developments.

The main features of a scheme

A scheme is a statutory procedure that permits a company to make an arrangement or compromise with its members or creditors (or any class of them), which, if approved by the requisite majority of such members or creditors and sanctioned by the court, will be binding on them. Schemes, therefore, bind *all* creditors, whether or not they had notice of the meetings or voted in favour of them. The relevant law is found in part 26 (sections 895-901) of the CA 2006.

The CA 2006 does not dictate the subject matter of a scheme and therefore any proposal may be determined by agreement between the company and its creditors. Notably, a scheme does not require the company to be insolvent. In fact, schemes are often used outside of the insolvency context, for example in mergers, takeovers and internal reorganisations, so as long as the necessary sanctions have been obtained. In summary, creditors will only be bound by a scheme if:

1) it is approved by those creditors or, if the scheme involves more than one class of creditors, by each class of creditors, at meetings convened by the court. A scheme is treated as being approved by creditors if it receives the support of a majority in number representing 75 per cent in value of the creditors (or each class of creditors) present and voting at the relevant court meeting, either in person or by proxy; and
2) it is sanctioned by the court at a formal court hearing and a copy of the court order is filed at Companies House.

> Unlike the situation in *Rodenstock*, the facts of *PrimaCom* raised a conundrum as it could not be said that there were creditors located in the UK.

Recent judicial treatment of schemes

In *PrimaCom Holding GmbH and others* v. *Credit Agricole and others*[1] (*PrimaCom*), the English High Court sanctioned a scheme as part of a general restructuring of a German company that provided basic and digital cable television, high speed internet services and telephony products to German households.

Prior to *PrimaCom*, the *Rodenstock case*[2] was the seminal judgment regarding the English court's authority to sanction schemes for foreign companies. In *Rodenstock*, the court confirmed that it had the power under Council Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the Judgments Regulation) to sanction a solvent scheme where there was a sufficient connection to England, notwithstanding the fact that the debtor company was incorporated and managed in Germany.

In *Rodenstock*, more than 50 per cent of creditors were domiciled in England and so the court left open for 'another day'[3] whether the sanctioning of a scheme where the majority of a company's creditors were located outside of England would fetter its jurisdiction. This issue was addressed in *PrimaCom* as the company was incorporated and managed in Germany, and further, none of the scheme creditors were domiciled in the UK. Notwithstanding this 'jurisdictional wrinkle'[4], the court held that, as the documents creating the scheme debts were all governed by English law and the priority for payment of the debts was set out by an intercreditor agreement governed by English law, the company had a sufficient connection to England and Wales to establish the English court's jurisdiction.

Forum shopping – choosing a jurisdiction beneficial to the company's interests

Forum shopping or bankruptcy tourism relates to the strategy employed by indebted companies (and individuals) who (i) identify the most advantageous jurisdiction to initiate insolvency proceedings and (ii) migrate their centre of main interest (or COMI) to open proceedings in that jurisdiction. Forum shopping to the UK has become increasingly popular for European companies in particular, due to its perceived debtor-friendly insolvency tools. Forum shopping also extends to schemes that are not viewed as an insolvency process (see further below).

Schemes can be used by any company that may be liable to be wound up under the Insolvency Act 1986. As a scheme only requires the support of 75 per cent of creditors, it is increasingly common for directors of foreign companies to take advantage of the English process to

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restructure their business. This can be shown by the *SEAT Pagine*, *La Seda*, *Tele Columbus* and *Wind Hellas* cases, where schemes were implemented in respect of Italian, Spanish, German and Greek companies respectively.

However, the practice of using English procedures to restructure debts has attracted criticism from some who believe that a local solution would be more appropriate, especially where local creditors are affected. In 2010, the creditors of *Wind Hellas* accused the company of 'bankruptcy tourism' and prompted Bertrand des Pallières, of hedge fund SPQR Capital, to claim that Britain was becoming a 'bankruptcy brothel', when a scheme coupled with a pre-pack administration of the company was implemented.

Jurisdiction in *Rodenstock* and *PrimaCom*

In *Rodenstock*, the court held that proceedings to sanction a scheme for a solvent company where 50 per cent of the creditors were located in England, was a civil and commercial matter that fell within the scope of the Judgments Regulation. The issue of jurisdiction was also discussed at length in *PrimaCom* – particularly the extent to which the Judgments Regulation impacted upon the court's jurisdiction where all of the creditors were domiciled outside of the UK.

One of the main principles of the Judgments Regulation is that the appropriate forum for the adjudication of a dispute is ordinarily the location of the defendant. Unlike the situation in *Rodenstock*, the facts of *PrimaCom* raised a conundrum as it could not be said that there were creditors located in the UK. The court, therefore, had to address whether there needed to be defendants who were domiciled in the UK in order for them to accept jurisdiction, in line with article 2 of the Regulation.

Importantly, when considering whether the connection between *PrimaCom* and the English jurisdiction was '*so flimsy that it would be improper to step over cross-border boundaries to exercise powers which are very different from the powers available under the German insolvency regime*'[5], Hildyard J held that:

> "Schemes bind *all* creditors, whether or not they had notice of the meetings or voted in favour of it. The relevant law is found in part 26 (sections 895-901) of the CA 2006."

- PrimaCom was a company liable to be wound up under the Insolvency Act 1986;
- the Judgments Regulation did not pose any obstacle to his accepting that the English court had jurisdiction in the matter. The very fact that the creditor agreements were governed by English law provided a sufficiently close connection to make it appropriate for English jurisdiction to be exercised; and
- despite the fact that his approval of the scheme may not be recognised under German law, this did not provide an impediment to sanction.

Exclusions of schemes from the EC Regulation on Insolvency Proceedings 2000 (the EIR)

The EIR provides a framework for jurisdiction, judicial recognition and the applicable law of insolvency proceedings throughout the European Union, where an insolvent company operates or has creditors in more than one member state. The Regulation does not seek to harmonise the substantive insolvency laws of the various member states. However, it enshrines the principle that the member state in which the debtor has its COMI should be the jurisdiction in which insolvency proceedings over an insolvent company are commenced. As such, the EIR ensures that procedural requirements for the debtor are a lot simpler – for example, allowing for the recognition of insolvency proceedings without the formality of a subsequent court order.

However, there are a number of requirements that such insolvency processes must satisfy in order to fall within the scope of the EIR. The proceedings must be collective insolvency proceedings and involve partial or total divestment of the debtor (ie partial or total loss of the debtor's control over its assets). In addition, there must be an appointment of a liquidator or administrator.

Importantly, the EIR does not extend to domestic processes that provide for the restructuring of a company at a pre-insolvency stage or where the existing management remains in place (hybrid proceedings). Consequently, schemes under the CA 2006 do not fall within the ambit of the EIR. This raises a number of issues, notably:

Forum shopping

One of the objectives of the EIR is to avoid incentives for parties to 'forum shop' to different member states (with the aim of obtaining a more favourable legal position). As a result, forum shopping is more likely with a scheme than with certain insolvency processes, as exemplified by the number of foreign companies seeking to execute their restructurings in the UK.

Sufficient connection

The threshold of the sufficient connection test, outlined in *Rodenstock*, is much lower than the threshold for the COMI/establishment test under the EIR. If the court in *PrimaCom* had ruled that it did not have jurisdiction to sanction a scheme where the majority or all of the affected creditors were domiciled outside of the UK, it would have resulted in schemes being unavailable as a restructuring tool for most complex, cross-border restructurings of overseas companies as there is no fallback position under the EIR.

Recognition

As schemes are not covered by the EIR, they are not automatically recognised in EU member states. In *PrimaCom*, » Hildyard J noted that the English court's sanction of the scheme may not be recognised and given effect in Germany. However, the issue of recognition did not prevent him sanctioning the scheme as each member state could continue to apply its own law in order to recognise the scheme.

Certainty in approach

Contrary to the objectives of the EIR, there is no collective approach to dealing with schemes as decisions are made on a case by case basis. This in turn increases the complexity of cross-border matters when dealing with schemes as they do not always sit comfortably alongside co-ordinated insolvency proceedings set out in the EIR.

Consultation on the future of European Insolvency Law – a gap in the EIR?

As we have seen, schemes are excluded from the scope of the EIR – leading to the issues highlighted above. Since the decision in *PrimaCom*, the European Commission published its Consultation on the future of European Insolvency Law on 30 March 2012. This consultation document seeks feedback on the general operation of the EIR and, particularly, whether it is appropriate to widen the scope of the EIR so that it encompasses pre-insolvency or hybrid proceedings (where the existing management remains in place).

> "The EC's Consultation on the future of European Insolvency Law seeks feedback on the general operation of the EIR and, particularly, whether it is appropriate to widen the scope of the EIR so that it encompasses pre-insolvency or hybrid proceedings (where the existing management remains in place)."

If the EIR is expanded to include pre-insolvency or hybrid proceedings, it is arguable that schemes could only be used where a company has its COMI or an establishment within the UK, thereby reducing the possibility of forum shopping to more favourable jurisdictions. It would also help to co-ordinate proceedings and provide certainty to ensure that schemes are recognised throughout the European Union.

However, it will be left to the individual member states to identify the relevant national procedures and add them to the list of proceedings covered by the EIR. This could be difficult as it will lead to a differentiation between solvent and insolvent schemes.

The restructuring process of choice

English insolvency procedures hold great weight in the global restructuring market. Hybrid proceedings, such as schemes, are versatile in that they can apply in different contexts, including corporate reorganisations, mergers and acquisitions. This is why we have seen many overseas companies such as La Seda, Rodenstock and PrimaCom pave the way forward for foreign companies to use the UK as a forum to implement their restructurings. Further, the recent judicial decisions of *Rodenstock* and *PrimaCom* have shown that a nexus to England can be achieved simply by having creditors domiciled in England or by executing English law governed documents.

However, it is questionable as to whether a local solution could be more appropriate. Some have argued that London is at risk of becoming the 'insolvency brothel of Europe' as multi-national firms look to the English courts to cram down dissenting creditors – compelling them to participate in the restructuring of the company if approved by the majority of creditors.

Perhaps the English courts have been willing to exercise jurisdiction partly due to a lack of an alternative procedure in the company's country of incorporation. For example, insolvency proceedings in other parts of Europe can be inefficient and destroy value, and smaller creditors can often frustrate the process by refusing to agree to restructuring plans that require unanimous approval. In *PrimaCom*, the English sanctioned scheme was viewed as the only credible alternative because of the reduced recoveries that would be available to creditors under a formal German insolvency process.

Nonetheless, recent reforms to insolvency legislation in jurisdictions such as Spain and Germany aim to address the perceived lack of credence of local restructuring procedures. For example, on 1 March 2012 a number of amendments were made to the German Insolvency Code, including amendments to the insolvency plan proceedings (*insolvenzplanverfahren*), whereby shareholders can be crammed down to accept the restructuring of a company. Such reforms aim to redress the balance between jurisdictions and promote Germany as a destination for complex restructurings.

Yet overall, the *PrimaCom* case has confirmed that the English courts, as well as insolvency practitioners and business professionals throughout the EU, welcome the use of English schemes for complex cross-border restructurings. Schemes have proved to be an invaluable tool for overseas companies, who favour a more flexible approach, especially where the underlying contractual documents or local law requirements necessitate unanimous (rather than majority) consent.

With special acknowledgement to my colleagues Oliver Jackson, a senior associate and Emma Lloyd, an associate at Nabarro.

References

1. [2011] EWHC 3746 (Ch) and [2012] EWHC 164 (Ch)
2. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch)
3. at paragraph 62, per Briggs J
4. [2012] EWHC 164, at paragraph 7, per Hildyard J
5. [2011] EWHC 3746, at paragraph 59, per Hildyard J

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Recent case summaries

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

Corporate insolvency

***Globespan Airways Limited (In Liquidation)* [2012] EWHC Civ 1159**

Facts: Globespan Airways Ltd was placed in administration by court order on 17 December 2009. On 14 December 2010, two days before the automatic end of the period of administration, a notice (the Original Notice) was hand delivered to the Registrar of Companies pursuant to paragraph 83 of schedule B1 of the Act. Paragraph 83 provided that a company seamlessly moved from administration to creditors' voluntary liquidation upon registration of the notice.

The registrar rejected the original notice as the administrators' addresses had been wrongly inserted. A further notice was sent and registered on 4 February 2011 (the Final Notice). The register therefore recorded that the liquidation commenced on the same date.

Briggs J applied a purposive interpretation to paragraph 83 and held that the effective date of registration of the conversion notice was the date the notice was *received* ([2012] BCC 479).

The registrar appealed against this decision.

Held: Arden LJ highlighted the importance of the conversion process, particularly regarding the determination of the 'relevant time' for the purpose of transaction avoidance provisions.

In allowing the appeal, Arden LJ held that the conversion notice did not take effect until it was actually *registered* by the registrar. Arden LJ gave a number of reasons for her decision, including the following:

1. As paragraph 83(4) used two different concepts, receipt and registration, it must be assumed that it was referring to different events. 'Registration' required a further act by the registrar.
2. The judge's interpretation meant the word 'registration' in paragraph 83(6) would not be given its ordinary meaning.
3. The statutory objectives of the streamlined conversion were achieved by giving paragraphs 83(4) & 83(56) their natural meaning.
4. The ordinary interpretation of paragraph 83(4) avoided any gap between the liquidator's appointment and the publication of the same at Companies House.
5. As the date of registration would almost certainly follow the date of receipt, the dates must therefore be treated differently in paragraph 83.
6. The court should prefer an interpretation that gave the registrar time to check the information provided before registration.

Actual registration therefore occurred on 4 February 2011. As this was after the period of administration had ended, it was not valid. However, the registrar could have registered the original notice. The court could therefore treat the act of registering the final notice as effective registration of the original notice.

Arden LJ further held that, in general, an administrator's term of office would be automatically extended if a conversion notice under paragraph 83 was filed (prior to the end of the administration). The end of the administration and the commencement of the liquidation therefore took effect simultaneously on 4 February 2011.

Comment: Following Brigg J's decision, Companies House published a notice that confirmed that the registrar nonetheless intended to maintain its pre-existing policy. Namely, that the registration date was the date the notice was actually *registered* and not when it was received. By ensuring the case law accurately reflected the guidance from Companies House, the appeal decision created certainty for office-holders.

(See also item in the 'Technical update' on page 12.)

Personal insolvency

***Arif* v. *Zar* [2012] EWCA Civ 986**

Facts: The appellant, Mr Zar, and his wife, Mrs Arif, were involved in ancillary relief proceedings in the Family Division.

Mr Zar had petitioned for his own bankruptcy and trustees in bankruptcy had been appointed (the Trustee). Mrs Arif believed many of the alleged debts were a sham and she therefore applied for an annulment of the bankruptcy order.

Mrs Arif also applied to transfer the annulment application to the Family Division. In dismissing her application, the bankruptcy registrar held that the matter would be dealt with in a more cost effective manner in the Chancery Division. The registrar also directed that the annulment application should be determined on a summary basis without cross-examination of witnesses.

However, during a case management conference in the Family Division, the judge made an order, of his own motion, transferring the annulment application to the Family Division under CPR 3.1(7). Mr Zar and the trustees appealed against this decision.

Held: Bankruptcy matters were conducted by bankruptcy registrars in accordance with the Insolvency Rules 1986 rather than the CPR. Rule 7.6A(3) provided that all High Court hearings in bankruptcy must come before a registrar in the first instance. Under s375(2) of the 1986 Act, any appeal against a registrar's order was to a High Court judge.

The CPR applied to insolvency provisions, except in so far as inconsistent with the Rules [r7.51A]. In accordance with rule 7.15(3), the power of a High Court judge of another division to transfer proceedings involving a bankruptcy estate into that division, of its own motion, was extremely limited. As an annulment application did not fall within the specified circumstances, any transfer application should have been made in the Chancery Division.

The power of the court to vary or revoke an order under CPR 3.1(7) was limited, for example, to cases where there had been a material change of circumstances. By contrast, the judge had merely relied upon criticisms of the merits of the registrar's decision. The proper forum for raising such issues was therefore to a judge of the Chancery Division on appeal.

Comment: Patten LJ commented that bankruptcy registrars needed to be alive to the real possibility that husbands (and wives) may attempt to use the protection of a bankruptcy order as a shield against the claims of their spouses for ancillary relief. This case highlights the tension often encountered between family law and insolvency law. ◻

(See also article on page 17.)

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Technical update

Informing and consulting with workers, anticipation and management of restructuring.

The Committee on Employment and Social Affairs (the Committee) of the European Parliament has produced a draft report with recommendations to the European Commission on Information and consultation of workers, anticipation and management of restructuring (2012/2061 (INI). Before we go much further we should emphasise that it is a draft; it is not (yet) policy or legislation. The content does, however, indicate the way in which at least a section of the European Parliament approaches the difficult social issues arising from restructuring and what changes there might be in the future. For that reason we thought we should share with you some of the principal proposals.

The preamble sets the tone of the document. The Committee refers to *'the crisis which began in 2008'*, the loss of jobs in the EU (double the number of jobs created in the third quarter of 2011) and previous Commission policy papers, which apparently said *'better anticipating and managing restructuring would help employees and companies to adapt to transitions imposed by excess capacities and by modernisation and structural adjustment'*.

The Committee goes on to refer to the *'positive export performance of some member states'* relying on wider factors such as *'sector specialisations, innovation and skills levels that enhance real competitiveness'* and deplores the Commission's *'disappointing responses to parliamentary resolutions on information, consultation and restructuring'* and its failure *'to take practical steps to ensure the wide application throughout the Union of the anticipative and proactive approaches and socially responsible restructuring practices'*.

> "The content… [of the draft] indicates the way in which at least a section of the European Parliament approaches the difficult social issues arising from restructuring and what changes there might be in the future."

Having indicated its displeasure the Committee sets out its own draft directive in 16 'Recommendations'. The first recommendation is the preamble, which stresses that the principal concern should be employees and the maintenance of their employment. For instance, item 7 reads *'serious action aimed at limiting the impact of restructuring requires companies to envisage redundancies as a last resort and only after having considered all possible alternative options and/or having implemented possible supporting measures'*.

Item 10 of the preamble applies the proposed restructuring framework to *'major companies and groups of companies'* employing at least 500 workers. Smaller companies are not involved in these proposals.

Draft articles numbered 4 and 5 and headed 'Anticipation of change' provide for training: *'employees shall recognise that education and lifelong learning are necessary to enhance their employability and shall accept relevant training offers'* while *'companies shall establish… mechanisms for the long-term planning of quantitative and qualitative employment skills needs'*. The idea seems to be that training would either reduce the need for restructuring because companies would have the necessary skills to innovate and remain competitive or soften its impact because better trained employees would be more readily transferrable.

Draft articles numbered 6 to 10 deal with the *'preparation and management of restructuring processes'*. Preparation is required as soon as possible *'except in circumstances where restructuring is triggered by unforeseen or sudden events'*. Whether or not this includes insolvency probably depends upon the circumstances. Where the need to restructure is caused by the overnight failure of a major customer the event might appear to qualify as being 'sudden'. On the other hand, a lack of profitability leading to failure probably should have been dealt with at an earlier stage and would appear not to be an exception. While the point might be academic insofar as the insolvent company is concerned it might be of considerable concern to directors and management facing possible penalties for non-compliance.

'Early explanation and justification to all the relevant stakeholders' is also demanded apparently with the intention that there should be a dialogue between the relevant stakeholders and, presumably, some sort of consensus. Naturally the *'public authorities'* shall be *'involved from the beginning'* as should *'companies and their employees in a situation of dependence in relation to the restructuring company'*. This seems to be a recipe for a managerial nightmare!

Recommendation 8 requires companies to *'consider redundancies only as a last resort and only after considering all possible alternative options'* when *'the need to restructure occurs as a result of the need to preserve their competitiveness and long term prosperity'*. If redundancies cannot be avoided, *'companies shall make available to the employees concerned measures that aim to enhance their employability'*. The measures are not specified but, presumably, they would include re-training and careers advice and result in a further cost to the restructuring company.

Recommendation 9 permits an agreement between the relevant parties to replace the requirements concerning early planning, reporting and justification.

Recommendations 11 to 13 provide for intervention and support by the public authorities while recommendation 14 requires that *'companies shall monitor, on a permanent basis, in co-operation with external bodies and authorities, the psycho-social health of employees affected by restructuring processes, both redundant employees and those staying in the company'*. It is not clear from the document why this should be done.

Were these recommendations or something like them to be put into European law it seems inevitable that they would increase the technical and practical complexity of restructuring and, by extension, insolvency processes. If it is thought to be important that the psycho-social health of employees should be monitored following a restructuring why should this not be extended to insolvency? And if the restructuring involved an administration might the monitoring cost be an expense?!

Collective redundancies

In June 2012 the Department for Business, Innovation and Skills issued a consultation document on collective redundancies following a call for evidence in November 2011. In our response to that call we explained at length the difficulties that arise in the context of formal insolvency proceedings, which make real consultation a practicable impossibility in most cases. We suggested that a possible answer was to make formal insolvency a special circumstance, and gave reasons why we thought this would be possible within the legal framework of the underlying EC Directive. Unfortunately the recommendation has not been referred to in the consultation document but we note that the Department will work with interested parties to review its guidance and ensure that 'conducting consultations in non-standard circumstances, including business transfers and insolvencies' are addressed in the proposed Code of Practice.

Administrations

In the recent case of *Globespan* (*Globespan Airways Limited* [2012] EWCA Civ 1159) the Court of Appeal held that conversion from administration to a creditors' voluntary liquidation takes effect only on the registration of the notice by the registrar, and not before. Fortunately the Court also held that where the term of office of an administrator would otherwise expire before the registration of the notice, it is automatically extended until the date of registration. This case is also commented on in 'Recent case summaries' on page 11. But what happens if the notice is sent to the registrar by first class post on the penultimate day of the administration?

Under part 6 of the Civil Procedure Rules, which are incorporated into the Insolvency Rules 1986 by rule12A.3, deemed service is *'the second business day after completion of the relevant step under rule 7.5(1)'*, which is the day of posting.

"Were these recommendations or something like them to be put into European law it seems inevitable that they would increase the technical and practical complexity of restructuring and, by extension, insolvency processes."

Paragraph 83(3) of Schedule B1 to the Act requires the Registrar to register the notice 'on receipt'. This means that, in this example, by the time the Registrar receives the document the administrators would be automatically out of office. In these circumstances it is difficult to see how the administrator's term of office could be extended; there is nothing to extend! The court did not consider this issue but it would seem sensible for practitioners to lodge their notices in plenty of time to avoid any uncertainty.

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Technical Bulletin

Technical Bulletin 100 was issued in October. Its contents included: :

- Information from HM Revenue and Customs
- Conditional fee arrangements in insolvency cases – implementation of Jackson reforms postponed
- Financial support directions and insolvency – statement from The Pensions Regulator
- Moving from administration to CVL – Companies House and registration of Form 2.34B
- Companies House – amendment of forms requiring court order
- Rent as an insolvency expense – High Court guidance on the Lundy Granite principle following *Goldacre*
- Costs of an administration application where an order is not made
- Rejection of administrator's proposals
- Scots law – Administrators permitted to avoid contractual obligations in order to achieve purpose of the administration
- High Court guidance on contingent claims in a solvent liquidation
- High Court considers the application of the *Eurosail* principles in relation to a default trigger in an ISDA master agreement
- Bankruptcy – Undrawn pension entitlements to be treated as income for the purposes of an IPO application
- Client money – Supreme Court decision on the CASS Rules
- Parallel bankruptcy proceedings – non-disclosure of jurisdictional issues
- Court approves Companies Act scheme for German company
- TUPE and pension rights.

Legal Q&A

Claire Sharp answers your insolvency queries.

I am the trustee in bankruptcy with a potential cause of action against a third party. I do not have the funds to run the claim, and my advising solicitors have advised the case is not strong enough for a CFA. There is only one creditor who is adamant the claim should be sold to him without being offered to the potential defendants. What should I do?

You remain an officer of the court, and so must use your professional judgment (taking into account the advice of your solicitor) about what to do with the cause of action. You are not bound to do whatever the sole creditor requests. The bankruptcy case of *Faryab* v. *Smith* is a good example of the creditors wanting the trustee to do something he believed was not a wise action, and being supported in his refusal by the court. In this case, you should only offer the cause of action if satisfied you are not offering a vexatious claim, and offer it to all interested parties, including the potential defendants. The safest course of action is to create a sealed bid process, and send out a letter to all potentially interested parties setting out the rules of the bid process. It would also be sensible to consider whether you will only consider lump sum offers, rather than a share of the proceeds, as there is a remote risk you could be later subject to a costs order if the claim is ultimately unsuccessful. It is a small risk though and all cases should be considered on their unique facts. The chance of being subject to a costs' order is considerably higher for a trustee in bankruptcy than a liquidator or administrator as the asset is held in your name personally (as trustee). Ensure all parties receive the same information and do not enter into separate discussions with one party in order to avoid any later challenges in court to set aside the successful bid. Finally, you are not required to accept the highest bid though to refuse to do so would normally require a good reason, such as the only offer being derisory and seeking further offers would be an unjustifiable expense (*Khan* v. *Official Receiver*).

"The chance of being subject to a costs' order is considerably higher for a trustee in bankruptcy than a liquidator or administrator as the asset is held in your name personally (as trustee)."

I am the administrator of a company, which I am trading with a view to sale as a going concern. The sale is proving to be somewhat of a nightmare with preferred bidders dropping out of the sale and then later returning to the process. I genuinely have no idea when the business will be sold, but am confident it will be sold eventually and will return a greater dividend to creditors when sold as a going concern. However, I am trading at a loss but could reduce the number of employees to a skeleton staff to keep going until sale. If I do dismiss some of the workforce in order to keep trading, what will be the impact under TUPE?

Given the immense difficulties faced by prospective purchasers in obtaining funding, you are not the first administrator to be in this position! It is automatically unfair dismissal to dismiss an employee due to a transfer of the business, and the new employer will become jointly and severally liable for any compensation payable to the employee. However, if the reason for the dismissal was only connected to the transfer but was for an economic, technical or organisational reason requiring changes to the workforce, then the dismissal is not automatically unfair and liability for any other type of unfair dismissal that might have occurred in respect of that employee does not pass to the new employer (*Thompson* v. *SCS Consulting Ltd*). What does all this mean for an administrator in your position? If you dismiss staff in order to make the business more attractive to a prospective purchaser, that is not an economic reason for dismissal (*Spaceright Europe Limited* v. *Baillavoine*). The dismissal will be automatically unfair and both the original employer and purchaser will be liable.

However, if you dismiss staff simply in order to be able to afford to keep trading with a long-term view to selling the business that is a reason connected to the transfer, although it is likely to be viewed as an economic reason, and therefore is not automatically unfair dismissal. Therefore, the liability for unfair dismissal will not transfer to the eventual purchaser (*Kavanagh and others* v. *Crystal Palace FC (2000) Ltd* and others). Everything turns on its actual facts in order to distinguish between dismissal to make the business more attractive and dismissal to 'mothball' the business. Bear in mind though, under TUPE it is not just potential liability for unfair dismissal that could transfer to the purchaser. Unpaid wages, liability for failure to consult regarding redundancies under trade union legislation, and other employee liabilities can transfer too. □

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Bankruptcy and divorce: the double whammy

Tessa Blank considers key issues for a trustee in bankruptcy when challenging the transfer of matrimonial assets to the spouse or civil partner of a bankrupt as a transaction at an undervalue.

Thorpe LJ recently summed up the tension between the statutory scheme for the protection of a bankrupt's creditors and the statutory scheme for the financial protection of the bankrupt's former spouse in *Hill* v. *Haines*[1] when he stated that: *'Bankruptcy Acts and Matrimonial Causes Acts may be said to compete for shares in the fund which will always be incapable of satisfying both.'*

Timing of the bankruptcy

One might assume that a conflict relating to transactions at an undervalue pursuant to s339 of the Insolvency Act 1986 (the Act) could only arise if any divorce settlement were concluded before the date of bankruptcy. However, *Re Pope Ex p. Dicksee*[2] concerned a post-nuptial settlement after, but within two years of, the husband's bankruptcy. The key question is whether the divorce settlement in itself constitutes 'valuable consideration'.

Consideration paid

In *Dicksee*, to prevent the settlement being unwound by the trustee, the wife had to show:

- that she had provided consideration; and
- whether she could be regarded as a 'purchaser' within the meaning of s47 Bankruptcy Act 1883.

The court was unanimous on the first point in that the right to relief for matrimonial offences was *'no doubt… valuable consideration'*. On the second issue, the majority considered the wife was 'a purchaser'.

Lewis v. *Kumar*[3] found that where the value of consideration provided by one spouse for the transfer of the other's interest in the matrimonial home was significantly less than the value of the interest transferred, the transaction is an undervalue for the purposes s339 of the Act. Here, the wife's assumption of sole liability for the mortgage was the only consideration provided for the transfer of her husband's interest in the property, the transfer was held to be an undervalue.

In *Hill* v. *Haines*, the Court of Appeal overturned the High Court's decision that parties to an order for ancillary relief did not give consideration for the purposes of s339. They found that the ability of one spouse to apply to the court for an order under the Matrimonial Causes Act 1973 s23 to s24D was a right conferred and recognised by law, and represented consideration for these purposes. The right had value as its exercise might lead to court orders entitling one spouse to property or money from or at the expense of the other.

> "Since *Claridge's*, trustees should be wary of challenging a transaction where the money has already been spent in good faith."

Papanicola v. *Fagan*[4] illustrates how widely the court was prepared to construe consideration. In this case, the wife was concerned about her family's financial future as her husband had an alcohol and gambling addiction. She threatened to divorce him unless he made a declaration of trust over his beneficial interest in the matrimonial home to her absolutely. He did this some years before becoming insolvent. The court held the wife's promises to forbear from petitioning for divorce and from bringing an application for ancillary relief were sufficient consideration.

However, *Claridge's Trustee in Bankruptcy* v. *Claridge*[5] shows even if the trustee can prove there is a transaction at an undervalue, this may not be sufficient.

Claridge's concerned a loan, taken out jointly by the couple, to fund improvements to a property owned solely by the wife. Shortly afterwards, the husband was made bankrupt. The husband's half share had been for renovations, the beneficial interest belonged to the wife alone and thus was a transaction at an undervalue. However, the court declined to make an order under s339(3) because this was the just result, taking into consideration that the funds were used to improve the property. The wife had acted in good faith; there was no simple way to restore the position; there was no evidence of the increase in value the renovation conferred on the property and causing the case to continue was disproportionate to the money involved (£30,719 between them).

Since *Claridge's*, trustees should be wary of challenging a transaction where the money has already been spent in good faith.

Exceptional circumstances defence

In *Stonham* v. *Ramrattan and Bortolussi*[6] Mann J reaffirmed the 'exceptional' circumstances that justify the court's refusal to exercise the discretion to make an order upon finding a transaction at an undervalue. Mann J said the starting point was always to exercise discretion in favour of the trustee unless there was something 'exceptional' or 'unusual' to allow the court to decline to exercise that discretion.

How long does the trustee have to bring his claim?

Helpfully for trustees, it was said *obiter* in *Stonham* that a claim under s339 to set aside a transaction was subject to a limitation period of 12 years but that period ran, not from the date of the bankruptcy order, but from the date when a trustee was first appointed or when the official receiver became the trustee. Until a trustee was constituted, proceedings could not be brought and time should therefore not run.

(See also 'Recent case studies' on page 11.)

1 [2007] EWCA Civ 1284
2 [1908] 2 K.B. 169
3 [1993] 1 W.L.R. 224
4 [2008] EWHC 3348 (ch)
5 [2011] EWHC 2047 (Ch)
6 [2011] EWCA Civ 119

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The bankruptcy of Asil Nadir

There are still questions that Kevin Hellard would like answered – what will 'The man from Del Monte' say?

I was appointed trustee in bankruptcy of Asil Nadir in 2003. Mr Nadir was declared bankrupt in November 1991, coincidently the year in which I began working in insolvency. Neil Cooper and Ipe Jacob, the original trustees, were appointed in March 1992. Their appointment occurred many months after the commencement of investigations against Mr Nadir by the Serious Fraud Office (SFO) in September 1990 and the subsequent failure of the Polly Peck empire in October 1990. Polly Peck was the business that Mr Nadir had built into a worldwide trading empire, which incorporated textiles, electronics, and fresh fruit and vegetable businesses including the brand Del Monte. The company was listed on the FT100 Index. Its collapse, owing *circa* half a billion pounds to creditors, eventually led to the bankruptcy of Mr Nadir.

Despite the on-going investigations of the SFO and consequent criminal proceedings there was never a restraint order put in place over Mr Nadir's assets and accordingly, on his bankruptcy, all of his global assets vested in his trustee in bankruptcy.

The history of the case

This has always been a contentious case and even prior to the appointment of my predecessors, Mr Nadir objected to Polly Peck's ability to vote for a trustee, disputing its claim in the bankruptcy. The joint trustees were eventually appointed but only after giving undertakings to the court that there would be no disclosure of any information gained by them to the SFO or to Polly Peck without first giving notice to Mr Nadir. In addition, any application brought by the joint trustees also had to be on notice to Mr Nadir. This order still remains in place today.

On appointment, the joint trustees were faced with claims from a small number of Mr Nadir's creditors that almost all of his assets were, in fact, already pledged to them. This was subsequently proved not to be the case. At the outset of the bankruptcy we took the step of obtaining a redirection of Mr Nadir's post, which led to the trustee having to account for his actions in the criminal proceedings as the judge presiding over Mr Nadir's criminal trial appeared unaware of the trustees' power in this regard.

Among the assets secured by the trustees at the outset of the investigation was an expensive watch worn by Mr Nadir, which was taken from him in one of his initial interviews. This led to the gift of

The man from Del Monte says...

another watch to Mr Nadir by Michael Mates, a junior minister, bearing the inscription 'Don't let the buggers get you down'. Michael Mates subsequently resigned. It was clear at the outset that Mr Nadir had supporters in both business and political life. It is widely reported that, at the time, Mr Nadir made substantial donations to the Conservative Party.

> "At the outset of the bankruptcy we took the step of obtaining a redirection of Mr Nadir's post, which led to the trustee having to account for his actions in the criminal proceedings as the judge presiding over Mr Nadir's criminal trial appeared unaware of the trustees' power in this regard."

Mr Nadir fled the jurisdiction in May 1993 by taking a private plane from an airfield in Hampshire bound for northern Cyprus. A self-declared territory, the Turkish Republic of Northern Cyprus is not recognised by the UK, and, therefore, has no extradition rights.

This was four months before the original criminal trial against him was due to commence and after disclosure orders were obtained against him in the bankruptcy. Mr Nadir remained an effective prisoner in northern Cyprus from then until his well publicised return to the UK in August 2010 (although I understand that during this period Mr Nadir has been able to travel relatively freely between northern Cyprus and Turkey where he also has influential friends).

Mr Nadir's return to the UK

Prior to his return to the UK, Mr Nadir reached an agreement with the prosecuting authorities to enable him to remain on bail pending his trial. However, he had failed to deal with the outstanding orders in the bankruptcy, which meant he was in contempt of court and therefore, in any event, potentially liable for imprisonment on his return to the UK. On his return I sought answers to many outstanding questions regarding numerous issues that Mr Nadir had failed to deal with prior to him fleeing the jurisdiction. Mr Nadir has provided a lot of information to me and this process, which was interrupted while his criminal trial took place, is ongoing.

On his return, the criminal trial recommenced with only 13 sample charges of theft bought by the SFO. All charges concerned funds that, it was alleged, were taken from Polly Peck by Mr Nadir. The trial lasted for seven months and in August 2012 the jury eventually found Mr Nadir guilty of all but three of the allegations. These counts of theft totalled £28.8 million. As a result, he has been sentenced to ten years imprisonment with the second half of the sentence to be served on licence. I understand that Mr Nadir is appealing his conviction.

The criminal trial had a direct impact on the bankruptcy in that the Conservative Party had previously stated that if Mr Nadir were found guilty of theft then they would return the donations previously made by Mr Nadir in the late 1980s. To date, donations of £440,000 have been identified and I am in correspondence with the Conservative Party on this issue.

There are now further proceedings against Mr Nadir as the SFO is making applications for compensation orders in favour of Polly Peck in respect of the sums taken from it, together with costs and interest. The figure being sought is £60 million. To the extent that a compensation order is made, it will not attach to any assets, but will require Mr Nadir to pay the compensation set out in the order. Failure to pay the compensation will result in Mr Nadir receiving an extended sentence. Clearly Mr Nadir cannot use assets vested in the trustee to meet any compensation order or assets that were acquired by him from any of the vested assets.

To put the criminal proceedings in some context, the applications brought by the SFO were in respect of a sample of the counts of which they were aware. Within the bankruptcy, while I have not yet formally admitted the claims of Polly Peck (see below) I am satisfied that I have received claims in excess £200 million that are sufficiently documented to be admitted. The administrators of Polly Peck believe that they have additional claims of maybe £100 million plus, which could be documented should it be commercially

> "The trial lasted for seven months and… Mr Nadir was found guilty of all but three of the allegations. These counts of theft totalled £28.8 million. He has been sentenced to ten years imprisonment with the second half of the sentence to be served on licence."

viable for them to do so. Accordingly, this suggests that much of the deficiency of Polly Peck relates to funds taken by Mr Nadir. In addition to the claims of Polly Peck, there are other creditors in the bankruptcy owed around a further £100 million; these are principally brokerage houses. These claims arose because in the final weeks of Polly Peck, following the publication of the SFO investigations, its share price plummeted and Mr Nadir attempted to prop up the share price by buying substantial shares himself. By the end of the stock exchange period, the share price was suspended and Mr Nadir was unable to settle his various accounts with brokers.

In early 2000, I attempted to make an initial distribution to creditors. I had to adjudicate on the claims of creditors including that of Polly Peck. This resulted in court proceedings with Mr Nadir who objected to my admitting Polly Peck's claim, as I assume he believed that the admission of their claim would have been tantamount to an acknowledgment that he had taken the funds. Unfortunately the legal proceedings that followed extinguished all available funds so the issue fell away and no dividend was paid.

Effect of convictions on bankruptcy investigations

While Mr Nadir was residing in northern Cyprus there was little that could be done to enforce his compliance with the bankruptcy procedures. Similarly there was little that I could do to repatriate assets found to have vested in the trustee. Now that Mr Nadir is in the jurisdiction and is likely to remain so for some considerable time, there is, for the first time, the opportunity to compel him both to provide information and, if appropriate, to repatriate assets vesting in the bankruptcy. Readers will appreciate that it would be inappropriate to set out full details of the ongoing investigations into Mr Nadir's assets. It is, however, a matter of public record that there are works of art formerly owned by Mr Nadir on the Arts Loss Register and limited enquires reveal Mr Nadir's interests in AN Graphics, a Turkish Cypriot media company, which publishes the newspaper *Kibris* in northern Cyprus. Clearly there are many other matters under investigation. Even Mr Nadir acknowledges that his family has wealth but maintains that he lives on their generosity together with that of many business associates. Specifically, a wealthy, Turkish business man is stated to have funded Mr Nadir's lifestyle while in the UK together with his bail surety.

Fugitive businessman Asil Nadir speaks to reporters outside his Mayfair home in August.

Additionally, now that Mr Nadir has been found guilty of taking funds from Polly Peck it would follow that those who assisted him in removing or concealing the funds may potentially be found criminally liable. Accordingly, I am now hopeful that assistance will be provided by people who previously have been unwilling or perhaps fearful of assisting with the trustees investigations. While Mr Nadir has now received his discharge from bankruptcy after some 20 plus years, his obligations to assist my investigation continue. What is clear among the many uncertainties in this case is that, in the absence of a settlement acceptable to Mr Nadir's creditors, the bankruptcy is likely to continue for some considerable time and, I suspect, in the same contentious way that it has to date.

> "Now that Mr Nadir is in the jurisdiction… there is… the opportunity to compel him both to provide information and, if appropriate, to repatriate assets vesting in the bankruptcy."

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Treading on eggshells: mental incapacity issues in bankruptcy

Roger Laville points out the pitfalls of dealing with bankrupts in this difficult situation.

The legislative landscape of mental incapacity law has changed significantly in the last decade. The effects of these changes are only likely to assume greater importance as they are fully explored by the courts, and the outcomes in the cases related below have been striking and, to many, unexpected.

It is important to remember that mental health conditions cover a wide spectrum of seriousness. At the severe end are grave mental health problems that require significant medical intervention. However, in other cases the conditions may be less severe, for example mild learning disability or depression, and may not even result in a lack of capacity at all. In each case, whether or not capacity is lacking will be a question for medical experts.

The law

Under English common law, where a party to a contract lacks mental capacity to enter into it, the contract may be voidable if it can be shown that the counterparty knew, or should reasonably have known, that the party lacked capacity. A contract that is voidable is valid but can be made void at the option of the incapacitated person.

For the purposes of this article, the principal statutes that deal with mental capacity issues are the Mental Capacity Act 2005 (the MCA) and the Equality Act 2010 (the EA). The MCA defines what constitutes a lack of capacity, and is primarily concerned with the management of the property and affairs of those who lack capacity. The court may appoint 'deputies' under the MCA to make decisions on behalf of persons who lack capacity.

The EA, which replaced, *inter alia*, the Disability Discrimination Act 1995 (the DDA), prevents discrimination against those with protected characteristics, such as mental and physical disability. The protections given by the EA include that public and private sector service providers and those exercising public functions must not discriminate against disabled people directly or indirectly and must make reasonable adjustments to prevent disadvantage to them.

Individuals with mental capacity limitations may become debtors. Indeed, the Office of Fair Trading Guidance for Creditors (September 2011) states, '*In some instances, it may constitute disability discrimination… to decline a borrower's application for credit on a presumption that he doesn't have the mental capacity to make a particular decision based solely on the knowledge that he has* 'a mental health problem'.

There are other statutes that legislate for mental health, including the Mental Health Act 1983 (the MHA), which provides for, among other things, the compulsory treatment of patients with a 'mental disorder'.

Mental incapacity in court proceedings

In civil proceedings (including insolvency proceedings), rule 21 of the Civil Procedure Rules (CPR) applies to any 'protected party' who lacks capacity to conduct the proceedings. Under CPR 21.3, no steps can be taken against a protected party without the court's permission until the appointment of a 'litigation friend' who can represent the protected party's interests in the proceedings.

> "The Insolvency Rules 1986 have their own provisions for incapacitated parties affected by insolvency proceedings. Under r7.44 the court may appoint a representative for the incapacitated person."

The Insolvency Rules 1986 have their own provisions for incapacitated parties affected by insolvency proceedings. Rules 7.43 and 7.44 apply to mentally and physically incapacitated persons who are incapable of managing and administering their property and affairs. Under r7.44 the court may appoint a representative for the incapacitated person.

CPR 21 and rules 7.43 to 7.44 overlap significantly, but there are differences. Rule 7.44 covers physical as well as mental disabilities but it also limits the classes of people who can make an application. Under CPR 21 other parties to the proceedings can apply for a litigation friend to be appointed.

Often a person's litigation friend (or representative under r7.44) will be a family member or friend. However, in cases where no other suitable person can be found to act as a litigation friend, a public official called the Official Solicitor may agree to take the role. The Official Solicitor may then instruct a firm of solicitors to act for the incapacitated person in the proceedings, although before doing so he or she will ensure that the legal costs can be met.

A deputy appointed under the MCA has the power to discharge the person's debts, but the MCA does not impose a regime for dealing with creditors' claims where the debtor is insolvent. There can therefore be the need for those with mental incapacity to be made bankrupt. It has long been established that mental incapacity is not, in itself, a bar to a bankruptcy order; see *Re A Debtor (No 1 of 1941)*[1], in which it was also held that a receiver appointed by the Court of Protection before the bankruptcy will have priority to the estate.

Haworth v. *Cartmel*[2]

Ms Haworth suffered from a longstanding mental illness and at all relevant times was supported by state benefits. She began showing and breeding Arab horses, and by 1995 this had become a business. She owned at least 24 horses.

In August 2005 HMRC was sent an anonymous letter informing it that Ms Haworth was not declaring her income of 'in excess of £100,000' per annum. This letter resulted in HMRC raising a determination for back tax of over £192,000. HMRC wrote to Ms Haworth to demand this sum, but received no immediate response from her, although in due course her mother became involved and told HMRC of Ms Haworth's mental health problems.

In May 2008, HMRC served a statutory demand on Ms Haworth. The demand was handed to Ms Haworth in an envelope, but (the judge found) she did not open it or read the demand. In July 2008, Ms Haworth was served with a bankruptcy petition. This was not in an envelope but Ms Haworth had no recollection of receiving it. Two days later, Ms Haworth was admitted as an in-patient at a mental health unit.

Ms Haworth was subsequently made bankrupt and a trustee in bankruptcy was appointed. Litigation ensued about title to the horses and costs of over £380,000 incurred in the bankruptcy. However, in due course it was accepted by HMRC that no back tax was due from Ms Haworth.

In 2009, she made an application to annul and/or rescind the bankruptcy. The application was based on the DDA and argued that HMRC should not have discriminated against Ms Haworth and failed to take steps to make reasonable adjustments to its procedures in order to take account of her disability.

The application was heard by His Honour Judge Pelling QC in the Manchester District Registry. The judge found as a matter of fact, based on the expert evidence, that Ms Haworth suffered from 'a phobia that prevented her from opening her mail', did not read the statutory demand and had no capacity to understand the petition or the bankruptcy proceedings.

These findings engaged the DDA, and the judge held that by (a) failing to inform Ms Haworth's mother about the bankruptcy; after proceedings; medical report; procedures; (b) not seeking a medical report (c) not considering alternative enforcement procedures; and (d) failing to draw the court's attention to Ms Haworth's lack of capacity at the hearing of the petition, HMRC had discriminated against Ms Haworth. He therefore annulled the bankruptcy and ordered that HMRC pay the trustee's assessed remuneration and expenses. The question of whether the trustee herself had discriminated against Ms Haworth was expressly unresolved.

The Marquis de Louville de Toucy[3]

The Marquis de Louville de Toucy (the Marquis) had purchased antiques from the auctioneers Bonhams and owed them around £20,000. Eventually Bonhams obtained judgment against the Marquis in contested litigation and commenced bankruptcy proceedings. Shortly afterwards, the Marquis attempted suicide and was detained as a patient under the MHA. A contemporary medical report recorded that the Marquis was unable to manage his own affairs.

No litigation friend was appointed in the petition proceedings. Nonetheless, although the Registrar was informed of his lack of mental capacity at the time, the Marquis was made bankrupt at the hearing of the petition.

Subsequently, the Marquis's former solicitors were granted legal aid and the Official Solicitor became the Marquis's litigation friend. The Official Solicitor applied to court to annul, rescind and appeal the bankruptcy. The matter eventually came before Mr Justice Vos in the High Court. Evidence was presented at that hearing, and accepted by the judge, that the Marquis was balance sheet solvent at the time of the petition hearing. Vos J then went on to decide whether the bankruptcy order should have been made in light of the Marquis's lack of capacity.

> "Where a trustee in bankruptcy becomes aware that a bankrupt has mental health problems, he or she should address the issue, possibly with the court, at the earliest possible stage so that irrecoverable costs are minimised."

He held that the Registrar should have realised that (a) the Marquis was incapacitated and did not understand that he had been served with a petition or its after effect; (b) his affairs were complex and he could not deal with them. Thus, she could not have been sure that his debt could not be discharged from his assets.

The Registrar should have adjourned the hearing to allow a representative or a litigation friend to be appointed. If she had, the representative might have arranged for the appointment of a deputy under the MCA and discharged the debt to Bonhams. The appeal against the bankruptcy order was therefore allowed.

Observations

In both of these cases, the approach of the debtors may have resulted in their creditors having little sympathy for their position. Many incapacitated debtors unfortunately fail to engage in the process and some may actively avoid their obligations.

A number of practical points emerge:

- While bankruptcy of the mentally incapacitated is still not impossible, it should be approached with a high degree of caution.
- There will be significant scope for unscrupulous debtors to plead the 'Saunders defence' by claiming mental health problems, which they do not actually have. In some cases, even the suggestion of mental incapacity will make some debts unenforceable through bankruptcy on a practical level.
- Petitioners may have a duty to inform the court if they know that a debtor has mental health problems. Where no other person is able to represent a debtor, consider contacting the Official Solicitor proactively, especially where there are assets in the estate to pay for representation.
- Where a trustee in bankruptcy becomes aware that a bankrupt has mental health problems, he or she should address the issue, possibly with the court, at the earliest possible stage so that irrecoverable costs are minimised. A trustee cannot always be confident that his or her costs will be covered if the bankruptcy is annulled.
- It is important to consider whether the petition debt arose from a voidable transaction.
- The protections given to the incapacitated bankrupt will not only apply in the petition proceedings. They will also apply in any proceedings brought by the trustee against the bankrupt after the bankruptcy order.

Conclusion

It may be conjectured that significant financial problems and mental health difficulties often go hand in hand, with one exacerbating the other. However, the bankruptcy process in most cases works because it is carried out at low cost by creditors, the courts and The Insolvency Service, who often follow standardised procedures with limited discretion in individual cases.

The *Haworth* and *de Louville* decisions, which might force participants to incur time and cost to address difficult issues, are at complete odds with this culture, and their ramifications may be profound.

References

1 [1941] Ch 487

2 *Nicola Jane Haworth* v. *(1) Donna Cartmel and (2) The Commissioners for HM Revenue and Customs* [2011] EWHC 36 (Ch)

3 *Marquis Francois-Eudes de Louville de Toucy* v. *(1) Bonhams 1793 Limited (2) The Official Receiver* [2011] EWHC 3809 (Ch)

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COMI tourism: Ireland fights back

William Day outlines the new Irish Personal Insolvency Bill, alternative routes for debtors and a way in which fleet-footed creditors can obtain justice.

Since the collapse of the Celtic Tiger era, an increasing number of individuals have left Ireland in order to have themselves declared bankrupt in the UK and elsewhere, the key attraction being a chance to emerge from bankruptcy within 12 months of adjudication. Recent case law and the introduction of new legislation indicate that this exodus is now set to slow down significantly.

The Personal Insolvency Bill 2012 (the 2012 Bill), introduced at the insistence of the EU/IMF and currently progressing through the various stages of Irish legislative approval following publication in June 2012, provides for significant changes to the Irish personal insolvency regime, as currently governed by the Bankruptcy Act 1988 (the 1988 Act). Chief among these changes are the reduction of the period for automatic discharge from twelve to three years and the introduction of three new debt resolution processes, namely debt relief notices (DRN), debt settlement arrangements (DSA) and personal insolvency arrangements (PIA).

Changes to the Bankruptcy Act 1988

The 2012 Bill proposes the following changes to the 1988 Act:

- The period for automatic discharge from bankruptcy is to be reduced from twelve to three years. There is a provision for the High Court to extend this period up to eight years where the court is satisfied that a bankrupt has either *'failed to co-operate with the official assignee in the realisations of the assets of the bankrupt'* or *'hidden from or failed to disclose to the Official Assignee income or assets which could be realised for the benefit of the creditors of the bankrupt'*.
- Bankruptcy will only be available where a debtor's liabilities are over €20,000.
- Bankruptcies that have been in existence for more than three years at the time the Personal Insolvency Act commences will be automatically discharged following a further six-month period.

> Chief among the changes [introduced by the new Bill] are the reduction of the period for automatic discharge from twelve to three years and the introduction of three new debt resolution processes.

- The circuit court will be enabled to make a 'bankrupt payment order'. Such an order may require a bankrupt to make payments to the official assignee or the trustee in bankruptcy from their income or other assets for the benefit of their creditors after the discharge from bankruptcy. This applies for a period of up to five years.

Non-judicial personal insolvency procedures

While ultimately remaining under the jurisdiction of the Irish courts, the proposed debt resolution procedures are largely non-judicial, the overseeing of which it is envisaged will be carried out by an independent body known as the Insolvency Service, the establishment of which is provided for in the 2012 Bill. Applications for these mechanisms will be made through a personal insolvency practitioner (PIP).[1] The 2012 Bill provides that PIPs will be regulated by a person designated by the Minister for Justice and Equality.

Debt relief notices

An insolvent individual with unsecured debts of up to €20,000 and very limited means[2] may apply through an 'approved intermediary' to the Insolvency Service for a DRN. The debtor must be resident in Ireland normally or have lived/had a place of business in Ireland for one year. They must be insolvent with no likelihood of becoming solvent within five years, while also maintaining a reasonable standard of living for themselves.

A DRN will not apply where 25 per cent or more of the debtor's qualifying debt was incurred within six months of the application for a DRN. It would seem that this provision is in contemplation of a situation where an individual opts not to pay debts in order to avail themselves of a DRN.

The effect of a DRN

Once a DRN has been issued, for a period of three years (the protection period) a debtor is insulated from legal proceedings in relation to their debts, whether or not already initiated. A debtor may be removed from the Register of Debt Relief Notices during the protection period if a repayment of at least 50 per cent of the value of the specified debts is made to the Insolvency Service. If the debtor is unable to pay the debt at the end of the protection period, the debt will be written off.

Debt settlement arrangements

A DSA system is proposed to enable an insolvent individual with unsecured debts to make, through a PIP, settlement proposals to one or more creditors for payment of debt over a period of five years, with a possible extension of a further year. While the 2012 Bill does not provide for any minimum threshold, it is expected that this process will be triggered by unsecured debt of amounts greater than €20,000.

Undischarged bankrupts, debtors subject to a DRN or PIA, and debtors who are the subject of a 'protective certificate' within 12 months prior to the DSA proposal, are all precluded from applying for a DSA. In addition, the debtor may not be eligible to apply for a DSA if they have, during the two years prior to their application, either transferred assets to a third party at an undervalue or preferred one of their creditors.

A DSA may be made with one or more of the debtor's creditors. The PIP notifies the Insolvency Service of the debtor's intention to propose a DSA and applies for a protective certificate. Following the issue of a protective certificate, the PIP invites and considers submissions from the relevant creditors regarding the manner in which the debts should be dealt with under the DSA. If a proposal is approved by at least 65 per cent in value of creditors voting at a creditors' meeting and is subsequently approved by the appropriate court on notification by the PIP (the circuit court if the total liabilities of the debtor are less than €2.5 million, or otherwise, the High Court), it will become binding on all creditors and will be registered by the Insolvency Service.

Effect of a DSA

While a DSA is in force, creditors will be unable to take actions regarding their debts against the debtor but can continue to recover the debts from a guarantor. At the end of the DSA, the debtor is discharged from the debts specified under the arrangement.

Personal insolvency arrangements

Designed to cover secured and unsecured debt, a PIA will allow for settlement of debt by an insolvent individual over a six-year period (with a possible extension to seven years), provided that at least one creditor involved is a secured creditor and the aggregate secured debts do not exceed €3 million (unless all secured creditors agree to waive this limit).

A protective certificate can be issued by the Insolvency Service for a period of 70 days with a possible extension for a further 40 days in certain circumstances. Following grant of a protective certificate, the PIP invites submissions from all creditors regarding how the debts due to them may be dealt with in the PIA. A PIA must be approved at a creditors' meeting by at least 65 per cent in value of actual votes cast at the meeting as a whole (whether secured or unsecured creditors) and by (i) more than 50 per cent in value of secured creditors and (ii) more than 50 per cent in value of unsecured creditors, and subsequently approved by the appropriate court on notification by the PIP, before it will become binding on all creditors.

Effect of a PIA

Where granted, the effect of the PIA is similar to that of a DSA. Significantly, a secured creditor will be unable to take any steps to enforce or recover its security during the period of the PIA.

Recent case law

It is clear that the proposed debt settlement mechanisms should go some way towards resolving the most straightforward cases of personal insolvency, particularly in relation to consumer debt. However, the door to traditional legal procedures is not fully shut. It still remains that the failure by a debtor and his or her creditors to agree to a suitable non-judicial debt settlement, or the challenge by a creditor to the issuance of a DRN, DSA, PIA or protective certificate leaves open the option of debt enforcement or judicial bankruptcy.

> "The 'first in time' rule will mean that a secured creditor who rushes in first will secure jurisdiction and defeat any arguments relating to COMI having been established by the debtor in another jurisdiction."

While at first glance it may seem unlikely that the attractiveness for an insolvent Irish individual to move their centre of main interest (COMI) to the United Kingdom to avail themselves of the possibility of discharge from bankruptcy after one year has lost much of its sheen, two recent cases suggest COMI migration is becoming much harder to achieve.

In January of this year, the Irish High Court in *Danske Bank trading as National Irish Bank* v. *NMcF*[3] ruled that where there is a dispute between parties as to the issue of COMI in circumstances where the courts of two contracting states to Council Regulation EC No 1346/2000 (the Insolvency Regulation) concurrently claim jurisdiction in accordance with article 3(1) thereof, the court first seised of the issue should proceed to deal with the issue and the courts of the second state should stay proceedings until the decision of the first court has been made. In effect the 'first in time' rule will mean that a creditor who rushes in first will secure jurisdiction and defeat any arguments relating to COMI having been established by the debtor in another jurisdiction pending a full judicial determination of COMI in that jurisdiction.

A decision of the Chancery Division in Northern Ireland, *Irish Bank Resolution Corporation Limited* v. *Quinn*[4], also of January of this year, provides an instructive consideration of the definition of 'centre of main interest' in the context of the Insolvency Regulation. In annulling a bankruptcy order obtained by Sean Quinn in that jurisdiction, the Belfast High Court found that that the centre of Mr Quinn's main interests was not in Northern Ireland at the time of bringing the bankruptcy petition but within the jurisdiction of the Irish High Court. Central to this conclusion was the court's analysis of recital 13 to the Insolvency Regulation, which provides that COMI should correspond with the place where the debtor conducts the administration of their interests on a regular basis and is therefore ascertainable by third parties. The court noted, in this regard, that while no obligation falls on a debtor to advertise their COMI – nor may they hide it. The court pointed to a number of factors that dictated that Mr Quinn's COMI had not moved to Northern Ireland, ruling that even if Mr Quinn had an office in Northern Ireland it was not sufficiently or reasonably ascertainable by third parties. This decision, which is consistent with the *Eurofood IFSC*[5] decision, was later confirmed by the High Court in Ireland. It is clear then that COMI should be ascertainable by a reasonably diligent creditor and disingenuous attempts to move COMI to another jurisdiction will not be entertained.

In short, Ireland will soon provide individuals with more practical alternatives to bankruptcy, the possibility of a quicker route out of judicial bankruptcy and, where an individual seeks to shift their COMI out of Ireland, the possibility for those who move quickly of having COMI adjudicated upon in Ireland.

References

1. In the case of a DRN the application will be made through an 'approved intermediary'
2. Net disposable income of €60 or less a month and assets calculated to be worth less than €400
3. Judgment of Ms Justice Dunne delivered 21 September 2011
4. *Irish Bank Resolution Corporation Limited* v. *Quinn* [2012] NICh 1
5. Case C341/04, ECJ 2/5/2006

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Sequestration: the same but different

Rachel Grant explains the differences between English and Scottish law in personal insolvency.

Bankruptcy in Scotland and England is broadly similar in substance and the main differences are procedural. Bankruptcy in Scotland is governed by the Bankruptcy (Scotland) Act 1985 and is devolved to the Scottish Parliament. Sequestration is the Scottish equivalent of bankruptcy although the terms are interchangeable.

Debt solution	1st quarter of 2012/13	% change on 4th quarter of 2011/12	% change on 1st quarter of 2011/12
Protected Trust Deeds	2,291	2.0%	-3.4%
Sequestrations	3,310	26.0%	12.3%
• by debtor application	2,915	36.1%	18.5%
• of which LILA	1,563	47.5%	19.8%
DAS	1,478	56.9%	129.9%

The sequestration process

The debtor's estate vests (with exceptions) in the Trustee in Sequestration who can be the accountant in bankruptcy (AIB)[1] or an IP. The trustee ingathers the debtor's estate and pays creditors. The debtor has a duty to co-operate with the trustee and is subject to restrictions, including the ability to obtain credit and hold certain positions. The debtor is automatically discharged from his or her pre-sequestration debts after one year, unless there is deferment of discharge or a Bankruptcy Restriction Order or a Bankruptcy Restriction Undertaking. The trustee remains in office to complete his duties.

Despite the debtor's discharge he or she must still co-operate with the trustee and can be required to make contributions from income beyond the discharge period for up to three years. The debtor's assets remain vested in the trustee and do not re-vest in the debtor. However, the debtor's home will re-vest in the debtor if not dealt with by the trustee within three years.

Access to seqestration

Access to bankruptcy is not unfettered. One threshold is the level of debt: £3,000 for creditors and £1,500 for debtors in Scotland compared with £750 for all applications in England and Wales.

Despite the higher financial threshold, debtor access to sequestration has been extended. Debtors can access low income low asset (LILA) sequestration if criteria relating to income, assets and debts are satisfied. In England, Debt Relief Orders are an alternative to bankruptcy for those with low levels of debt. In Scotland debtors can also obtain a Certificate for Sequestration from 'an authorised person' (such as an IP) confirming inability to pay debts as they become due, which allows the debtor to apply for sequestration.

Creditor applications are made to the local sheriff court and all debtor applications are made to the AIB. Similar changes are proposed for England and Wales.

Sequestration is cheaper in Scotland: £200 for debtor applications and £195 for creditor petitions (including court dues), compared with £700 and £920 in England.

Court application

Creditors applying to court must first establish the 'apparent insolvency' of a debtor, usually by relying on an expired statutory demand or a decree (judgment) and expired charge for payment. The court fixes a sequestration hearing. On cause shown, an interim trustee can be appointed

"The recent Scottish consultation[2] proposes some interesting changes."

immediately to take control of the debtor's estate. Sheriff officers serve the petition personally on the debtor. A debt advice and information pack is also provided to debtors. At the hearing, provided everything is in order, the court will award sequestration and appoint a trustee unless the debtor pays or provides security for the debt. The hearing can be continued for up to 42 days for payment or where a debt arrangement scheme (DAS) has been or will be applied for.

The date of sequestration is backdated to the warrant to cite date, which can cause practical problems if the debtor continues to deal with his estate between warrant to cite and award of sequestration.

Trust deeds and debt arrangement schemes

Alternatives to sequestration are trust deeds or DASs. A trust deed is a voluntary deed by a debtor conveying his assets to a trustee to administer for the benefit of creditors. Provided the trust deed satisfies certain statutory conditions and procedures it becomes a protected trust deed (PTD) which binds all creditors. Most trust deeds become PTDs. A trust deed usually lasts for three years and is roughly equivalent to an IVA although the basis and structure are fundamentally different. A DAS is a debt payment programme for repayment of debts over a period of time during which enforcement action by creditors is prevented.

Increased regulation of trust deeds, easier access for debtors to sequestration, reduction in the period of sequestration and the introduction of debt relief to DASs has affected debtors' choice of debt solution. Trust deeds, once viewed as an attractive flexible alternative to sequestration are becoming less popular while sequestration and DAS numbers are increasing. The question as always for creditors is whether the system is too debtor friendly.

Changes ahead

The recent Scottish consultation[2] proposes some interesting changes although it is of concern that the difficult and sensitive issue of the family home has been excluded from the consultation. The Scottish government wants 'appropriate, proportionate, debt management and debt relief mechanisms'. It also recognises debt solutions must be fair to both debtors and creditors. It remains to be seen whether the changes suggested will achieve this. □

[1] Accountant in Bankruptcy is an Agency of the Scottish Government in terms of the Scotland Act 1998. The Chief Executive is also The Accountant in Bankruptcy (the Accountant), who is an independent statutory officer appointed under section 1 of the Bankruptcy (Scotland) Act 1985, as amended.

[2] Consultation on Bankruptcy Reform, The Scottish Government, February 2012. Consultation – Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up November 2011.

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Making sense of the personal insolvency statistics

Ed Thomas examines the statistics and underlying trends.

The latest personal insolvency statistics held no great surprises. The rate of formal personal insolvencies (especially bankruptcies) continues to decrease and it appears that Debt Relief Orders (DROs) remain on the increase. Of course, if one perceives the DRO as a 'poor man's bankruptcy', one trend is a direct result of the other.

Equally predictable, following an unsettled period of debate between providers and creditors, Individual Voluntary Arrangements (IVAs) seem to have flattened out at around 45,000 to 50,000 a year; no great surprises.

What does the future look like?

So what patterns are emerging and what conclusions can we draw now and for the future? Are we seeing more debtors who are hopelessly insolvent, with no assets and no disposable income to meet their indebtedness; or are we just seeing a greater awareness, among the (younger) indebted, of the still relatively new DRO procedure?

The latest statistics on bankruptcy petitions reveal that creditors appear more wary of issuing petitions, perhaps based on the fact that many debtors are of insufficient net worth to pursue. For many of the preceding years the percentage of debtors' petitions was consistently around 85 per cent of the total, and many of those entering bankruptcy themselves would have been consumers, living beyond their means with no assets, or had no disposable income.

> "Unemployment rates, public sector austerity measures, diminishing house prices, the scarcity of high loan-to-value (re)mortgages, inflation and perpetually low returns on investments are all contributory factors in pushing people over the edge."

Recent numbers of Income Payment Agreements/Orders also demonstrate a decrease in those able to dip into disposable income to contribute to their bankruptcy estate.

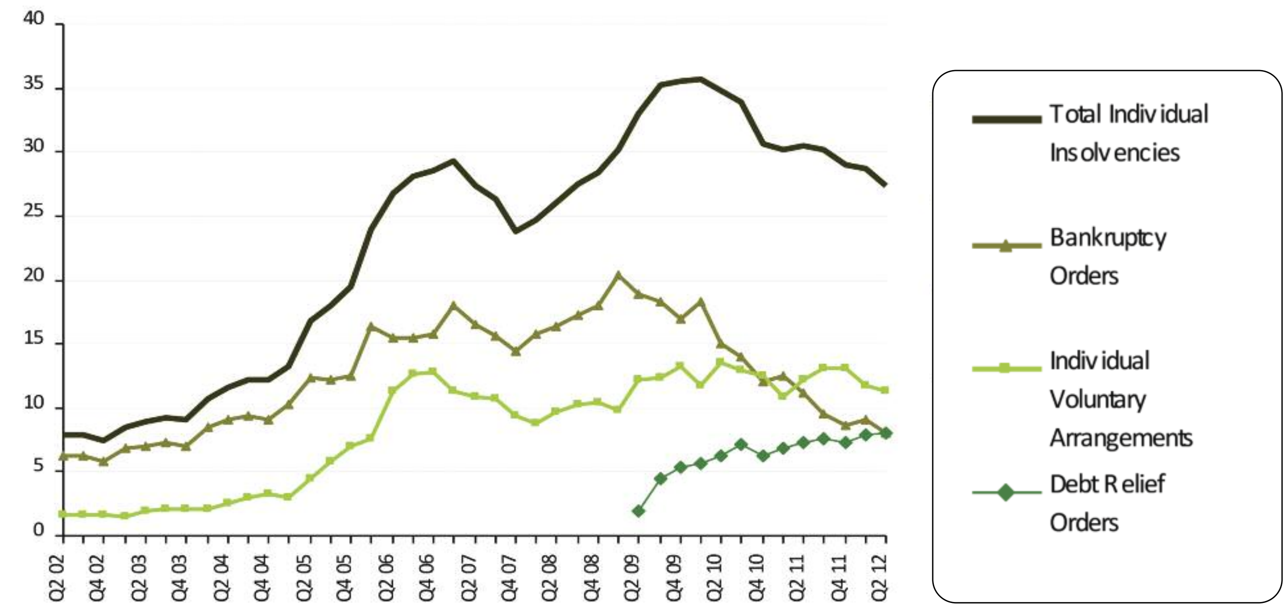
The insolvency rates in economically challenged regions (particularly rural coastal areas) have spiked in the wake of seasonal high unemployment and regional low pay rates. Indeed the percentage of lowest income (often claimant) groups in the insolvency totals are beginning to increase.

Demographically, the over 65s are beginning to account for a greater proportion of the personal insolvency numbers, as low interest rates on savings and underperforming pension funds sap their income, or what's left of it after the kids and grandkids have been bailed out.

So the general conclusion might be that there is progressively less prospect of recovery for creditors via formal personal insolvency procedures.

Individual insolvencies in England & Wales

Thousands, not seasonally adjusted



Source: Insolvency Service

Beyond the statistics

But that only deals with the statistics for the formal insolvency procedures. The significant number of informal debt arrangements cannot be ignored and this (statistically vague) mass of debt relief can only result in largely under informed conclusions being drawn about what is really happening in 'debtorland'.

Estimates of the number of current, informal debt arrangements range greatly from 120,000 to 2,000,000. These arrangements will involve debtors spanning the full spectrum of socio-economic groups and as a result, to put a finger exactly on what is driving personal insolvency patterns is extremely difficult. Behaviour in a distressed situation often does not conform to a pattern.

With the UK economy in retreat, recently there appears to be generally less income and property equity available to service debt. Unemployment rates, public sector austerity measures, diminishing house prices, the scarcity of high loan-to-value (re)mortgages, inflation and perpetually low returns on investments are all contributory factors in pushing people over the edge.

However, each debtor is a human being with their own varied ability to recognise the financial mess they are in, to source help and information to enable them to assess the options available to them and then to act proactively. The millions of debtors will move (and be moved by creditors and advisors) in myriad different ways and not always in the best direction (as the growth of the payday loans industry might indicate).

> "Debt sale and purchase seems to be on the move again and the flushing through of acquired debt portfolios will undoubtedly see a spike in creditor-driven insolvency processes and more debtors having to take positive action in the face of proactive collection."

A debt culture

There seems to be a growing recognition of over-indebtedness, an emerging culture of responsible lending and borrowing, even a culture of servicing debt and saving alongside a willingness to address the issues faced by many who simply lived beyond their means.

But for those who still have their heads firmly in the sand the inevitable 'trigger event' will soon arrive, if not from their original creditor, from those who have acquired the debt.

After a slow period of uncertainty between buyers and sellers, debt sale and purchase seems to be on the move again and the flushing through of acquired debt portfolios will undoubtedly see a spike in creditor-driven insolvency processes and more debtors having to take positive action in the face of proactive collection.

During the recession in the early 1990s there was a two- to three-year lag before a marked increase in personal insolvencies. In the current recession, the period covering the rise and fall in personal insolvencies seems to have been somewhat more elongated as the diverse debtor population seem to take their time in dealing with their equally diverse indebtedness formally, or informally – the latter option obviously being something that was, of course, far less prevalent in the 1990s. □

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Regulating the unregulated: introducers

Samantha Hawkins points out the dangers of IPs making payments to introducers and failing to disclose them.

The pre-1986 'good old days' are gone when an IP would be lauded as suitably 'commercial' if he or she dealt with or disposed of assets to achieve a desired outcome, irrespective of ethics and existing law. Business and commerce are more compliant in their approach now than they have ever been and, for IPs, the 1986 Act regulated our profession to an organised, professional group of commercial but highly compliant practitioners.

Being an IP remains a rewarding position and it is not an exclusive club. Anyone can seek to join but there are substantial barriers to entry founded on law and education with a high degree of ethical and judgmental responsibility attached to the role.

Referral fees

So with this in mind, why would an IP even consider not disclosing a referral fee, paid by a debtor to an 'introducer' at any stage of the debt advisory process? Generally, an introducer works in the unregulated personal debt advisory arena and, beyond giving what is often poor advice or otherwise acting negligently, has little in terms of regulation to consider. Any payment or benefit they derive for their service though is subject to scrutiny.

Introducers may quickly establish when an IP is required. However, by design or otherwise, the debtor may be strung along trying alternate rescue or debt mitigation plans. The introducer will of course seek a fee for their services, prior to the inevitable introduction to an IP. It is not unknown that introducers may encourage or allow debtors to withdraw cash on a credit card to pay the introducer's fees.

The result can be that a vulnerable individual has received unregulated, inconclusive, advice and by doing so (and paying the introducer's fee) has increased their creditors and risked a BRO offence under schedule 4A(h) of the Act. If the debtor then enters into an IVA, or petitions for their own bankruptcy, any payment to an introducer must be disclosed and only if value to the creditors was added by the introducer will this not amount to a transaction at undervalue (TUV). This may appear harsh to an introducer who may have expended time and effort on behalf of a debtor – but has not improved the position of the creditors in doing so.

R5.3(2)(c)(iii) requires any potential TUV to be disclosed in the IVA proposal. Where the debtor is an undischarged bankrupt and has paid a bankruptcy assistance company this should also be disclosed. Further, if entering a protocol compliant IVA, paragraphs 4.1 and 4.2 require transparency and disclosure of all attempts to deal with the debt and any payments made in respect of attempting to deal with the debt.

SIP3

Statement of Insolvency Practice 3 (SIP3), as agreed by the Joint Insolvency Committee and our regulatory bodies, sets out the principles by which IPs are expected to comply. The terminology makes it clear this is an imperative, not a choice. SIP3 paragraph 4(3)(a)(xviii) states disclosure of any TUV is required, therefore if a debtor has used their credit card to pay an introduction fee and not disclosed this, this may amount to a material irregularity and a ground for challenge of an approved IVA.

> "A number of IPs might bring a joint claim under a Group Litigation Order allowing stakeholders to be represented under one action."

A TUV is defined under s339 of the 1986 Act as a transaction for significantly less or no value made within a relevant time. The court can make such order as it sees fit (principled on the doctrine of restitution) to restore the position that existed before the TUV was entered into. This provision is not available to the supervisor and, in the event of a failure of an IVA and subsequent bankruptcy, there may be limitation period exemption under the 1986 Act.

Consequently, in the event of bankruptcy by a supervisor, or a debtor's petition during the currency of an IVA, there may also be claim against the introducer. This claim may be relatively small and non-viable on an individual claim basis. However, a number of IPs might bring a joint claim under a Group Litigation Order (GLO) allowing stakeholders to be represented under one action. For example, if you have 20 debtors who have all paid £2,500 for assistance in completing a debtor's bankruptcy petition, the respective 20 IPs could form one cohesive group represented under one GLO action.

Another solution may be to inform HMRC and/or the large voting houses to look for a disclosed TUV in a proposal and either reject the arrangement or propose a modification that the introducer pay the fee back. This approach is reliant on the disclosure, however, and, given no IP wants to see a proposal fail, might be problematic as this opens up fit, fair and feasible issues for the IP who should not be presenting an IVA which is not fair and viable.

IPs must be vigilant

The problem, though, can be with 'tame' IPs, nurtured and used by introducers who know the fee will not be disclosed in a proposal. It is for the IP to be vigilant as to the source of the referral. When placed in this position, the IP might not only flout the Act, Rules and Guidelines but will be distorting fair competition between IPs, again to the detriment of creditors.

Introducers may take the opposite view: that IPs charge substantial fees for the service rendered. This ignores the highly regulated environment the IP acts within, mandated to act in the best interest of the client and all stakeholders to whom the IP owes a wider duty of care. Case law in the area of IVAs establishes the courts will agree a fair nominee fee given the training, education and experience all IPs have. Whereas, extracting a fee when knowing or suspecting you cannot realistically help the debtor out of his problems, or charging £2,000 to £3,000 to complete a debtors' bankruptcy petition, is not fair, ethical or adding value to the creditors and remains challengeable as a TUV.

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Ten practical lessons from the *Farepak* statement for litigating IPs

After a damning statement from the judge in *Farepak*, **Chris Harlowe** and **Tom McLachlan** caution that litigation should not be embarked upon lightly.

Farepak's collapse into administration in October 2006 attracted widespread media coverage due to the nature of its business: a savings scheme allowing families to smooth Christmas costs by putting aside a sum each month, which was to be exchanged for vouchers shortly before Christmas. Farepak's total deficiency was £37 million, which was owed to 114,000 creditors, who were mainly low income families. Most media coverage blamed the directors for the collapse.

There matters might have rested, but for a remarkable statement given by Peter Smith J following the collapse of the Secretary of State's directors' disqualification proceedings in June 2012. The Secretary of State withdrew the disqualification application mid-trial (having presented all of his evidence, over 14 days), when it seems to have been appreciated for the first time that the application was hopeless. The judge took the unusual step of making a statement following the withdrawal, as he felt it was important for Farepak's creditors to understand what the evidence had revealed regarding the cause of Farepak's collapse.

The judge's statement completely exonerated Farepak's directors, while excoriating HBoS and the conduct of the case by the Secretary of State.

However, the aim of this article is not to dwell on the facts of that case, but to draw from the judge's statement some of the broader points and identify the risks that apply to all litigation, particularly when conducted by office-holders.

Ten practical lessons

1. Office-holders' cases are, of their nature, based on a retrospective interpretation of events. However objectively reasonable your conclusions might be, remember that they could still be incorrect. It is important to test your interpretation against the evidence you have obtained using your statutory powers of investigation – does any of that evidence contradict your conclusions? Are those contradictions sufficiently compelling to cast doubt on whether the claim can succeed? It is easy to be driven forward by your initial interpretation, but you must remain objective. If the doubts thrown up by the evidence are serious, save yourself costs (and face) by being prepared to drop the case before proceedings are issued.
2. Be absolutely clear in identifying the claims you will pursue, and in identifying the legal requirements you will have to meet to succeed in them.

> "The judge's statement wholly exonerated Farepak's directors, while excoriating HBoS and the conduct of the case by the Secretary of State."

In his *Farepak* statement, Peter Smith J commented: *'What was particularly surprising was the fact that the Secretary of State, whilst saying what the defendants did was of such a poor quality that they were unfit to be directors, was unable to point to any other steps that they could have done to try and save the company.'* (paragraph 33).
This suggests that the Secretary of State lost sight of what he was trying to prove, and implies that the failure of his case had its origins in this failure to identify at the outset specifically what he was asserting the Farepak directors should objectively have done differently, and how they failed to meet the objective standards expected of them.

3. Having identified your claim, use the available evidence as economically as possible. The Secretary of State's lead affidavit in the *Farepak* application ran to 1,087 paragraphs over 435 pages, with '*thousands of pages of exhibits*'. Unnecessarily large documents create the impression of having 'thrown everything in' in the hope that the case will make itself. Peter Smith J deprecated the use of such lengthy affidavits, primarily because they carried the risk of '*overwhelming*' the respondent, limiting his ability to challenge the evidence in any

meaningful way. If litigation is the art of winning the judge's heart and mind, brevity and conciseness are the way to get there.

4. Make sure that every witness who signs or swears a witness statement or affidavit actually knows what is in them – it is their evidence. This may sound obvious, but in *Farepak* the judge referred to: '*…instances, for example, of the following. First, witnesses were only being shown selective parts of defendants' affidavits; second, witnesses… not being shown relevant documents; third… large exhibits were assembled without the witnesses either ever having read them or even having understood the significance of them. To give… Mr Kelly* [of HBoS] *700 pages and then have him sign the affidavit a week later was a daunting task by any stretch of the imagination... to ask him to see and analyse the significance of those documents in relation to events six years ago is a daunting task.'* (paragraph 58). He continued: *'Witnesses were... presented with their affidavits which they perused briefly and ultimately signed. They swore to them and they of course all verified them in giving evidence in this case, but it is completely unhelpful, for example, to have a single exhibit running to 700 plus pages appended to an affidavit which a deponent does not really understand and which does not tell the defendants what is the purpose of the large exhibit.'* (paragraph 44).
This way of presenting the evidence for the Secretary of State completely backfired: some witnesses withdrew parts of their signed or sworn statements or affidavits, and one critical witness from the bank was forced to accept that his criticisms of the directors' conduct were entirely unjustified when tested against the available evidence.

> "Make sure that every witness who signs or swears a witness statement or affidavit actually knows what is in them – it is their evidence."

5. Never start proceedings, in the hope of provoking a settlement, without any real intention of going to trial. This carries a real risk that your bluff will be called and, if it is, you will have to face a humiliating and expensive climb down. Litigation is not a game of poker: it is played out in a public forum, in front of an impartial arbitrator and with your opponent trying to trip you up at every step. The judge in *Farepak* implied that this might have been part of the Secretary of State's tactics: having persuaded two directors to give undertakings, he might have hoped to persuade the remainder to do likewise by issuing proceedings. As the judge noted, even where a case is launched with the intention of settling, the pleadings and evidence should be drafted on the basis that they will face the full scrutiny of a trial.

6. Remember that as you were not involved at the time, much of your evidence will be hearsay, or secondary evidence, and that you must be prepared to go into the witness box to explain and defend it. If you don't, adverse inferences will be drawn. Peter Smith J pointed out that: '*… when a... hearsay statement is put forward but there is no reason provided as to why that person cannot give evidence* [in the witness box, subject to cross-examination], *the inference usually drawn is that that person is not called because he will not support the case that is being put forward.'* (paragraph 74).

7. If you do go into the witness box to give evidence, remember that cross-examination is brutal and unpleasant. As Peter Smith J commented: *'Nobody knows what an ordeal giving evidence is in cases like this until they go into the witness box and endure it. It is a hard, unyielding process and can be oppressive and unfair. We try and guard against that but at the end of the day the defendants have to put their case to the people who are put up for witnesses.'* (paragraph 71)

8. Remember that witness statements should be the evidence of the witness, not of the witness's lawyer. The same point was made recently in the Abramovich/Berezovsky judgment, in which Mrs Justice Gloster noted that: '*…no evidential stone was left unturned, unaddressed or unpolished. Those features, not surprisingly, resulted in shifts or changes in the parties' evidence or cases, as the lawyers microscopically examined each aspect of the evidence… It also led to some scepticism on the Court's part as to whether the lengthy witness statements reflected more the industrious work product of the lawyers, than the actual evidence of the witnesses.'*
As Peter Smith J put it in *Farepak*: *'The Courts have regularly reminded parties that the purpose of witness statements is to replace oral testimony... and whilst* [they] *necessarily have to be drafted with the collaboration of lawyers,* [they] *should not be documents created in the language of lawyers by the lawyers, because the lawyers do not go into the witness box and defend it.'* (paragraph 47).
Your evidence should be your thoughts, in your words, which you are willing, able and prepared to defend.

9. Office-holders are always conscious of the costs risks in litigation, but when the points made in Peter Smith J's statement are disregarded, these risks can become very real. Following the collapse of the Secretary of State's case the directors indicated that they were seeking costs on an indemnity basis. Given the stinging criticisms from the judge, it is hard to imagine that these were not awarded. While media speculation suggesting a total legal bill of £5 million is probably overstated, even small cases are expensive to litigate. Remember to consider the possibility of Conditional Fee Arrangements and After the Event insurance to minimise the risk to the estate.

> "Office-holders are always conscious of the costs risks in litigation, but when the points made in Peter Smith J's statement are disregarded, these risks can become very real."

10. When deciding whether to litigate, consider the reputational risk if you lose. In *Farepak*, both the Secretary of State and, in particular, HBoS suffered severe criticism. Although not a party to the disqualification proceedings, the reputational damage suffered by HBoS (characterised by the judge as only interested in protecting its own position at the expense of creditors, and putting the directors in the impossible position of having to take further deposits from the creditors to protect the bank's position) will take some time to heal.

The messages from the *Farepak* statement are that litigation is not something to be embarked upon lightly; that the costs and risks involved should never be underestimated; and that if you are going to litigate, be absolutely clear what your claim is, what evidence exists to support it and, perhaps just as importantly, any weaknesses that might exist in it.

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Restructuring: death by a thousand cuts?

Vernon Dennis explores the balance between life and death.

Since 2008, with crushing regularity the passing of each rent quarter day brings further news of crisis on the UK high streets. It has been evident for some time that many businesses with large long-term leasehold property portfolios, often negotiated in a more benign economic climate, are encountering difficulty. For retailers, changes in consumer spending patterns, weaker demand and a move to online purchasing mean that less floor space is required and a fundamental structural change to the retail sector is in operation. Pitching into this volatile changing landscape is the restructuring profession.

The timing of any attempted restructuring process will, by reason of *Goldacre* and *Luminar Leisure,* often be driven by when rent falls due; a situation that can create unfairness for landlords and may even be of hindrance to those seeking to restructure the business. The timing of what is a collective process, for the benefit of the creditors as a whole, should not be so influenced by the rights of one stakeholder. Unfortunately, we must wait for judicial or more likely legislative intervention to remedy this inequality.

Should reconstruction provide the solution to fiscal problems?

The reconstruction industry rightly prides itself on innovation and an ability to provide solutions for key stakeholders, be they existing owner/management and/or principal funders. As an alternative to administration we have in recent years seen a number of attempts to restructure property portfolios by use of a CVA process; these have included JJB Sports, Blacks Leisure, Focus DIY, Speciality Retail and more recently La Tasca restaurants and Travelodge.

A landlord is a creditor in a unique position; even if not owed rent at the time of the tenant restructuring, they will in any event be a future/contingent creditor. They will also have unique rights pursuant to the lease to forfeit on an event of default,

> “A landlord is a creditor in a unique position; even if not owed rent at the time of the tenant restructuring, they will in any event be a future/contingent creditor.”

invariably for non-payment of rent, generally on the insolvency of a tenant. For some years landlords remained largely unaffected by a CVA with two first instance decisions, that of *Re Naeem (a bankrupt)* (No 18 of 1988) [1990] 1 WLR 48 and *March Estates Plc* v. *Gunmark Limited* [1996] 2 BCLC 1 holding that that a voluntary arrangement did not affect a landlord's proprietary right to forfeit.

In *Thomas* v. *Ken Thomas Limited* (2006) EWCA Civ 504, however, the Court of Appeal held:

- A CVA is concerned with obligations not remedies. If the rent obligation is consumed within the CVA then all remedies must be modified.
- To allow the landlord the right to commence proceedings for forfeiture in respect of sums payable within the terms of a CVA was inconsistent with a rescue culture.
- The effect of the CVA meant that the rent was no longer owed from the tenant to the landlord; consequently there was therefore no right to forfeit.
- The landlord's right to forfeit is not a secured right and therefore as an unsecured creditor the landlord was bound within the terms of the CVA. (See also *Re Lomax Leisure* [2000] BCC 352).

As a result, the use of a CVA was opened up as an alternative to administration (which, of course, stays the landlord's rights of action). The use of the CVA as a means of restructuring an overburdened leasehold property portfolio has developed apace, although with some notable failures along the way.

In *Prudential Assurance Co Ltd* v. *PRG Powerhouse Limited* [2007] EWHC 1002 (Ch) the terms of the proposed CVA provided that employees, local authorities and other creditors (including landlords) of closed stores would share a pot of £1.5 million provided by the parent company. The remaining creditors would be unaffected and paid out of the trading receipts of the reconstructed business, a typical form of CVA proposal in this area.

Although the CVA was approved, the 'minority' landlords immediately challenged the CVA. After determining as a matter of construction that the *Powerhouse* CVA released the parent company from its guarantees to the landlords, the court went on to question whether this was unfairly prejudicial. Mr Justice Etherton held that there was no single test for unfairness; instead in exercise of the court's discretion all circumstances of the case must be examined and a 'vertical comparison' (ie what is the effect of the CVA as opposed to other insolvency procedures?) and a 'horizontal comparison' (ie what is the treatment of other creditors under the CVA?) carried out.

What about the creditors?

Generally the debtor will need to establish that the CVA offers the best available alternative and that creditors are being treated fairly. The fact that one creditor is being treated differently does not in itself deem it unfair treatment; instead the court should move on to balance the interests of that creditor against the interests of the creditors as a whole.

> "The collapse of JJB Sports after two previous CVAs… and the subsequent failures of Blacks Leisure, Focus DIY and Speciality Retail… are leading to an accusation that the use of the CVA is a sticking plaster when radical surgery is required."

In the *Powerhouse* case it was held that the landlords of the closed stores were left in a worse position; in contrast to liquidation they had lost a potential valuable right of guarantee against a solvent third party (namely the parent company guarantor), furthermore if a Companies Act Scheme of Arrangement had been proposed they would have been treated as a separate class of creditor. They were also being treated unfairly when compared with other creditors in that their dividend was calculated without reference to the value of the guarantees. The effect of the CVA was therefore held unfairly prejudicial.

In the case of the *Miss Sixty (Mourant & Co Trustees Ltd* v. *Sixty UK Ltd (in administration)* [2010] EWHC 1890 (Ch)) a women's fashion retail chain sought to use a CVA as an exit route from administration but was challenged on the grounds of unfair prejudice and material irregularity, by the landlords of two retail units.

The CVA sought to distinguish open store landlords (who would effectively have been unaffected by the proposal) from closed store landlords who would receive a sum in the CVA equivalent to the estimated surrender value of the leases. As in the *Powerhouse* case, the parent company, which had provided guarantees to the landlords, was willing to fund the CVA provided it was released from the guarantees in return for a one-off 'compensatory' payment of £300,000 (which it said represented the company's liability on surrender).

At the hearing Henderson J applied the 'vertical and horizontal' analysis provided in *Powerhouse*; finding that:

- in the event of liquidation, the landlords of the closed store would have had a continuing ability to call on the parent company guarantee and hence the CVA was unfairly prejudical to their position (vertical analysis);
- in contrast with other creditors, (the parent and connected companies were not bound by the terms of the CVA) the landlords of the closed store were treated unfairly (horizontal analysis).

Lessons were clearly learned from these legal challenges and earlier skirmishes with landlords (eg the failure of the Stylo Plc and Oddbins CVAs). Clearly, a better dialogue with key landlords and a more realistic expectation from them, led to a number of successful restructurings of property portfolios via a CVA process. However, the collapse of JJB Sports after two previous CVAs is attracting controversy. This accompanied the subsequent failures also experienced in Blacks Leisure, Focus DIY and Speciality Retail, leading to an accusation that the use of the CVA is a sticking plaster when radical surgery is required.

Complaints of unequal pain

Criticism is also mounting from landlords who note that they are being treated differently, not only from other creditors but also other landlords, with some CVAs providing for a range of different outcomes for various classes of landlord. Whether this differing treatment is unfairly prejudicial on a horizontal analysis is a moot point, although in practice it is clear that these landlords have the weakest economic interest and will feel that going through an expensive and uncertain challenge process is unlikely to yield a willing, solvent tenant. This is particularly evident where the funders to the business, be they banks or private equity, will expect the landlords, or at least certain classes of landlord, to bear an element of pain; often it is made clear that the company will not be refinanced and will pass into administration (with the closure of many stores) unless the CVA proposal is accepted.

Time for the kindest cut?

Is the use of the rescue procedure in these circumstances causing secured creditors to 'kick the can along the road' and thereby allow uncompetitive businesses to remain in operation? Such rescue processes may have the effect of avoiding an unwelcome jolt to the economy but is it potentially delaying necessary corrective structural change? One also needs to face the criticism that such rescue procedures also deprive those with greater efficiencies and more coherent long-term strategies from investing in or buying up such failing businesses.

It is perhaps inevitable that key stakeholders, be they secured creditors, employees or suppliers to the business would much prefer to see the rescue of the business, not least because a softer landing is provided if the business is allowed to gently decline. It is also correct to say that, at least in the short term, the CVA will almost certainly offer a better return to creditors as a whole. Indeed, if the majority of creditors accept what is, of course, the company's or the directors' proposal, what place has an insolvency practitioner to say that the business is one that is doomed to eventually fail? Few of us are blessed with such foresight. In addition it could well be said that the failure of those businesses that have undergone a property portfolio restructuring is due to unprecedented economic conditions.

> "If rescue procedures are ultimately seen not to work… and the business dies by a thousand cuts, is it not inevitable that criticism will result and potentially lead to erosion in confidence in rescue techniques?"

A balance, however, needs to be struck. The reputation of our profession rests upon its credibility. If rescue procedures are ultimately seen not to work, where the existing management and key stakeholders remain unaffected and the business dies by a thousand cuts, is it not inevitable that criticism will result and potentially lead to erosion in confidence in rescue techniques?

We must always ask what has changed in the business that will mean it should succeed in the future. If the business remains over-geared and/or requires fundamental remodelling should it not be put out of its misery?

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Reinventing Spain

Agustín Bou explains how Spain found itself in an unsustainable economic situation and what it needs to do to find a new place in the sun.

It is agreed that most of the Eurozone countries are in the middle of a severe crisis and that each of them is trying to solve its situation with different measures. In the case of Spain, its crisis has some elements that make it different from the situation suffered by other Eurozone countries and may make its problems even more difficult to solve. Not only do we have a reduced GDP and sovereign debt of high prime risk but also the highest unemployment rate of all EU countries.

Spain's main economic indicators deteriorated at an accelerated rate during the first half of 2012. The problems in the finance and banking sector and sovereign debt coupled with deteriorating consumer spending rates have negatively influenced the confidence in the economy, which, analysts say, will not start recovering until 2014.

Although during 2012 there has been steady progress in resolving European governance issues and the restructuring of Spain's financial sector, during Q2 2012 almost all economic indicators have deteriorated at the same rates observed during the previous two quarters.

Spanish GDP

The Spanish GDP growth rate published by INE[1] shows a contracting economy during the previous four quarters, with a –1.3 per cent annual growth rate in Q2 of 2012.

Chart 1 shows the year-on-year growth rate of Spain's GDP before and after the 27 August revision of the Spanish National Accounts. The update revised the growth for the year 2011 at three-tenths lower, from 0.7 per cent to 0.4 per cent and at two-tenths lower for the year 2010.

Both the European Union as a whole and the Eurozone registered negative quarter-on-quarter growth (–0.2 per cent). Even so, some of the main European economies presented positive or zero growth: Germany (0.3 per cent), Austria and the Netherlands (0.2 per cent) and France (zero growth). Conversely, the UK and Italy registered negative growth (–0.7 per cent), which was even more severe than Spain's (–0.4 per cent).

Risk premium

All this financial stress has put the Spanish risk premium under enormous pressure, and it has risen from a low of 300 bp[2] in February to 432 bp in October, with an all time high of 639 bp at the end of July. (See chart 3.)

Unemployment

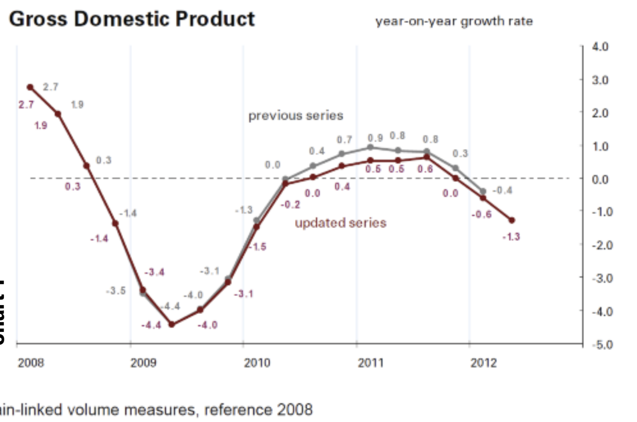
Employment decreased at a year-on-year rate of 4.6 per cent, one point higher than in the first quarter of 2012, indicating a net reduction of 801,000 full-time jobs in one year. As the labour market kept deteriorating in the worsening economic crisis, on 6 July parliament approved the Law 3/2012 of urgent measures for the reform of the labour market. (See chart 4.)

Reinventing Spain

During the last 30 years, Spain has undergone one of the most profound revolutions in the developed countries – becoming incorporated into the EU in 1986 and then becoming a member of the Eurozone. These two elements had an enormously positive effect on the Spanish economy – but there was also a negative downside, which was not recognised at the time.

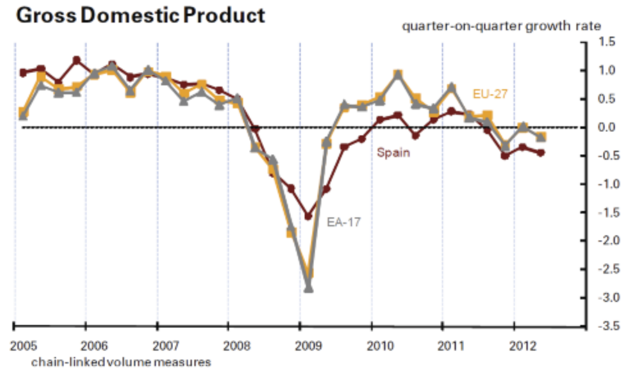
In the early 1980s, the Spanish economic model was based on tourism and

Chart 1



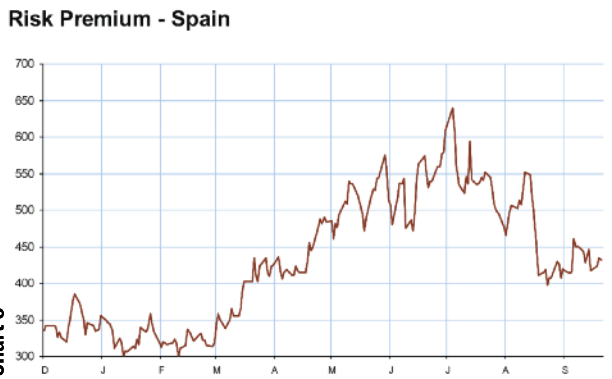
Source: INE; Quarterly Spanish National Accounts. Base 2008 – Second quarter of 2012; 28 Aug 2012

Chart 2



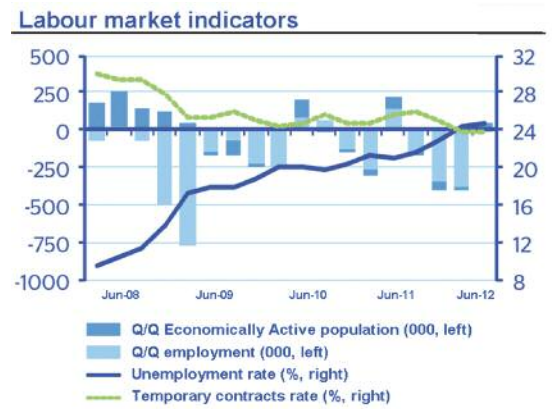
INE; Quarterly Spanish National Accounts. Base 2008 – Second quarter of 2012; 28 Aug 2012

Chart 3



Source: INE Base; Jausas.

Chart 4



Source: Situación España: Tercer trimester 2012; Servicio de Estudios del Grupo BBVA industry and, in the less developed regions (placed at the lower rank of the EU regions), on an economy based on agriculture. Spanish labour costs were calculated in pesetas and were lower than those in other European countries. Spain was a good place to invest, though its productivity was lower than other places and it also suffered from systemic inflation, but this was periodically corrected through devaluations. Also, the weakness of the Spanish peseta in comparison with that of other European currencies meant that Spain was a place to which many people decided to retire. This encouraged the growth of the construction sector.

Entering into the EU gave the industrial regions access to a big market and this had a very positive impact for exporting companies; and it gave the undeveloped regions access to enormous amounts of subsidies from the EU. The euro provided additional economic stability, cheap money and a better control of inflation. However, as Spain was now linked to more productive nations and unable to compete against emerging countries outside of the Eurozone, it was no longer a place where costs were cheap and, therefore, returns on investments fell and companies started disinvesting.

But at the same time, and in a period of large expansion and cheap money, instead of trying to reinvent itself and seeking higher productivity, or investing in emerging sectors to replace those leaving the country, Spain entered into a situation of 'easy money'. In a 'real estate bubble', many people decided to close their businesses as it was much easier and faster to make money speculating on the real estate market. Simultaneously, the undeveloped regions invested the money they were receiving from EU subsidies by subsidising people and created big bureaucratic structures of public sector employees[3]. People abandoned the agricultural sector and lived on subsidies while foreign employees took their jobs in the agricultural sector.

Unsustainable culture

This amazing situation explains, to some extent, the high Spanish unemployment rate. It was easier for many people to live on the subsidies than work in unpleasant jobs or to get trained for jobs far away from their homes.

When the unsustainable situation collapsed, this left Spain with two big problems: many industries had been lost from the traditional manufacturing areas (namely the Catalan, Vasque and some Mediterranean and Atlantic regions) in favour of the construction sector; and many people had come to rely on subsidies.

Now neither the construction sector nor the EU subsides exist anymore. For many regions there is no immediate alternative and it will be very difficult for them, in the middle of the crisis, to find alternative ways to reinvent their economy.

It is likely that this will only be achieved by returning to industrial activities in which the production costs have been reduced by lowering salaries. This has already started to take place. It is the only way for Spain to be able to turn around the present situation and, once again, become attractive for investors. ◻

1 Instituto Nacional de estadistica (National Statistics Department)
2 Basic points in comparison with German risk premium
3 In some Spanish regions, the number of public employees comprises 25 per cent of the total number employed

AGUSTÍN BOU is a partner at Jausas.

The status of retention monies

A recent case in the Malaysian Court of Appeal has introduced a new perspective on retention of monies that is likely to be influential in future English cases.

The status of retention monies under a main contract, in the event of an employer becoming insolvent, has been the subject of several court cases over the past 30 years. The courts have considered whether, in the event of an employer's insolvency, retention monies actually have to be placed in a separate account (or trust) in advance of that event or whether just an intention to do so will suffice in order to protect the retention.

What happens when monies have not been set aside and the employer has become insolvent?

In normal trading circumstances, the courts have been clear that, even if an employer has either refused or failed to set aside retention monies in a trust, they can be compelled to do so. However, the problem for contractors arises if monies have not been set aside but the employer has become insolvent.

> “The problem for contractors arises if monies have not been set aside but the employer has become insolvent.”

The judge in *Rayack Construction Ltd* v. *Lampeter Meat Co Ltd* decided that it was important to protect a contractor against the possibility of the employer becoming insolvent but indicated that a separate trust fund must be constituted and the retention monies deposited in it before the trust can become effective.

The Court of Appeal in *Mac-Jordan Construction Ltd* v. *Brookmount Erostin Ltd* went one step further. It ruled that, once an employer was insolvent, it was too late to get an injunction to compel the setting aside of retention monies, regardless of whether or not there was contractual provision. The point underpinning this was that the court believed that by enforcing the retention clause, post insolvency, it was possible to circumvent insolvency legislation by giving unfair, preferential treatment to the contractor over and above other creditors.

However, neither of the judges in the above cases referred to the judgment in *Re Kayford Ltd*. In *Re Kayford Ltd*, a mail order company, fearing its own insolvency, had intended to set up a separate account designated as a trust fund to hold client

monies but had failed to constitute it correctly. The court overlooked this fact, maintaining that the intention to set up a trust was sufficient and that all the requirements of a valid trust were present.

Potentially influential case

A fresh perspective has been introduced by a ruling in the Court of Appeal in Malaysia, which, in *Qimonda Malaysia Sdn Bhd* v. *Sediabena Sdn Bhd and APC Corporate Holding Sdn Bhd*, has concluded that retention monies should be treated as a trust, even if they have not been set aside prior to an employer's insolvency.

If it is clear that both parties in a building contract intend that the retention should be held as trust monies, then an implied trust will exist even if there is nothing in writing to that effect.

Unlike *Rayack* and *Mac-Jordan*, the Malaysian court did refer to *Re Kayford Ltd* in coming to its conclusion. If the Malaysian court's reasoning is correct, then the view of the English Court of Appeal in *Mac-Jordan* – that retention clauses can create an unfair preference and interfere with insolvency legislation – is misconceived, as the monies, being held in trust, never belonged to the employer in the first place.

Subcontract retention

It is arguable that the status of retention is the same under a subcontract as it is under a main contract, even though it may not be expressly stated to be fiduciary. However, some subcontracts contain conditional payment clauses stating that, in the event of an employer becoming insolvent, the contractor is not obliged to pay the subcontractor (which is lawful). Regardless of this, it is questionable as to whether such a clause could defeat an implied trust of the retention; taking the same view as the Malaysian court, the monies never belonged to the contractor: they are held in trust and the contractor is obliged to pay this trust money to the subcontractor.

English case law on subcontract retention monies has tended to concentrate on nominated subcontracts (which have largely disappeared) rather than domestic subcontracts. The old JCT (Joint Contracts Tribunal) nominated subcontract regime allowed for the employer to pay the nominated subcontractor directly if the contractor failed to do so, but there is no provision for

> “It can be argued that if the main contractor has had the retention set aside but fails to pay the subcontract retention to the subcontractor this amounts to wrongful non-payment.”

such an arrangement under domestic subcontracts. However, the obligations on the main contractor to hold the retention for the subcontractor are similar to the position under the main contract.

Although the law holds that the main contractor can operate a ‘pay if paid’ system on the employer's insolvency, it can be argued that if the main contractor has had the retention set aside but fails to pay the subcontract retention to the subcontractor this amounts to wrongful non-payment, not ‘pay if paid’.

The Malaysian judgment may well prove to be useful in deciding future cases around retention monies in domestic subcontracts. This is likely to make more work for insolvency practitioners dealing with insolvent companies that are engaged in building contracts, but it will bring welcome relief to hard-pressed contractors.

PHILIP HARRIS is head of the construction law team at Wright Hassall.

Striking the balance: is it time to extend bankruptcy?

Will Black outlines R3's suggestion for a new 'three-tier' bankruptcy system.

Tensions will always exist within the bankruptcy system. It has to operate as a debt relief procedure, rehabilitating indebted individuals and granting them a financial second chance. Yet, the need for debt relief must be balanced against the entirely reasonable desire of creditors to recover what they are owed; as well as upholding the fundamental principle underpinning all lending, that debts should be repaid.

A similar tension exists in terms of the public's attitude towards bankruptcy. Perhaps angered by the antics of now remorseful celebrities or shady businessmen who went bankrupt through reckless spending or gambling, the public now feel bankruptcy should last longer than a year (58 per cent of the GB population according to R3's research). On the other hand, we polled again just after the announcement that The Co-operative Bank were withdrawing their basic bank accounts for bankrupts and found 79 per cent of the population believed that undischarged bankrupts should have access to a basic account.

Finding a balance

It is vital that we get this balance between relief and redress right: too lenient and you damage lending, too harsh and you risk snuffing out entrepreneurship and punishing the vulnerable.

At 12 months, the UK's bankruptcy term is among the lowest in the developed world. The reduction from three years in 2003 was justified on the grounds that it would enable a new generation of entrepreneurs to try, to fail and to pick themselves up and try again. The bankruptcy courts, however, rather than heaving with budding Richard Bransons, are far busier dealing with over-indebted consumers with unwieldy credit card bills. In fact, the proportion of trading related bankruptcies, accounting for only a third of cases when this change was introduced, has declined significantly over the last decade. This makes the argument for a 12-month term of bankruptcy start to look rather shaky.

An argument can be made, of course, that a short bankruptcy term is right for a certain type of debtor: specifically those who have arrived at their present situation through little fault of their own – an illness, the sudden loss of a job, rising prices and low, stagnant wages. It is hard to see how making the bankruptcy process increasingly Draconian for such people

helps to uphold the principle that debts should be repaid when, but for unfortunate circumstance, they would have done so.

On the other side of the coin, what of those for whom responsibility for their debts lies squarely on their own shoulders, who have acted recklessly and with scant regard for repayment? Currently, they too emerge debt free 12 months down the line. They could be made subject to a Bankruptcy Restrictions Order or Undertaking (BRO or BRU) extending the restrictions, but not the term of bankruptcy. If any assets are acquired after the 12-month term, they are the debtor's to keep, whether or not he or she is subject to a BRO or BRU. Similarly, as an Income Payments Agreement or Order (IPA or IPO) can only be applied for during the term of bankruptcy, the individual's earnings could increase dramatically after discharge and, without an IPA or an IPO already in place, the trustee cannot go near it. An individual subject to a BRO or a BRU may still be subject to the restrictions of bankruptcy for a number of years after their bankruptcy, but as far as redress and repayment goes, he or she is treated no differently to the very least culpable of debtors.

'Three-tier' bankruptcy system

It seems clear that there is a problem, but how do we go about solving it? Well, one potential answer, put forward by R3's Personal Insolvency Discussion Group, is a new 'three-tier' bankruptcy system.

1. Firstly, they suggest, the standard term of bankruptcy should be returned to three years. The argument based on supporting entrepreneurship fails to hold water when bankruptcies continue to be overwhelmingly dominated by consumer debtors. This still gives the UK a comparatively short bankruptcy term but would allow a longer period for individuals to move from bankruptcy to an IVA if their circumstances improved and for the trustee to claim new assets or put an IPA or an IPO in place if the individual's income increased, thereby increasing returns to creditors.
2. Secondly, the court – or the adjudicator, following the introduction of debtor petition reform – could be granted the discretion to reduce the term of bankruptcy to 12 months, in certain circumstances. This would ensure that individuals who were least culpable for their situation are made no worse off than under the current system. Indeed, if this were accompanied by changes to increase the eligibility thresholds for Debt Relief Orders, many could find themselves treated less harshly.
3. Thirdly, discharge could be automatically suspended for the duration of a BRO. This would provide more opportunity to claim after-acquired assets for creditors and gives the trustee longer to apply for an IPA or an IPO, should the individual's circumstances change. Extended bankruptcy restrictions are one thing, but the very real threat of a claim against new assets or increased income in an extended discharge period is likely to provide more deterrent to reckless or culpable spending behaviour before bankruptcy.

Maintaining the balance of bankruptcy is vitally important for the UK economy. The process has to provide financial rehabilitation for those in over their heads, while at the same time maintaining the confidence that underpins the lending environment. The current 'one size fits all' 12-month term, however, seems to have tipped the scales too far in one direction on the basis of an argument that no longer stands up. A more robust bankruptcy system – but one that recognises that people arrive at their situation through different routes – could be a step towards redressing that balance, to the benefit of vulnerable debtors, creditors and the wider economy.

WILL BLACK is communications manager at R3.

SPG Forum 2012

Andrew Tate takes over as chair of the SPG commitee and reminds members of up-coming technical courses.

It was great to see so many of you at October's SPG forum in Birmingham. Thank you for supporting the conference and R3, and thereby making this event another sell-out and a great success. For those of you who couldn't attend the forum, let me introduce myself – I'm Andrew Tate, an IP and partner in a firm with a small insolvency team called Reeves & Co LLP based in London and the South East. Having just succeeded Liz Pywowarczuk as SPG chair at the forum, I would like to thank Liz for all her work and commitment to R3's Smaller Practices Group over her term as chair. Liz will be staying on the SPG committee for the foreseeable future so I look forward to working with her and the rest of the committee to continue to put the interests of smaller firms at the heart of R3's work and to provide you with the resources and support you need as a member from a smaller firm.

> "There were some thought provoking presentations and questions at the forum and I am very grateful to all of the speakers for giving their time."

There were some thought provoking presentations and questions at the forum and I am very grateful to all of the speakers for giving their time. I was certainly taking notes back to the office to share with my colleagues. As ever, the social and networking aspect of the forum was as important as the technical input and there was a great mix of people interacting and sharing experiences.

Technical training for SPG members

Please remember that you don't have to wait until next year's forum for further technical sessions dedicated to smaller firms. In the first half of 2013 we have the SPG Technical Review course taking place in three locations throughout the country. The course programme will be issued shortly so please watch this space and save the most appropriate date for you in your diary.

R3 and the SPG committee are also looking for new ways to provide training to smaller firms, in addition to the SPG-specific training and general R3 courses already on offer. We have started to put together webinars in order to provide some short, cost effective training on key subject areas, the first of which took place on 28 September and provided a detailed review of SIP 9. I'm very pleased to say that the majority of members who registered to watch this webinar were from the SPG community. Future webinars should cover compliance issues, monitoring visits and how to develop a strategy for a professional services firm so please watch this space for further announcements regarding dates and topics. If you have any suggestions for topics you would like to see covered in a webinar, please get in touch with the committee via the contact details at the end of this article.

SPG Technical Review course, 2013

16 April – Huddersfield
14 May – Bristol
4 June – London

There are many areas that I hope the committee can address and I know that my colleagues on the committee have many more! Above all, I will strive to ensure that the committee remains relevant and practical to practitioners in smaller practices. Many delegates at the forum gave me thoughts about the areas they would find useful and we will take these back and consider them.

> "We have started to put together webinars in order to provide some short, cost effective training on key subject areas, the first of which… provided a detailed review of SIP 9."

Don't forget to keep in touch!

Please contact Emma Hobson, R3's SPG manager if you have any issues or concerns that you would like the SPG committee to address or put on our list of potential topics for next year's courses. Emma can be contacted at emma.hobson@r3.org.uk or you can find contact details for myself and the committee members on the R3 Committees' section of the R3 website, **www.r3.org.uk**.

ANDREW TATE is a partner at Reeves & Co LLP and chair of the R3 SPG committee.

COMING IN SPRING 2013

13 March 2013
R3 Annual Dinner, Lancaster Hotel London

24–26 April 2013
R3 Annual Conference, Hotel Martinez, Cannes

R3 events, courses and conferences

Month	Date	Event	Venue
December	3	North West Regional Meeting	JMW Solicitors, Manchester
December	4	Introductory Programme – Partnership Insolvency	Prospero House, London
December	4	Introductory Programme – Partnership Insolvency	Irwin Mitchell Solicitors, Leeds
December	4	South West and Wales AGM	Dynasty Restaurant, Bristol
December	5	North West Women's Group Event	House of Fraser, Manchester
December	5	Southern Regional Meeting and AGM	Southampton
December	5	Introductory Programme – Partnership Insolvency	Deloitte LLP, Birmingham
December	6	Asset Recovery	Hyatt Regency, Birmingham
January	24	Yorkshire Regional Meeting	Crowne Plaza, Leeds
January	31	London & South East Women's Group Event	London
February	5	Introductory Series	Prospero House, London
February	6	Introductory Series	Deloitte LLP, Birmingham
February	6	North East Regional Meeting	Newcastle
February	7	The Issues of Key Stakeholders in Insolvency	Leeds
February	14	Directors' Duties	London

Regional events
R3 events

For further information on R3 courses and conferences, please visit the R3 website www.r3.org.uk, where you can download the full 2013 spring/summer programme. Alternatively, call the Courses team on 020 7566 4234 for more information.

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R3 membership categories

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

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

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

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

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

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

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

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IFC = inside front cover
OBC= outside back cover

Interview with…

Pat Boyden

Pat Boyden talks about the rise and fall of personal insolvency and the human face of the struggle that besets so many people.

Why did you choose to work in personal rather than corporate insolvency?

It was an accident. When I started working as an examiner in the OR's office in Birmingham in 1973 new entrants were meant to rotate between bankruptcies and liquidations – but I never got rotated and stayed there for six years. By then, I had built up my knowledge and have continued working in personal insolvency throughout my career at Deloitte Haskins & Sells, Coopers & Lybrand and PwC.

Would you recommend insolvency as a career to a university leaver today?

Not for personal insolvency but there is always plenty of work in the business advisory and restructuring sector.

> "For self-employed people the level of bankruptcy has remained pretty consistent but the current economic situation is likely to play a more significant role in personal debt."

Personal insolvency figures have declined recently but are much higher than ten years ago. Is the root cause of debt lifestyle or is it caused by the economic situation?

The credit boom of 2000–2006 caused a huge surge in the numbers of personal insolvencies, which lead to the growth of IVA companies. It was a bubble waiting to burst. However, since 2008, with the lack of ready lending available from banks and credit cards, 'lifestyle' debt has declined and bankruptcies have fallen back to 2003–2004 levels. For self-employed people the level of bankruptcy has remained pretty consistent but the current economic situation may have an impact on business bankruptcies. A new base level is probably being established, as after the 1992–1993 peak.

Barclays is now the only major bank that will provide accounts to recent bankrupts. Should the government lean on LBG or RBS to provide accounts?

Undischarged bankrupts may well be in receipt of the soon-to-be-introduced universal credit. If the government is saying that bank accounts are mandatory in order to receive the new single payment, then they must ensure that banks provide basic accounts so that people can receive money and make payments up to the same value. It flies in the face of rehabilitation if they are denied this basic facility. An account gives access to discounts offered for direct debit. It can't be that expensive for banks with 35,000 bankruptcies per annum and the risk of after acquired assets passing through it is small. The Insolvency Service is aware of the matter and perhaps the minister can be persuaded.

Individual insolvencies in England & Wales

Year	Total
2002	30,587
2003	35,604
2004	46,652
2005	67,584
2006	107,288
2007	106,645
2008	106,544
2009	134,142
2010	135,045
2011	119,941

> "If the government is saying that bank accounts are mandatory in order to receive the new single payment (universal credit), then they must ensure that banks provide basic accounts so that people can receive money and make payments up to the same value."

»

Pat Boyden after his first solo flight as a pilot.

Introducing financial education at a young age would be beneficial but how can this be achieved?

It should be mandatory and included in the syllabus for those above age 14. No exams, but straightforward education on what credit is, and the risks. At that age, youngsters start getting involved with mobile phone contracts. It is doubly important now with payday lenders. There is also a lack of consistent, good advice for those who become indebted.

Do payday loans hinder or help those who are struggling financially?

It's easy to sneer at the market with their high annual interest rates but, in theory at least, payday loan providers do provide a service. What troubles me is that it is a continuous problem; if someone needs a loan one month, what is going to change the next? There should be rules about 'revolving' loans, which is where 4,000 per cent interest starts to look very real, as opposed to £15 to borrow £100 for a month. Maybe DROs will become more popular as a result of payday loans in a couple of years.

> "There should be rules about 'revolving' loans, which is where 4,000 per cent interest starts to look very real, as opposed to £15 to borrow £100 for a month."

Do you think a bankrupt's spending behaviour prior to bankruptcy should be a factor in determining the length of their term?

At present, if a person has taken on a reckless amount of debt they can be discharged after a year but their borrowing and company director restrictions can be extended – up to 15 years. The R3 personal insolvency group has recommended that the basic term for bankruptcy should be returned to three years (as before 2004) and Bankruptcy Restriction Orders (BROs) should be extended in scope to include after acquired assets, then BROs would be reserved for serious cases. Most creditors are indifferent about BROs as they bring them no benefit.

> "The R3 personal insolvency group has recommended that the basic term for bankruptcy should be returned to three years and should be extended in scope to include after acquired assets."

Are there any particular cases that stick in your memory, and why? Do you ever find yourself wondering what became of any particular bankrupt?

In the mid-1970s I dealt with a couple who were record pools winners. They went bankrupt four years later and lost everything, and he became seriously ill. I still remember them saying that they wished they'd never won the money.

There was also a chap who took up residence on the roof of his house for two years as he refused to accept that he owed anything.

The ones that usually stick in my mind are the serial complainers who cannot accept that they are wrong. Four of my bankrupts are vexatious litigants and several others should be!

Is bankruptcy likely to be a core business area for IPs going forward given the reduction in cases and the consolidation of IVA work in large 'factories'?

Bankruptcy will remain core to two or three firms such as Mazars and Tenon but, unless IPs have bulk providers – banks or credit card companies, it is hard to build a significant business. The IVA market will continue to mature, with fewer players but less volatility.

You have recently become a member of The Insolvency Service's Steering Board. How do you see the future of the IS – and, in particular, the issue of its competing with IP firms for cases?

The IS has to deal with the fluctuations in numbers and knows it needs to balance its books. It cannot keep increasing fees, as the purpose of bankruptcy as a recovery process will cease totally. Defending the costs of bankruptcy often falls upon IPs, even though the IP has no say in IS charges. It is a difficult balance to achieve, and if creditors receive nothing from any bankruptcy, its purpose is purely punitive.

These are difficult times for the IS. There is unlikely to be a big increase in bankruptcies in the next few years but the IS needs to plan for all eventualities. Making use of technology and a degree of centralisation is essential. Its role in enforcement remains critical – it is here that public interest is probably best served. ◻

Pat Boyden

1973–1978: examiner at Official Receiver's office Birmingham

1979–1994: manager at Deloitte Haskins and Sells/Coopers & Lybrand

1994–2011: partner Coopers & Lybrand/PwC

From 1996 was in charge of personal insolvency for PwC

- Post Enterprise Act (2004) became PwC spokesman for PI, wrote articles, produced largest (then) report on PI, *Living on Tick: the 21st Century Debtor*
- Member of IS panel on IVA reform 2004–2007
- Predicted in 2006 the flattening of PI numbers post 2007
- March 2012 appointed member of IS Steering Board

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audit & property advisers

Corporate Recovery - Why CAPA..?

- Over £125m of Over-Spend Recovered for Trading & Administration Clients
- £15m Recovered for Administrators in 2012
- Proven Credentials with Insolvency Practitioners
- Valuation & Realisation of Property Assets and Disposal of Properties
- Bespoke Accounts Payable and Property Audit
- Returning Value to Shareholders
- Creating Positive Premiums from Leasehold Assets
- Contingency Fees Only Rewarded on Success
- The Only Complete Client-Focused Recovery Audit Service
- Securing Rental Savings During Trading Period

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