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RECOVERY

Avoiding insolvency

When is turnaround a good fit?
The key considerations for IPs and how their insolvency skill set is relevant to turnaround

A rare find: RAAs in pension scheme restructuring
The PPF explain the criteria needed for a business to be eligible for this uncommon arrangement

A solution for all (or a test for one?)
Modelling different outcomes to determine whether that consensual solution truly is the best available

Held to ransom? The essential supplier regime
Will the introduction of section 233A give more power to insolvency professionals dealing with essential suppliers?

Breaking new ground: complex debt restructuring and the IP
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Battling the old boys' club
The restructuring profession faces big challenges in diversity and inclusion

A way to fill an empty pot
There is a lot more to be had for IPs from the MasterCard litigation than might be first thought

An interview with… Adrian Hyde
R3's president speaks about current issues with the power of the Official Receiver, HMRC and the fight against fraud

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From the editor

Turnaround, restructuring, advisory. A variety of descriptions of rescue, recovery and renewal outside formal insolvency are discussed throughout this issue. As a profession we embrace solving the problems of distressed businesses whether or not an insolvency procedure is required. But the emphasis is changing. More of us are doing more non-formal work.

Insolvency has not been booming for some time, but the UK economy is not strong and there are signs of an insolvency uptick. On this occasion I will leave others to explain or speculate on the cause of the economic weakness, but I don't see us returning to historical levels of formal insolvency appointments. For those of you keen to consider the non-formal side of our work in more detail, we have a raft of articles on pages 21–48.

Our president, Adrian Hyde, on page 7 makes a powerful point about the need for reform of the UK's corporate insolvency framework. Imperfect as many of the government proposals are, implementing those that address the World Bank metrics could move us up to third place in its rankings.

Expect (when the government finds time to do its day job) to see further extension of the essential supplies provisions in s233A; a new restructuring plan with voting by class of creditor and the requirement for dissenting creditors to receive at least what they would have received in a liquidation; and additional rights for creditors to request and receive information from IPs. There is much to look forward to.

We wish all our readers a Happy Christmas and a prosperous New Year.

C. Laughton

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

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Themes of *RECOVERY* 2018

SPRING	**Disruption**
SUMMER	**The court system**
AUTUMN	**Data and cybersecurity**
WINTER	**Where does the UK fit now?**

Features

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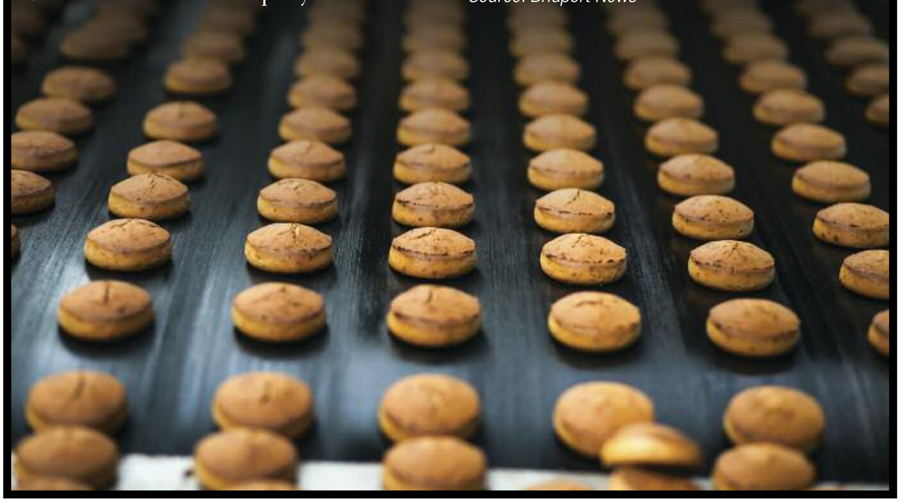
Bakery director disqualified for undercooked taxes

The director of a bakery company based near Lyme Regis has been disqualified from acting as a director for five years in the wake of an Insolvency Service investigation. Clive Cobb joins fellow director Alexander Qaun in disqualification after the Service revealed that the pair were accountable for Our Bakery Number Two failing to pay VAT, PAYE and NIC between May 2013 and the company's eventual liquidation in October 2015. The arrears amounted to £142,666.

The Secretary of State for Business, Energy and Industrial Strategy accepted a disqualification undertaking from Cobb in October 2017, which has now come into force. The business had operated under the title of the Royal William Bakery, a restaurant and bakery in Plymouth.

Source: Bridport News



Wheels fall off cycle company

The Cirencester-based custom bicycle retailer Mango Bikes called in administrators from RSM at the beginning of October. Mango Bikes was formed by mountain biker and mechanic Ben Harrison and his university housemate Jazz Skelton, a marketing professional. They imported frames and parts to build custom day-glo city, road and commuter bikes for sale. Mango Bikes was sold back to Harrison for just £1 earlier in 2017, after it emerged that Mango had accrued £250,000 in debt. Cycling websites such as **Bikebiz.com** have suggested that the weak pound and pressure from Brexit led to cash flow problems for the company. Administrators are looking at options for the business.

In May this year, the directors of Mango Bikes formed a new company, Wilchap 564, to purchase the troubled cycle clothing brand Vulpine out of administration for £70,000.

The UK cycling industry is currently in steep decline. **Bikebiz** reported that, despite the government's plans to promote cycling nationwide, the first quarter of 2017 saw a hefty drop in bike sales. HMRC statistics suggest an 11 per cent reduction on bike imports for the second quarter and an estimated 2.5 million bicycles due to be sold in 2017, around 1 million fewer than 2016. The decline is attributed in part to the weak pound, which has led to small British manufacturers thriving, but companies dependent on foreign imports suffering.

Source: Insider Media/Bikebiz

Scottish engineers power on regardless

An engineering company that manufactures large-scale equipment for offshore oil and gas plants, as well as wind turbines and tidal energy generators, is on the cusp of bringing in administrators. Buntisland Fabricators, also known as BiFab, operates two sites: in Fife and Arnish on the Isle of Lewis. Last year the company agreed to undertake a contract for Dutch contractor, Seaway Heavy Lifting, to work on an offshore windfarm project led by major energy business SSE. The contract was worth an estimated £100m, but it is thought that cash flow issues for BiFab connected to the project have caused problems for the Scottish company, with a notice of intent to appoint administrators filed to the court.

A statement from BiFab said that its cash situation was critical and that all options are being explored to allow the business to keep trading. Emergency talks have been held between unions and the company and, on 13 November, unions announced that staff had agreed to a 'work-in'. Employees agreed to work until further notice to ensure that the current contract, which is 77 per cent complete, is kept by the BiFab sites.

The company was founded in 2001 and grew to become a major player in offshore oil and gas projects around Scotland. The business combined fossil fuel and renewable energy work and has grown to accommodate around 1,400 workers at the Fife and Arnish sites.

Source: BBC

Roofing firm shelters under administration

A building company based in Winchester, which had worked on large-scale projects such as the O2 Arena in Greenwich and the Olympic Stadium in London, has gone into administration. Lakesmere specialised in roofing, cladding and fascias, but ran into trouble after a number of unprofitable contracts. Joint administrators have been appointed from Deloitte to oversee the parent company Graceful Holdings Ltd and 109 of the 241 staff have been made redundant. In 2015 the company reported a pre-tax profit of £3.5m and an annual turnover of £118.5m.

Administrators said that the parent company, Graceful Holdings, was not affected by the administration and options are currently being explored.

Source: Daily Echo

Prevaricating producer gets ten-year bankruptcy

A Brighton film producer who was made bankrupt in 2013 has received ten more years of bankruptcy restrictions after an Insolvency Service investigation discovered he had been hiding three bank accounts and a six-figure salary, despite being £5m in debt. Steven Clifford Wilkinson claimed to have big name Hollywood stars such as George Clooney, Tom Hanks and Leonardo DiCaprio signed on the books to make films. However, the claims to having signed the stars were false, which led the courts to close down the companies involved. Warlord Productions and Spice Factory UK were wound up by the High Court in 2015, following a petition from the Secretary of State in the public interest.

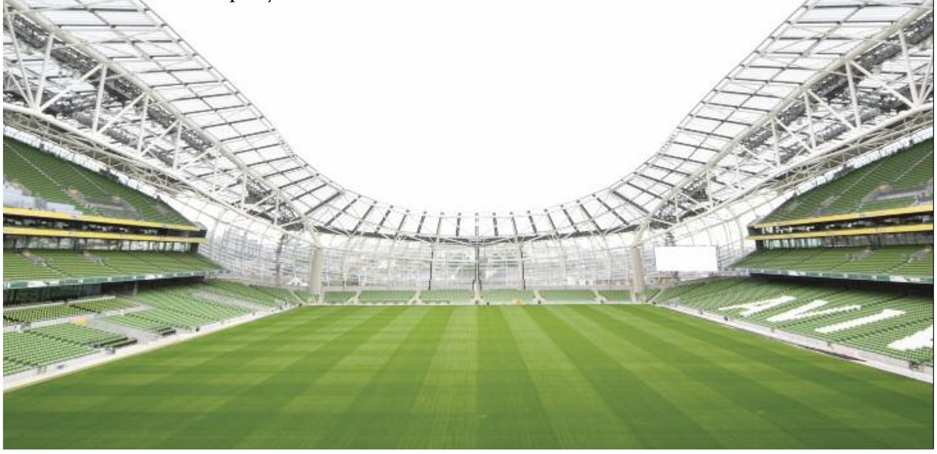
The Insolvency Service investigation discovered Wilkinson had failed to disclose an income of more than £180,000 during his original 12-month bankruptcy as well as three bank accounts held at the date of bankruptcy. Wilkinson had entered into an IVA in April 2012, which led to a petition for bankruptcy. He was accused of raising money for films that did not get made, in one instance raising £6m, of which the Insolvency Service could trace only £3m.

Source: The Brighton Argus

Sod's law for turf company

A business that provided turf for sporting venues around the UK has fallen into administration due to a 'difficult trading position'. Joint administrators from RSM Restructuring and Advisory were appointed for Souters Sports in early November. The majority of the 47 workers at the company have been made redundant, with some kept on to assist on high-profile contracts or with the administration. The company had provided a full range of work, including construction, reconstruction, drainage, aeration and maintenance to different sporting venues from its base in Cheshire.

Source: Insider Media



Railway engineer out of steam

The assets of a railway engineering specialist are up for sale after the company was forced to cease trading. Rowlescourt Engineering had manufactured point fittings and trackside equipment since 1977, but increasing competition and pressure from the market forced the business to close down. Joint administrators were appointed from Wilson Field to handle the case and are now seeking buyers for the assets. The company had employed 35 people at its Derbyshire site and possessed assets including machine tools, computers and CAD equipment as well as a large freehold industrial premises.

Source: Insider Media

Public interest disqualifications on the rise

Public interest disqualifications against unfit directors have increased sevenfold over the previous year, according to figures released by the Insolvency Service. In the period 2015–2016 just four public interest disqualifications were made, while 28 directors were disqualified on the same grounds in 2016–2017. The Service suggests that it has prevented losses of £92m over the last year and that each disqualification saves creditors around £114,000. The use of the public interest disqualification is expected to grow in 2017–2018, after 20 were invoked in the first six months of this year.

Source: Credit Strategy

Director of Derbyshire engineers rescues firm

A Derbyshire engineering firm has been bought out of administration by one of its directors. D.C Steelfabs, based in Stavely, had struggled with cash flow and accumulated arrears with creditors and HMRC. The company specialises in fabrication work for the energy, mining, transport and construction sectors. Joint administrators were called in from Wilson Field when the cash flow difficulties occurred. The problems were attributed to unprofitable contracts and issues with the quality of work undertaken by agencies. The company has been sold on as part of a pre-pack deal that will preserve all 18 jobs at the company.

Source: Derbyshire Times

President's column

Adrian Hyde writes on turnaround, the UK's place in the insolvency world rankings and the possible future for pre-pack reform.

The theme of this latest edition of *RECOVERY* – turnaround and restructuring – is one of the issues I've been focusing on as R3 president. Our profession is much changed from even a short time ago, but the growing role of pre-insolvency work is under-explored. The change is impressive and reaches from the largest firms to the smallest. It was eye-opening to hear from delegates at November's Smaller Practices Group Forum about the advisory and restructuring projects being taken on in their market.

Restructuring and advisory work helps underpin the UK's strength as an insolvency hub and boosts our economy's reputation as a good place to do business. But as it grows and develops the market will pose fresh regulatory and legislative challenges. How do you monitor the advice given in the absence of a statutory process? Where would legislative change make it easier to rescue a business before an insolvency procedure might be necessary? These are some of the issues R3 will be exploring. In the meantime, the thoughts on consensual restructuring from creditor groups and others elsewhere in this edition are invaluable.

As the profession changes, it's important R3 makes sure it still does what members need it to and represents the full breadth of our profession. Over the next few months, R3 will be conducting a strategic review of its operations, strategy and purpose to ensure that it is fit for the future and that membership is a must-have for those working in insolvency, restructuring, turnaround, advisory and related fields. Members will have a chance to engage and help set R3's future direction, and I would urge them to get involved where they can. Speaking from experience, R3 makes a fantastic contribution to the health and success of this profession – and what members put in, they get back in spades. Keep an eye on *RECOVERY* and R3's website for updates on the progress of the review and changes.

Corporate insolvency reform

One area that *isn't* changing as much as we'd like is the statutory corporate insolvency framework. I've written before about the government's package of planned corporate insolvency reforms – including a moratorium from creditor action for struggling businesses, a new court-based restructuring tool, and 'essential supplies' reforms – but, frustratingly, at the time of going to press, it's been over a year since any announcement from the government on the next steps and the issue was sadly missing from the Queen's Speech.

Are the reforms perfect? No, there are plenty of changes that could be made. But, for the time being, the details of those changes are secondary to making sure there is momentum behind the reform process in the first place. Reform is increasingly vital.

> "Restructuring and advisory work helps underpin the UK's strength as an insolvency hub and boosts our economy's reputation as a good place to do business."

At the end of October, the UK's insolvency framework slipped from 13th to 14th best in the World Bank rankings. Our skills as professionals remain exceptional and our framework hasn't worsened. The simple fact is, other countries are making their own changes and are catching up to us.

The Netherlands, for example, has introduced changes to its own framework that have seen the Dutch rise from 11th to 8th in the World Bank rankings while the UK heads in the opposite direction. Other EU countries will be making their own reforms in the wake of the EU's latest insolvency directive, which is currently being implemented. In itself, this isn't the direction we want to be heading in.

Brexit provides added impetus for reform. On the one hand, leaving the EU without a good deal could create barriers to resolving cross-border insolvencies and restructurings from the UK, and the more we can do to make our framework competitive in other ways, the better. On the other, if the government wants the UK to thrive post-Brexit as an international trading hub, then our insolvency and restructuring framework needs to be in the best possible shape, combining the existing unique advantages of the UK framework with tools and procedures familiar to international investors and entrepreneurs. If we want to stay ahead of the game, reform is needed.

Progress being made

The good news is that we are making progress elsewhere.

Raising awareness of the profession's role in tackling fraud has been another priority of mine as president. In October, I met Home Office fraud minister Ben Wallace MP. Encouragingly, the minister was engaged with the work we do and recognises that there are opportunities for our profession and government to work together to pursue fraudsters and provide redress for victims. He was also very positive about opportunities to increase that engagement.

Likewise, there has been progress on the personal insolvency front, with the government finally launching a long-promised consultation on introducing a 'breathing space' for indebted individuals to give them protection from creditor action while they seek advice on resolving their debts. This is something R3 members have been calling for since 2015. Crucially, the government's planned six-week breathing space is closer to R3's 28-day proposal than the months-long proposals of others. A shorter breathing space would provide a better balance for the interests of both creditor and debtor.

Finally, further change may be afoot for connected-party pre-packs. With the government's power to regulate or ban connected-party administration sales expiring in 2020, a review of the implementation of the 2015 Graham pre-pack reforms is likely to begin soon. At a recent R3 roundtable, sponsored by Squire Patton Boggs, IPs, regulators, creditors, and representatives of the government discussed the progress of pre-pack reforms. There was widespread recognition of the value of pre-packs, while the Graham-instigated changes to pre-pack valuations and marketing were seen to be working. On the other hand, the sense was that further reforms might be necessary to make the Pre Pack Pool truly effective. The roundtable will have given the government plenty of food for thought ahead of its review. ◻

ADRIAN HYDE is president of R3 and a partner at CVR Global.

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▶ If you are a lawyer and would like to write for Legal Q&A please contact: **matthew.jukes@groupgti.com.**

Legal Q&A

Leanne Schneider-Rose answers your insolvency queries.

Q I have been asked by a lender to take an appointment as a fixed charge receiver over a company's assets. The lender wants to make a demand and immediately appoint me as they are concerned about what might happen to the company property if they leave a long period between making a demand and my appointment. Is there a problem with this?

A It depends on whether the lender's charge is an 'on-demand' charge or not. If it is an 'on-demand' facility then case law has confirmed that all the lender has to do is give the debtor time to get money 'from a convenient place'. This has been held to be one hour in one case (I suspect this would not apply if the demand was made outside of banking hours). This is known as the 'mechanics of payment test'.

> Check the lenders' own documents carefully and ensure that the lenders' own time provisions about the service of notices and demands are complied with.

However, be careful and ensure that you check (1) it is an on-demand facility; and (2) what the lender's own facility documents and/or terms and conditions state with reference to the service of demands. In respect of (2), some lender's own terms and conditions provide, for example, that all 'notices' given by the lender (and a demand could fall under this) will be deemed served two days after posting. Of course there may be provisions for service by fax and/or email, but many still require service to the correspondence address and/or the registered office of the borrower. Therefore, check the lenders' own documents carefully and ensure that the lenders' own time provisions about the service of notices and demands are complied with.

If a lender does not comply with its own lending documents, with regards to service of demands, then arguably the borrower could state that sufficient time for payment was not given between the demand and the appointment being made; this could make the appointment of a receiver invalid. I suspect that, in support of any such argument, the borrower would also need to show that there was the ability to make payment, but I suggest that to avoid the argument in the first place it is probably better just to check the relevant lending documents prior to appointment to avoid the costs of any such arguments arising.

Q I was the liquidator of a company some time ago that has now been dissolved following my final report. I have recently received a letter from the company's former bank indicating that the company is due a refund of some money following a review of the bank's lending. What should I do and how do I get re-appointed as liquidator?

A The company will need to be restored to the company register but firstly you need to establish exactly when the company was dissolved, since a company can only now be restored to the register within six years of its dissolution (save in some circumstances such as a third-party claim against a company for personal injury). Please note that an order can be made outside of this time limit providing the application to restore has been made to the court within this time limit. If this is met, an application to the court can be made to restore the company to the company register. As the former liquidator you have the standing to make the application to the court pursuant to the provisions of section 1029 of the Companies Act 2006.

> You can of course be re-appointed but the process differs depending upon whether the liquidation was a compulsory or creditors' voluntary liquidation.

Where a company was previously in liquidation then it will be put back on the company register in its former 'state' (in liquidation) and the general effect of the order is that the company is deemed to have continued in existence as if it had not been dissolved.

As to your being re-appointed as liquidator, you can of course be re-appointed but the process differs depending upon whether the liquidation was compulsory or a creditors' voluntary liquidation. In the case of a compulsory liquidation, because the appointment would have been made by the Official Receiver, the Official Receiver must be

> Once the court has ordered that the company is placed back on the register, the Official Receiver will deal with the re-appointment document.

served with the application to the court and provide his/her consent to your re-appointment as liquidator. Once the court has ordered that the company is placed back on the register, the Official Receiver will deal with the re-appointment document. In the case of an appointment arising out of a creditors' voluntary liquidation, the court has the power to re-appoint pursuant to the provisions of section 108 of the Insolvency Act 1986 and an order should be accordingly requested within the claim form in respect of the application to restore. □

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

Recent case summaries

Latest insolvency update from **James Hannant**.

PERSONAL INSOLVENCY

Yang* v. *The Official Receiver and others
[2017] EWCA Civ 1465
Yang is an interesting decision that addresses the relationship between the court's jurisdiction to review its own orders under s375 of the Insolvency Act 1986 (IA 1986) and its jurisdiction to annul a bankruptcy under s282(1)(a) IA 1986, ie on the basis that on 'grounds existing at the time the... [bankruptcy] order ought not to have been made'.

The appellant (A) owned a rental property that was designated a house of multiple occupation (HMO) by the second respondent (the Local Authority), which raised council tax bills totalling £1,102.54. The outstanding liability went unpaid and the Local Authority obtained liability orders before successfully petitioning for the bankruptcy of A on the strength of those orders.

Following the bankruptcy order, the valuation tribunal found that A's rental property should never have been designated as an HMO. A applied to have the bankruptcy order annulled pursuant to s282(1)(a) IA 1986.

At first instance, district judge Khan declined to annul the bankruptcy order but ordered the bankruptcy order be rescinded pursuant to s375 IA 1986. HHJ Hodge QC dismissed an appeal by A against the order of DJ Khan and A appealed to the Court of Appeal.

The Court of Appeal (Gloster LJ giving the only reasoned judgment) declined to allow the appeal and held as follows:

- While it did not directly relate to the construction of s282 IA86, the general ambit of the power to rescind under s375 AI 1986 might be thought to inform the scope of the power to annul – in particular, if it were thought that these powers should dovetail rather than overlap.
- The only sensible interpretation of s282(1)(a) IA86 was that the liability orders constituted a legally enforceable debt, regardless of the underlying factual position relating to the relevant property, unless and until the liability order was set aside.
- Dictates of certainty and expediency require that a bankruptcy court should not go behind the liability orders, except in the event of fraud or some miscarriage of justice.
- The fact that the liability orders were subsequently set aside was not a ground 'existing at the time the [bankruptcy order] was made' as required by s282(1)(a) IA 1986.
- Even if all the underlying facts in relation to the property had been known at the time that the bankruptcy order was made, the court would nonetheless have been entitled to make a bankruptcy order.

Yang provides useful guidance on the inter relationship between the court's jurisdiction under s282(1)(a) IA 1986 and that arising under s375 IA 1986 and it now seems clear that, where a bankruptcy order is made on the basis of a properly entered liability order (or other form of tax assessment), the appropriate provision for challenging the bankruptcy order will be s375 and not s282(1)(a). Less clear is the approach that the court will take in circumstances where judgement has been entered by default as was the case in *Royal Bank of Scotland* v. *Farley*, which was departed from by Gloster LJ. It is also interesting to note that (by implication at least) the Court of Appeal appears to have adopted a comparatively restrictive approach in determining what constitutes a miscarriage of justice.

CORPORATE INSOLVENCY

***Randhawa and another* v. *Turpin and another (as former Joint Administrators of BW Estates Ltd)* [2017] EWCA Civ 1201**
Randhawa is a recent Court of Appeal decision that considered whether a company that only had one director, but whose articles of association required there to be two directors in order for its board to be quorate, could appoint administrators under paragraph 22(2) of schedule B1 of the Insolvency Act 1986 (IA 1986). The situation was complicated by the fact that, while the company's sole director held 75 per cent of the shares, a dissolved corporate entity (Belvedere) was the registered holder of the remaining 25 per cent.

The validity of the appointment was challenged by two creditors with HHJ Purle QC finding in favour of the company and holding that the joint administrators had been validly appointed. The creditors (the appellants) appealed, with that appeal being allowed for the following reasons.

First, the company was not a one-member company within the meaning of s318(1) of the Companies Act 2006. The word 'member' included any member registered on the companies register, whether alive or dead, and, if corporate, whether subsisting in an insolvency procedure or dissolved. Accordingly, Belvedere remained a member and the company could not rely upon s318(1) to establish that it was quorate.

Second, paragraph 22(2) of schedule B1 did not provide an independent right to appoint an administrator, rather it provided for a power to appoint that needed to be exercised in accordance with the articles.

Third (and importantly), the court held that the company could not rely upon the *Duomatic* principle in circumstances where Belvedere had been dissolved. The *Duomatic* principle required the assent of all shareholders who have a right to attend and vote at a general meeting of the company. In circumstances where Belvedere was registered as a member of the company the court found it hard to see how the *Duomatic* principle was applicable. Per Sir Geoffrey Vos:

'Without labouring the point, those who must assent are "all shareholders who have a right to attend and vote at a general meeting of the company", not those of the shareholders that may be available at the time.'

Fourth, the Court of Appeal held that the application did not smack of an abuse of process and neither were the appellants estopped from challenging the appointment by reason of their acquiescence. The administrators could have been expected to check that their appointment was valid when it was made and had not done so. In contrast, the appellants did not have any involvement in the appointment and it would have been inappropriate for them to be prevented from questioning the legal status of the company, just because they acquired their interest from someone who consented inappropriately to an invalid resolution to appoint the joint administrators.

The decision is a useful reminder of the importance of complying with formalities generally. However, it also emphasises the limitations of the *Duomatic* principle in curing such defects. ◻

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held to ransom?

The essential supplier regime

Richard Hodgson and **Paul Sidle** examine how far recent changes go toward fending off payment requests from suppliers and giving power to IPs.

Insolvency practitioners have powers to:

- limit the terms essential suppliers can impose (directly or indirectly) as a condition for the continued supply of their service (section 233 'market abuse' powers); and
- compel continued supply by restricting the effect of existing insolvency-related terms in an essential supply contract (section 233A 'continuity of supply' powers).

> The genesis of section 233 was to stop utility suppliers from obtaining payment of their pre-appointment unsecured debts ahead of even priority creditors by abusing their dominant market position in a monopoly.

The two powers are the product of different legislative goals. While affecting the same types of suppliers, their scope is not equal (see box 1). Applied in practice, there are limits as to what each can achieve.

The policy behind section 233

Section 233 powers were introduced in an era when the only utilities operators in town were those of the public sector, acting free from competition. As a statutory monopoly, they could take a tough 'no payment, no service' approach, strong-arming their way ahead of other unsecured creditors in what came to be seen as an abuse of power. The introduction of section 233 of the Insolvency Act 1986 aimed to put some of the power back in the hands of the office-holder of an insolvent business.

The *Cork Report* suggested the fictional treatment of the company in liquidation/administration as a 'new' customer, preventing disconnection simply because the 'old' customer had outstanding debts. This led to section 233 allowing an essential supplier to require from the liquidator/administrator a personal guarantee for payment of any new supplies, while at the same time preventing them from making it a condition of future supply that pre-appointment debts were paid (or doing anything that had that effect).

Section 233 ensures that an IP may therefore request the supply of the relevant services during the period of the insolvency, without being required to pay charges outstanding at the date the proceedings began.

But, primarily concerned with preventing an abuse of power in a monopoly, section 233 fails to address two key real-world problems:

- Termination rights: section 233 does not ensure continuity of supply. There is no restriction on the exercise of a contractual right to terminate (eg triggered by entry into an insolvency procedure or by non-payment); and
- Ransom payments: section 233 does not prevent suppliers holding debtors to ransom. For example, there is no restriction on a supplier exercising a contractual right to switch tariffs, raise prices or change payment terms.

Section 233A to the rescue?

The section 233A continuity of supply powers partially address the issues left open by section 233. However, IPs need to consider the interpretation and scope of the section 233A powers, particularly when carrying out any pre-appointment contractual due diligence.

> IPs need to consider the interpretation and scope of the section 233A powers, particularly when carrying out any pre-appointment contractual due diligence.

The aim of section 233A is to enhance the prospects of successful business rescue, improve returns to creditors and preserve employment. Unlike section 233, section 233A is focused on ensuring continuity of supply. It seeks to do so by restricting the effect of an 'insolvency-related term' in an essential supply contract where a company (the customer) 'enters' administration or a CVA 'takes effect'. As highlighted in box 1, the section 233A regime will not apply to other types of insolvency proceedings. In practice, this is probably not likely to be a significant issue. It reflects the fact that liquidation and receivership are not 'rescue' procedures in the same way as administration and CVAs are intended to be, so continuity of supply is less relevant.

Editor recovery@r3.org.uk

Restriction of termination rights

Where the trigger under an essential supply contract is the customer entering administration or a CVA taking effect, section 233A prevents termination of the supply or contract (*section 233A(8)(a) and (b)*).

Of course, it may be that a supplier's termination rights kick-in before a company enters administration or a CVA takes effect (eg when a notice of an intention to appoint is given or a CVA is proposed). In that case, however, unless automatic, a supplier will need to be quick to exercise its termination right (assuming it knows it has one). Where the termination trigger is *'an event that occurred'* before entry into administration or a CVA taking effect, then section 233A restricts the exercise of any termination rights based on that event (*section 233A(8)(c)*).

Ransom payments

Where the trigger is entry into administration or a CVA taking effect, section 233A prevents the supplier from doing *'any other thing'* – such as raising prices or changing payment terms (*section 233A(8)(a) and (b)*). But, suppliers continue to be able to rely on some other event – such as a ratings downgrade or late payment – to trigger other non-termination rights, including putting a customer on to a higher tariff or changing payment terms. This is because while section 233A(8)(c) restricts termination because of *'an event that occurred'* before entry into administration or a CVA taking effect, it does not prevent the supplier from doing *'any other thing'*. This affords suppliers with a potentially simple route to increase prices where a customer is in financial difficulties.

The supply type and date of contract

The type of essential supplies to which the section 233 and 233A powers apply was, of course, extended in 2015. In particular:

- on-sellers are now within scope. This is particularly relevant to landlords who on-sell energy to tenants (although where energy costs are wrapped up as part of the service charge, there could be questions over how the regimes apply); and
- IT-related supplies. As box 2 shows, in recognition of their importance to modern day businesses, the types of IT-related supply within this category is broad.

Although not expressly listed, services for internet access, broadband or email are clearly caught as IT-related supplies but, in any event, would fall within a supply of 'communication services' in s233(3)(e) (as confirmed by government guidance on the October 2015 changes). There will always be some supplies, however, where it is less clear whether they fall within scope. For example, would a contract to develop a new IT system be a supply of 'software'?

As box 1 shows, only those contracts entered into after 1 October 2015 fall within the section 233A continuity of supply powers. Some possible issues IPs would need to consider include:

- where services or goods are contracted for under a pre-1 October 2015 framework or master agreement but provided on terms set out in a post-1 October 2015 schedule, there could be debate as to whether their provision might fall within the section 233A regime; or
- where significant amendments are made to a pre-1 October 2015 agreement after that date (eg the addition of extensive new services, revised payment terms and amounts etc), an IP might look to argue that a new in-scope supply contract has in fact been entered into.

Expected usage of section 233A powers

Category of essential supplier	Utilities	Telecoms	IT
No. of trading administrations	35	50	77
No. of trading CVAs	20	29	44

Box 1: Scope of section 233 and section 233A powers

<table>
<tr><th colspan="2">Scope</th><th>s.233 powers</th><th>s.233A powers</th></tr>
<tr><td>Supplier type</td><td>Utilities (water, gas, electricity)
Communication services
IT-related*
On-sellers</td><td colspan="2">✓
✓
✓
✓</td></tr>
<tr><td>Contracts</td><td>Entered before 1 Oct 2015
Entered after 1 Oct 2015</td><td>✓
✓</td><td>✗
✓</td></tr>
<tr><td>Insolvency procedures</td><td>Administrator
Liquidator
Provisional liquidator
Supervisor of voluntary arrangement
Administrative receivership</td><td>✓
✓
✓
✓
✓</td><td>✓
✗
✗
✓
✗</td></tr>
</table>

* see Box 2.

Box 2: What are IT-related supplies?

Sections 233 and 233A apply to suppliers of a range of IT-related goods and services given for the purpose of 'enabling or facilitating anything to be done by electronic means'. Section 233(3A) provides that these goods and services are:

- point of sale terminals;
- computer hardware and software;
- information, advice and technical assistance in connection with the use of information technology;
- data storage and processing; and
- website hosting.

Provision of multiple services

Large IT-related agreements will often provide for a mix of different services – eg software maintenance, software development or hosting etc. Some of the services might be essential for the purposes of section 233A continuity of supply powers, but others might not. Even though entry into administration, for example, might be a trigger for the termination of a contract as a whole or for service fees to increase across the board, where some supplies are essential, exercising such rights in respect of *all* services would seem to be restricted by section 233A. An IP will still, however, need to understand whether a supplier is entitled to terminate, or increase prices for, individual supplies (ie other than the in-scope essential supply).

> "Suppliers continue to be able to rely on some other event – such as a ratings downgrade or late payment – to trigger other non-termination rights."

Similarly, if a supplier provides a bundle of interconnected essential services, but some are under pre-1 October 2015 contracts, an IP will need to consider whether termination of an essential supply not caught by the continuity of supply powers could harm the effective provision of another essential supply that does fall within the section 233A regime.

Provision to multiple companies

Essential services may be provided under one contract to several customers within a corporate group. Could all of the group customer companies seek to indirectly benefit from the restrictions imposed by section 233A where just one company enters administration or has a CVA take effect and in respect of which section 233A » clearly applies? It will depend on the terms of the contract, but the situation could arise where, on default, a contract only allows termination of the contract or supply as against all companies, rather than as regards individual group companies.

In these circumstances, a supplier might well argue that an inability to exercise its termination or other rights against group customer companies who have *not* entered administration or had a CVA take effect would go beyond the policy intent of section 233A. They might also suggest it constitutes a 'hardship' such that a court should permit it to terminate the whole contract.

> Only those contracts entered into after 1 October 2015 fall within the section 233A continuity of supply powers.

Discretionary IT-related supplies

IT agreements sometimes make the provision of supplies discretionary. For example, an agreement might provide that a supplier 'may' (rather than shall) choose to accept a customer's order placed under a framework agreement. Where a supplier has a discretion, rather than an obligation, to supply, section 233A ought not to apply, although the precise wording would need to be considered.

Supplier protections

An essential supplier has the benefit of certain protections under section 233A:

- it may terminate the contract if the administrator or CVA supervisor consents, the court grants permission because continued supply would cause the supplier hardship or because charges for post-administration/CVA supplies are unpaid for 28 days after payment is due; or
- it may terminate the supply if the administrator or CVA supervisor does not provide a personal guarantee for the payment of continued supplies within 14 days of receipt of a notice asking it to.

Oddly, in contrast to other essential supply regimes (such as under the special administration regime for investment banks) there is no express mention that charges for post-administration/CVA supplies will constitute an expense of the procedure nor if they do where they would rank (with other expenses). It is unhelpful that the position is not made clear as it introduces a degree of uncertainty, particularly where, for example, an administrator refuses (or has not been asked) to give a personal guarantee. In its guidance on the October 2015 changes, the government simply states that it considers *'it likely that charges incurred under an actual contract continued at the discretion of the administrator will be expenses of an administration'*.

For energy suppliers, there could be a gap between terminating a contract and being able to physically disconnect the supply. The status of the costs for such supply could be a source of contention. There is case law to suggest that charges for utility supplies made to stores after an administrator has vacated a property will not be expenses but provable debts (*Laverty* v. *British Gas* [2014] EWHC 2721 Ch). But the case concerned charges under statutory deemed contracts that had arisen because British Gas had terminated the supply contract while continuing to supply. That is quite different to where a supplier may be forced to continue supply under section 233A but is then unpaid for 28 days after payment is due and so seeks to terminate the contract and the supply.

The additional protection of a personal guarantee should be unnecessary if charges for post-administration/CVA supplies are expenses. While the concept of a personal guarantee exists in the section 233 market abuse powers, that is primarily because at the time they were drafted the position on administration expenses was far less clear. In any event, there is no standard form of personal guarantee. Clearly, an IP will want to avoid being responsible for any charges accruing after it has requested the cessation of a supply. But time spent dealing with requests for personal guarantees and negotiating them could, where there are multiple suppliers, cause delay and incur additional costs.

Cross-border issues

The application of the section 233A regime in a cross-border context is likely to be complex. For example, what if the supply agreement is governed by a law other than English law or if the supplier is located overseas? It may be that section 233A has extra-territorial effect binding foreign suppliers/foreign law supply contracts. In *Re Sahaviriya Steel Industries Public Company Ltd (a company incorporated in accordance with the laws of the kingdom of Thailand)* [2015] EWHC 2877 (Ch), HHJ Pelling QC was willing to make a without notice order under section 233 on the company's Thai parent company, while acknowledging that there was a serious issue to be tried as to whether the section had extra-territorial effect. However, even then, enforcing section 233A would still require the IP to litigate in a foreign court, which would clearly be unattractive.

What is the impact of section 233A?

Figures in the government's impact assessment on the introduction of the section 233A continuity of supply powers suggest that ransom demands are made by utilities in 25 per cent of trading cases, by telecoms in 36 per cent of trading cases and by IT suppliers in 55 per cent of

> An IP will still, however, need to understand whether a supplier is entitled to terminate, or increase prices for, individual supplies.

trading cases. The government suggests that, on average, just 10 per cent of administrations/CVAs are trading. Updated for current levels of insolvency, that is approximately 80 trading CVA cases and 140 trading administration cases per year. Therefore, by way of illustration only, the number of trading administrations/CVAs where the section 233A powers might be expected to be used can be seen in the table at the top of page 13.

The government has committed to carry out a non-statutory review on the effectiveness of the changes within five years of implementation – ie by 2020. The review will be required to consider whether the changes have had a positive impact on business rescue and delivered the hoped-for benefits. Given that insolvency levels are relatively low, we are unlikely to see the use of the section 233A powers to any great extent so it may be difficult for the government to make a meaningful assessment.

In the end, the section 233A continuity of supply powers are a useful addition to the UK insolvency framework, and while current data suggests their impact will be limited, that does not mean to say that that they won't be helpful in any one case.

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Breaking new ground: complex debt restructuring and the IP

Sarah Paterson examines the shifting role of the IP in complex debt restructuring and what it may be in future.

At the end of the nineteenth century the British banking industry amalgamated and a few large banks became the main providers of debt finance to British industry. If a company ran into trouble, the bank worked with management to try to agree a solution. If that could not be done, the bank's preferred accountant, an expert in insolvency matters, would try to realise the assets for as much as possible to pay down the debt. Like a medieval crop system, we can see the lines of this institutional structure in insolvency practice in England and Wales today.

Things, though, have changed. The decline of relationship banking, the rise of the originate-to-distribute business model and developments in the bond markets have contributed to the birth of a deep secondary market for distressed debt and the arrival of distressed debt traders in London. While a large corporate work-out may still be led by one or two banks holding par value loan debt, with an administration sale as the contingency plan, it is now much more likely to focus on deleveraging the balance sheet, to be conducted among numerous financial creditor constituencies and to resort to, or threaten to resort to, legal process given the large and potentially unruly number of interests that must be corralled.

This is not the sort of transaction that accords well with our natural view of the role of the insolvency practitioner (IP), and the IP was not particularly visible in the development of large corporate debt restructuring practices in noughties England. English lawyers have turned to schemes of arrangement to implement complex debt restructuring transactions, and valuation and marketing advice has more often than not been provided by the investment banking community.

Schemes and pre-packs

In a small minority of cases it has been necessary to 'twin' the scheme of arrangement with a pre-packaged sale of the shares that the finance company holds in the operating subsidiaries in order to strand dissenting creditors out of the money (because the English scheme of arrangement does not permit a scheme to be crammed down on an entire class that » dissents). Yet even here the IP has tended to be in the supporting cast; stepping up to implement the pre-packaged sale and fading from the limelight very shortly afterwards.

Things are, though, changing again. Although the English scheme of arrangement has worked remarkably well, experience of using the scheme to achieve a debt restructuring in the decade after the financial crisis has highlighted a number of areas where it could be improved or made more adaptable for the future.

In 2016 the Insolvency Service launched a review of the corporate insolvency framework in the UK (and published many of the consultation responses),[1] and the European Commission published a proposal for a new directive setting minimum harmonisation standards for restructuring law.[2] It is not clear how much legislative capacity there will be for reform of debt restructuring law in England and Wales after the Brexit referendum result, but the contours of the debate give us a new chance to consider whether there is, or should be, a role for the IP in complex debt restructuring in twenty-first century English law.

Moratorium as a tool

The first area is the discussion of whether a so-called preliminary moratorium should be in the English insolvency and restructuring toolbox. Insofar as large corporate debt restructuring is concerned, it is not clear that the absence of a moratorium in schemes of arrangement

> The insolvency practitioner was not particularly visible in the development of large corporate debt restructuring practices in noughties England.

has posed a particular problem to date. At the same time, the growth in access to the high-yield bond market, and the explosion in so-called Term Loan B (TLB) financing in recent years, give some cause for concern.

Neither high-yield bonds nor TLB typically provide detailed maintenance financial covenants, so it may become more challenging to bring the borrower to the table to negotiate, and there may not be a long runway in which creditors can trade in and out before something must be done. Situations may become inherently more hostile. This may also necessitate stronger tactics, such as threatening to cease interest payments until a restructuring has been agreed – tactics that will also implicate difficult questions of directors' duties

> The growth in access to the high-yield bond market, and the explosion in so-called Term Loan B (TLB) financing in recent years, give some cause for concern.

unless statutory endorsement of a payment moratorium is available. The next downturn may also take a different form, necessitating compromise of trade credit as well as financial liabilities, so that new incentives for another class of creditor to grab assets are introduced.

For all of these reasons, it is possible that some sort of moratorium should make an appearance in the legislative structure. This immediately raises the question of whether it will become a charter for the unscrupulous board to place the protective shield of the moratorium around the company and progressively dissipate the assets with no solid restructuring proposal in mind. This is not a purely hypothetical concern. The case of Eastern Airlines is a cause célèbre in US Chapter 11 literature with commentators alleging that, after acquiring the airline in 1985, Frank Lorenzo used the protective umbrella of Chapter 11 to keep creditors at bay, handing the business over once virtually nothing was left. There is also anecdotal discussion in the market about certain Chapter 11 shipping cases after the financial crisis.

Historical legacy of corporate insolvency

The Insolvency Service consultation suggested that the solution to this problem is not the supervision of the courts but rather the appointment of a private actor known as the 'supervisor'. The consultation did not suggest that this would necessarily need to be an IP, but many respondents thought that this should be mandated. The profession, though, seems cautious. This is not surprising given the lack of detail around the obligations and, crucially, liability of the supervisor.

Classically, a moratorium is provided within an insolvency proceeding in order to keep the assets of the business together to enable the insolvency practitioner to achieve a value-maximising sale, and there is a well-developed framework within which the office-holder approaches questions of lifting the stay. We can perhaps think about the preliminary moratorium in much the same way when it is wrapped around a company that is well advanced in debt restructuring negotiations in order to protect the restructuring plan. At the same time, the supervisor is likely to be able to apply to court for directions and the court is likely to wish to continue to lend its support to the reasonable and diligent insolvency practitioner (to maintain the division of labour between existing commercial and legal issues).

However, if some of the problems highlighted above arise as a result of high-yield bond debt or TLB financing, the moratorium may need to happen at a very early stage in order to make negotiation of a plan possible at all. This would be very different territory for the IP: the obligation would be to ensure that there is a genuine commitment from management to develop a solution and that a rational expert would conclude that a restructuring is reasonably possible.

Doubtless this would require considerable fleshing out, new SIPs and more detailed legislative proposals than those suggested in 2016. But it is tentatively suggested here that the profession should embrace the potential for a greater role in

> Recent debate about reform of Chapter 11 in the US has questioned whether some sort of independent mediator could be appointed between the parties.

large corporate debt restructuring. Modern financial creditors in complex debt structures are considerably less focused on a business or asset sale (other than as a technical method of implementing a debt restructuring) and considerably more focused on restructuring the balance sheet. This has necessarily implicated corporate finance technology as well as, or often instead of, insolvency technology. But as we begin to put more of the architecture of insolvency around the process, it must be right that it is the regulated profession that should hold the ring between efforts at a rescue and the financial interests of the creditors, aided where necessary by the court.

Questions of risk, reward and the role of the IP also raise their head when we consider whether England should implement a cram down procedure between classes of creditor. Although it is possible to cram a scheme of arrangement onto minority creditors within a class, it is not possible to cram a scheme of arrangement onto a dissenting class. As mentioned above, English common lawyers have overcome this challenge by 'twinning' the scheme of arrangement with a pre-pack sale of the business and assets to a new company, stranding creditors in the dissenting class in a shell company with no assets. Although this has worked, it undoubtedly uses the pre-pack in a way that was not envisaged by the legislature. Moreover, absent other changes to English law moratoria technology, it may not be a viable option for certain types of service or contracting businesses.

Mediation

Recent debate about reform of Chapter 11 in the US has questioned whether some sort of independent mediator could be appointed between the parties and, potentially, to assist the bankruptcy judge in a complex debt restructuring case, and the European Commission proposal suggests that member states may require the appointment of a practitioner in the field of restructuring where the

> "It is tentatively suggested here that the profession should embrace the potential for a greater role in large corporate debt restructuring."

restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram down.[3] In England there is already a party well positioned to take this role, in the shape of the IP. In most cases the company will be arguing in favour of the restructuring on the basis that it produces a better result for creditors as a whole than the best available alternative option, which will often be an administration sale of the business and assets as a going concern. But for this analysis to withstand scrutiny, the administrator-in-waiting must be convinced of the case for moving to a sale transaction if the debt restructuring fails. This is because paragraph 3(1)(a) of schedule B1 to the Insolvency Act 1986 mandates a rescue of the company as the first purpose of the administration unless the administrator thinks that is not reasonably practicable and he or she acts in the best interests of creditors, in which case they can move down the hierarchy of purposes to a going concern sale.

There are considerable difficulties with the construction of the hierarchy in paragraph 3 but it cannot be intended to entitle the senior class to hold the administrator to ransom, and refuse the debt restructuring plan, where the administrator considers (weighing the interests of the different classes and the expected recovery in an administration) that another, fairer, scheme is available and the question is the allocation of the debt and equity rather than strategic decisions such as who to sell the business to. There may thus be a role for an IP if a new cram down provision is introduced.

One solution to mediate between the rather blunt application of a valuation methodology based on the going concern value of the business and assets in what might be a depressed market and the problems inherent in moving towards the valuation approach more commonly adopted in the US (which uses professional valuers, using valuation techniques such as discounted cash flow, to assess the 'intrinsic' value of the business) may be to mandate that the parties must come to court for sanction with evidence provided by the IP with which they have entered into private bargaining, taking into account not only the value in current market conditions but also the forecasts for the business. This could be bolstered by enhanced regulation setting out how the IP should approach the valuation mediation role and new legal rights that creditors could have to make representations to him or her.

Inspiration could be taken from the field of takeovers and the role of the independent adviser. The court would then ask the IP to report two things at sanction: first, that the IP is satisfied that the scheme has been arrived at following good faith private bargaining between the parties, which took into account the forecasts for the business after the restructuring, and secondly, that if the scheme fails and the administrator is appointed as things stand he or she anticipates that they will move down the hierarchy to para 3(1)(b) or (c), and that no creditor is worse off under the scheme scenario than they would be in the counterfactual. Reform of this type would be limited to large corporate situations, and it would be important for the IP's willingness to take on the role that any challenge to the IP's opinion is dealt with before any final court sign-off on the plan.

Learn from Canada

Further inspiration might also be drawn from the Canadian CCAA process (highlighted in responses to the Insolvency Service consultation). If a stay is ordered in CCAA proceedings, a monitor is appointed (and the court has discretion to order the appointment of a monitor in other cases). Crucially, the court has discretion 'to direct the monitor to perform duties such as acting as liaison with the creditors and giving an opinion on the debtor corporation's ability to meet the requirements of a revised business plan.'[4] Like the English law administrator, the monitor is an officer of the court who can provide a dual function as the court's officer in holding the ring in commercial discussions between the stakeholders and in reporting to the court. But unlike the English law administrator, he or she does not replace the company's directors and the company's governance structure continues through the process. Professor Janis Sarra has commented: 'Monitors increasingly navigate the debtor company through the complexity of the CCAA process, providing business judgment, negotiation skills and financial advice. The monitor can act as mediator or facilitator, bringing the parties together in an effort to build consensus on a viable going forward business plan.'[5] The Canadian

> "Times are changing and not in ways that may be immediately recognisable to IPs."

courts have consistently emphasised the need for the monitor to act independently, and their repeated emphasis on this point appears to have been crucial in the perception of market players and trust in the monitor role.

In the words of Dylan

Overall, then, times are changing and not in ways that may be immediately recognisable to IPs. But there are opportunities here, and some of the roles that may develop in the next decade may be best filled by regulated professionals used to making difficult commercial decisions within a complex legal framework. Caution will be needed, but the profession should certainly be part of the debate in shaping the ridges and furrows in the next stage of development in English debt restructuring law and practice. ◻

1. Available at **https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework**.
2. European Commission proposal for a directive on preventative restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.
3. European Commission proposal Article 5
4. J. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2nd ed. (Thomson Reuters Canada Limited 2013), 32.
5. *Ibid.*, 571

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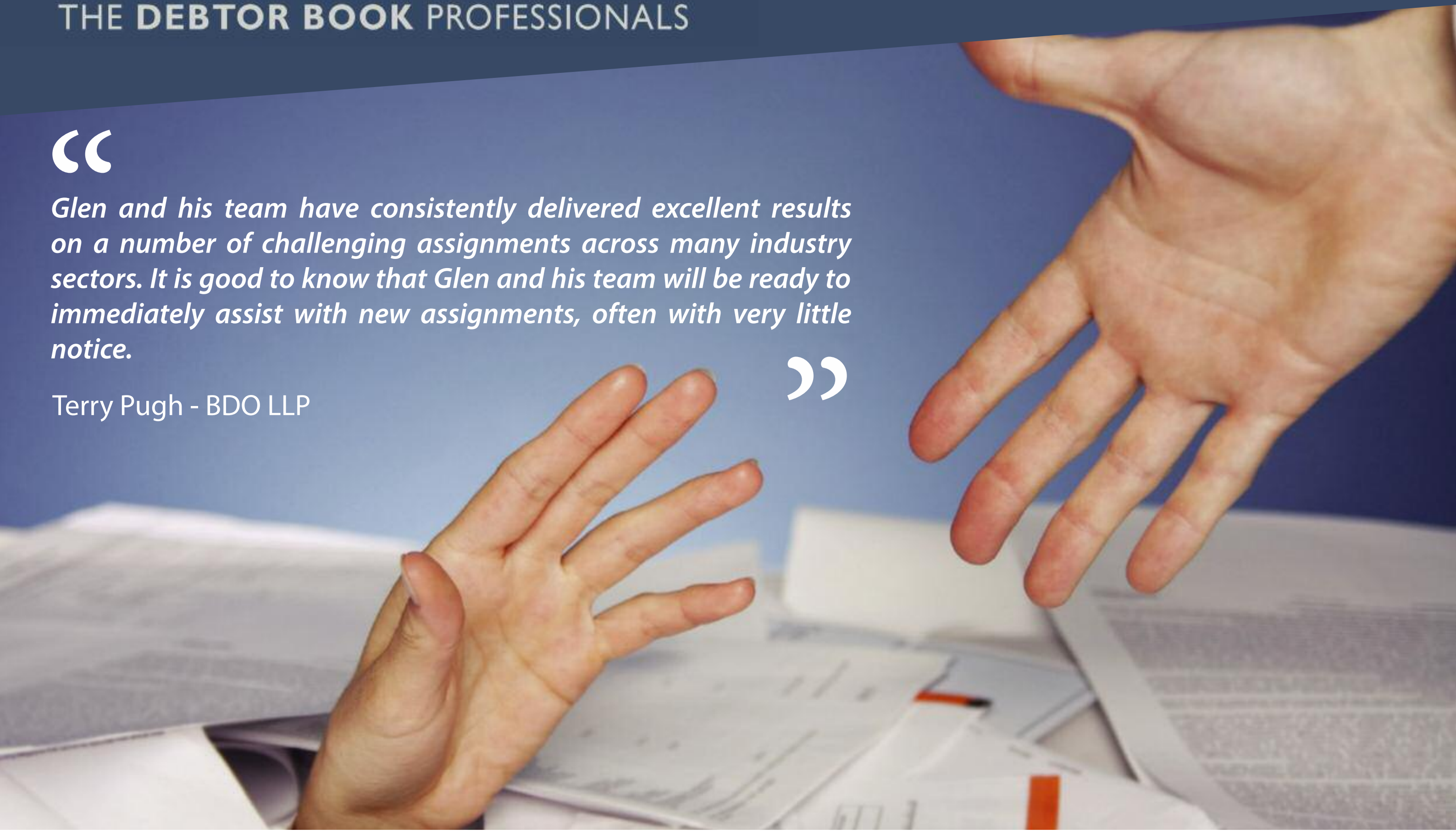

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When is turnaround a good fit?

Matthew Tait and **Matt Hill** put together a blueprint for practitioners considering turnaround work.

From a corporate's perspective, the significant differences between 'turnaround', 'restructuring', and 'insolvency' can be unclear. However, the differences are important; not least for the practitioner who wishes to undertake mutually rewarding and potentially long-term client engagements.

The challenge in achieving clarity arises because the end points of insolvency and restructuring tend to be more certain when compared to turnaround. If 'turnaround' has a single definitional issue, it is that of the measurement of its delivery: the measurement of position, pace and progress.

Defining any concept is hard. When that concept (turnaround) relates to a series of inter-connected activities that may (or may not) share the same broad terminology and objectives as other concepts (eg restructuring), it becomes harder. To put it very broadly, restructuring re-cuts the cloth. Turnaround re-weaves the cloth. So, for the purposes of this article, we will use the following definitions:

Turnaround is the coordinated and measurable activity (eg operational, financial, legal) that addresses the underperformance of a business (or business unit) over an extended period with the objective of stabilising the business and securing, or increasing, value for its stakeholders. The extent to which both the 'pace' of turnaround and 'progress' is required will depend on the entity's opening 'position'.

Restructuring is more narrow, and defined as the specific actions that address financial risk, commonly with respect to debt. It does not address directly the interrelated activities of the business itself. Consequently, a business can be 'restructured' but still remain under-performing.

The objective of a turnaround (medium to long term) and a restructuring (short term) may be the same, eg the avoidance of an insolvency event. So, unsurprisingly, turnaround commonly involves some level of restructuring. But the skills and approach differ greatly. Importantly, the need for turnaround has to be identified and agreed to by management as their participation is a critical success factor.

> "To put it very broadly, restructuring re-cuts the cloth. Turnaround re-weaves the cloth."

When are turnaround skills needed?

Many of the skills and experiences acquired by insolvency practitioners are transferable and valuable to the delivery of a successful turnaround. As always, the maximisation of the value of those skills requires practitioners to carefully consider the commitment of their resources. For turnaround, this commitment can be considerable and correlates strongly with the challenge of measurement. The skills of others (including turnaround professionals and other specialists) may also of course be required or desirable.

While not a unanimously held view, some more hawkish economists forecast that the UK economy will contract at some point next year and enter a recessionary phase. However, the adage that it takes three economists to predict a change rings true: one says 'up', one says 'down', one says 'no change'. One is always right.

But what seems more certain is that the correlation between economic recession and the rates of corporate failure is not as strong as it once was.

The recent 0.25 per cent base rate increase (and the prospect of more) combined with historic levels of consumer debt would classically indicate a roll-on impact on many sectors eg retail, leisure and residential construction. However, it seems that other macro-economic and political factors will be of equal if not greater influence. It is the authors' view that the weight of these other factors will mean that any relationship between interest rates, debt and insolvency is either broken or substantially diluted. In turn, practitioners may wish to think again as to the value of turnaround services.

Broadly, there are two other factors that practitioners may wish to consider: »

- The inevitability of performance issues during the average corporate life-cycle. Even the most successful companies are likely to face performance issues at some stage. While the scale will differ, there will always be a demand for effective advice to help companies navigate choppy waters.
- The further development of and focus on corporate rescue. Next year marks the 15th anniversary of the coming into force of the Enterprise Act 2002. This had the promotion of corporate rescue at its heart through the prominence of administration over administrative receivership. It would be wrong to argue that it has achieved its higher aims but undoubtedly it led (through practice not statute) to accelerated merger and acquisition processes, the expansion of alternative funding providers and the growth of the 'pre-pack' sale. It seems probable that this focus will be maintained. By extension it is probable that increased attention is paid as to whether a business was simply put up for sale or was 'turned around' and then, from a more financially stable platform, presented to the market.

This focus on transparency is a corollary of the need for practitioners to demonstrate the delivery of stakeholder value. An ability to distinguish between engagements where entities are widely marketed compared to entities that have been 'improved' may become a valuable differentiator.

The Insolvency Service's consultation last year, *A Review of the Corporate Insolvency Framework*, adds to the continuing trend towards corporate rescue, with a number of proposals put forward for consideration including the introduction of a pre-insolvency moratorium for distressed businesses to offer protection when considering rescue options. That must include turnaround.

While each instruction is unique, in this article the authors will seek to describe in broad terms some of the considerations when advisers are contemplating a turnaround engagement with the aim of giving some experience-based guidance on the first stages, commitment and challenges.

Recognition

The most common plea made to readers of articles of this nature is for practitioners to be 'called in' as early as possible. For turnaround, there are two significant problems with that. Why would an experienced management team make that call? And what are they calling about?

As turnaround is a stable for numerous specialisms, recognition of the issues and acceptance of a need is a 'condition precedent', to import some legal language. From recognition follows identification and definition.

The factors that appear to increase recognition and need are, in no particular order:

- The size (turnover or asset base) of the entity. While many entities can be 'improved', there is a cost, commitment and value impact of any turnaround that needs to be assessed on a cost/benefit basis.
- The involvement of a private equity or other sponsor whose position may be enhanced eg as a multiple of EBITDA.
- The governance structure eg the influence of non-executive directors.
- Whether the issues and the solutions are outside or within the control/influence of management. For example, a single 'software as a service' provider (wholly market dependent) may not be capable of turnaround. It is more likely to be restructured or refinanced.
- The level of existing (or likely) engagement of key stakeholders. For example, a medium-sized residential builder will likely require the support of reluctant but critical suppliers.

> "The practitioner's transferable skills of rapid analysis, clear communication and assessment of alternative options come into play during the diagnostic phase."

Once recognition has been achieved, quantification of the value of the need is required. This is commonly referred to as the 'diagnostic'. This is the first stage of measurement and provides the primary assessment of value versus cost; the latter often being front and centre in management's thinking.

Diagnosis

The practitioner's transferable skills of rapid analysis, clear communication and assessment of alternative options come into play during the diagnostic phase. Commonly, stakeholders benefit from objective diagnosis and analysis particularly where there is a need to obtain a greater understanding of the potential consequences of a situation. Most importantly, the diagnostic stage identifies which, or in what combination, services are required. Again broadly, this will be a combination of the following elements:

- Operational improvement: being the detailed assessment of the efficiency of connected processes to identify and remove factors that increase cost or reduce profit.
- Working capital improvement: being the detailed assessment of the processes and policies that impact the conversion of activity into cash with the objective of removing factors that increase borrowing or reduce cash.
- Cost reduction: being the removal or reduction of unwarranted or unsupported costs without impacting the operational efficiency of the entity. Significant interaction with legal advisers is normally required as cost reduction is synonymous with head count reduction.
- Financial restructuring: as defined above and requiring legal advice.
- Governance structuring: not solely for the entity but for the turnaround itself.
- Strategic assessment: being a consideration of the market direction of the entity and the steps required to deliver any change.

Prioritisation

Prioritisation must factor in the available time and current financial position. Gaining agreement as to the degree of urgency and size of the issues places a turnaround on a strong footing. Where the luxury of time is not available (and even when it is) a directional quantification and assessment of issues (value, cost, difficulty) and the high-level outlining of a turnaround process reassures management.

The greater the urgency of the situation, the greater the focus on immediate cost reduction and working capital efficiency. Cash stabilisation should involve careful consideration (and recording) of the directors' legal duties particularly where the payment terms of creditors may be varied. Additionally, a review of the purchase ledger and the underlying contractual terms for payment may result in a fundamental change of collection policy. Both elements must be assessed in the context of the commercial needs of the entity but a clear and informed record of the decision-making process is prudent.

Turnarounds are difficult and experience peaks and troughs of progress. While it is common sense that an evidenced, reasonable decision is less likely to be found to be in breach of duties, that doesn't mean it will never be challenged. Hindsight can be a capricious judge. It seems sensible that any decision that may interact with a director's duties is subject to legal advice.

Context

Only by fully understanding the company's operations (and, where relevant, those of the wider group) will the practitioner be able to identify and address the various risks (and restraints) inherent in the company's operations. This will involve understanding the markets in which the company operates and the manner in which it conducts business. In the case of the legal adviser, this will involve understanding any regulatory context, the contractual matrix underpinning the company's business (including default terms), and the legal relationship with key stakeholders.

Healthcare is a prime example of a sector where deep understanding of the regulatory environment is critical. For example, a restructuring of the employee base will require an understanding of at least: employment law; regulatory standards of both staffing levels and qualifications; the potentially personal impact of safeguarding breaches; and the individual rights of the service users.

Stakeholders

Crucial to understanding the situation and being able to formulate options for a successful turnaround is an identification of the key stakeholders and their respective interests. Such stakeholders might include:

Directors/management: where the directors are also founders of the business, the emotional investment might mean that they are reluctant to face the reality of the company's problems. Directors might also be concerned that their position is vulnerable, particularly in circumstances where further support has been recruited to address problems.

> The greater the urgency of the situation, the greater the focus on immediate cost reduction and working capital efficiency.

The directors also need to be alive to the issues faced in group structures, particularly where there are common directors across group companies and where the potential for conflicts will be greater.

Employees: turnarounds are not secret. Employees will be aware. Employees often have the best ideas. At a fundamental level, employees will deliver the turnaround through changes to the way they work.

Inevitably, they will be concerned for their position, especially if the company needs to streamline its operations and cut costs. Key employees who are essential for implementing a successful turnaround might be considering their options, and the entity will be at pains to ensure that they are motivated to remain with the business.

Lenders*:* lenders may be looking at their exposure and, in particular, whether there are undrawn commitments that might increase their exposure or on-demand facilities, such as overdrafts, which they wish to reduce or cancel. They may also be considering whether or not they remain supportive of the business or whether they wish to exit the lending relationship.

A key issue is that a provider of debt can only be repaid their capital, interest and contractual charges. In effect, there is no upside. Rarely is motivating a lender by emphasising the potential for a loss the best plan. Certainly, it does not achieve buy-in.

Shareholders/investors: as identified above, shareholders (private equity or individuals) will ultimately be looking to preserve and enhance or restore equity value. Their support might be crucial for achieving the turnaround, for example by providing further investment, support functions or expertise. If the shareholders are not willing to invest further, are they willing for others to invest in the business either alongside them (dilution) or by selling their investment?

Suppliers: suppliers might be concerned about the potential loss of a customer if the company ultimately fails. They may also be concerned about credit risk and might look to reduce credit terms or introduce retention of title provisions governing when title to supplies passes. If the business is reliant on credit insurance, then the relationship with credit insurers will require focus.

Customers: consideration may have to be given as to how to drive demand if this is a key aspect of the turnaround plan. Certain customers may be heavily reliant on the company and the goods or services it provides. If these cannot be readily obtained elsewhere then the customer may be a potential source of support during the turnaround process.

A common role for the practitioner will be to support management (directly or indirectly) in engaging effectively with key stakeholders on behalf of the company and providing them with information appropriate to their needs. This is drawn from the agreed platform of information, being the detailed financial assessment and resulting model against which progress is measured. Such stakeholders will themselves often be understandably concerned about the situation and their own positions.

Stabilisation

Stabilisation is not solely achieved through working capital management. It is a broader concept of the point at which there is:

- an agreed platform of financial information confirming the 'start point' and financial objective
- a detailed plan aggregating and prioritising the discrete activities (or 'workstreams') required to deliver the objective and identify interdependencies
- an agreed governance, control and reporting structure to monitor and measure the pace and progress of the plan
- clarity as to the roles and requirements (including timescales) for individuals and teams responsible for delivering the workstreams
- a clear communication strategy
- a workable measurement metric for pace, progress and reward, not just for the turnaround practitioner but the wider team.

> It is perhaps one of the indications of a successful turnaround that a practitioner can end their engagement in the safe knowledge that positive change has been embedded.

As part of the wider process the practitioner will guide management (who are often stressed and lack experience of such situtations), helping them to focus on the critical issues and to move quickly and decisively, and while the practitioner may end up undertaking the management role directly, he or she will often find themselves in the unfamiliar position of supporting, but not leading, the management team and seeking to resolve conflicts or competing priorities among them.

Conclusion

There is no average length of a turnaround and, for believers in the ideal of continuous improvement, there shouldn't be an end. For any practitioner, commercially, there has to be an end point. It is perhaps one of the indications of a successful turnaround that a practitioner can end their engagement in the safe knowledge that positive change has been embedded. If the engagement is correctly commenced, that possibility is greatly increased. □

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A solution for all (or a test for one?)

Simon Edel places consensual solutions under the mathematical lens of an insolvency magnifying glass.

In order for a turnaround to work creditors need to pull together on a consensual deal, but when dealing with the shifting capital structures of financial creditors and a business that may be facing the imminent threat of an insolvency, this may be a case of firing at a moving target. There are two key questions for any financial creditor or, indeed, regulator when assessing a consensual solution to a distressed situation.

How confident are you that a consensual solution can be achieved and, more to the point, how do you know that the consensual offer is in fact the best offer on the table?

Determining the priorities

While a corporates' capital structure may have previously comprised of a senior loan and perhaps a second ranking debt instrument, it is fairly common in today's market to be faced with a multi-tiered debt structure comprised of super senior debt, senior debt, mezzanine, PIK instruments and high yield notes. In many cases, especially with corporates at the larger end of the scale and with cross-border operations, these debt instruments will be governed by a plethora of local jurisdictional law, and sometimes with an overarching English Law inter-creditor agreement seeking to piece everything together.

The evolution of capital structures has meant that accurately determining a financial creditor's position has become very challenging. Added to this is the recognition that the alternative to a consensual deal may, at the extreme, be insolvency. It is therefore important for all stakeholders around a consensual restructuring negotiation to consider what their insolvency level of returns may be relative to the consensual outcome with which they are faced.

> "The evolution of capital structures has meant that accurately determining a financial creditor's position has become very challenging."

However, it is not unusual for many capital structure negotiations to commence from a pure legal seniority position, perhaps with the benefit of a high-level consolidated waterfall analysis applying enterprise value estimates against the face value security structure. This approach risks significant value being left on the table and indeed may not appropriately identify the drivers of a respective creditor's position.

Working with (and against) the facts

Counterfactual is defined as an expression of 'what has not happened but could, would, or might under differing conditions' (*Collins English Dictionary*). In a restructuring context it is often taken as what the insolvency/liquidation outcome may be for stakeholders and, importantly, what would drive that alternative outcome.

As a result, understanding the entity, jurisdictional, market and security dynamics is critical to value assessment. Outcomes are not always predictable and sometimes can be counter-intuitive.

As *RECOVERY* readers will well appreciate, insolvency is a legal-entity-by-legal-entity affair, even within a group of companies. Each entity has its own pool of assets, liabilities and, under insolvency, local liquidation priority rules. While security may comprise a fixed charge over a particular asset, it may also comprise floating charges and guarantees that are subject to local statutory insolvency priority rules that dilute recovery values.

The solution, therefore, to understanding the counterfactual–theoretical insolvency returns analysis is to simulate a group liquidation/or enhanced insolvency filing strategy through an entity priority model (EPM). An EPM in its simplest form can be described as a simultaneous and interdependent estimated outcome statement analysis for every single entity in a corporate group structure.

An EPM analysis involves modelling the entire group structure on an entity-by-entity basis, based on common reference date entity balance sheet information, overlaying local jurisdiction liquidation priority rules and modelling the legal, statutory and contingent considerations of each entity's arrangements.

Unlike a waterfall model, which often takes a view of consolidated business units' value allocation, an EPM is truly a 'bottom up' detailed analysis that seeks to articulate what drives creditor recovery at an entity level, taking into account a number of factors that could be overly simplified in a top-down approach.

> The solution, therefore, to understanding the counterfactual–theoretical insolvency returns analysis is to simulate a group liquidation or enhanced insolvency filing strategy through an entity priority model.

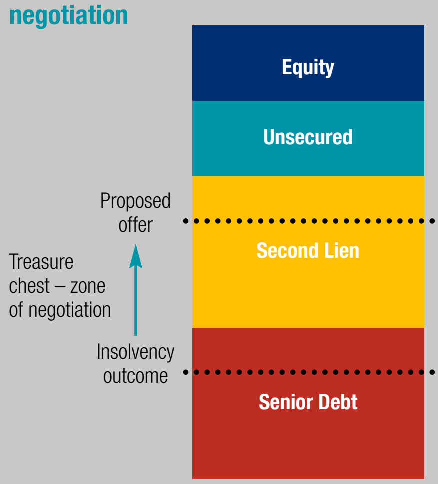
It allows a stakeholder to identify what more they can hope to achieve in negotiations relative to both the offer presented and the 'insolvency floor' price beyond which they will not trade.

More than maths

The EPM analysis is much more than a mathematical exercise. Applying the lens of a theoretical insolvency, questions pertaining to the validity of creditors' security, subordination of intercompany claims, quantum of competing contingent claims, effectiveness of guarantees, and quantum and ranking of employment redundancy claims, are considered and modelled.

Our experience shows that without a detailed understanding of the contractual, financial, operational, statutory and group dynamics that not only affect your negotiating position but also the position of all other parties in the capital structure, or indeed regulators and other parties whose view and consent will ultimately be required, value can easily be left on the table. Some examples are set out below to illustrate this point:

Understanding the insolvency outcome is critical to understand the zone of negotiation



- A secured creditor's negotiating position was at risk as a consequence of security having been taken well within a two-year timeframe of a restructuring, in effect severely challenging their assumption of being the fulcrum creditor. In this case the second lien had claim as fulcrum creditor, changing the negotiating dynamic.
- In another situation, lenders' recoveries were not in fact coming from their security but from guarantee claims from several jurisdictions that had statutory limitations on the quantum of guarantee claim that could be made. When the local jurisdictional guarantee limitations were modelled recoveries were lower than parties had thought.
- EPM analysis identified significant value leakage from a creditors' security pool as a consequence of the local European priority afforded to certain employment and tax claims in an insolvency that would in effect 'top slice' recoveries.
- Given the importance of where cash is located in a group structure at a point in time. The analysis showed that the timing of an insolvency could yield materially different creditor returns.
- Funds on loaned within a group structure transpired to be treated as subordinated in an insolvency context as between certain jurisdictions (and depending on if the loans were upstream, downstream or cross-stream lending). This meant that the creditors of the lending entity, under insolvency conditions, were in a materially worse position than had been assumed.

EPM provides negotiating power no matter where the stakeholder sits in the value curve. The flexibility of the model allows for alternative restructuring options, both consensual and non-consensual, to be analysed and helps identify opportunities for value enhancement. It is also an important tool in considering the impact to other creditors and regulators. For example, in a restructuring situation with a defined benefit pension scheme, it may be important to demonstrate whether the consensual term sheet impacts on the covenant to the pension scheme. EPM can identify what a creditor's position may be and then assess the revised term sheet structure to see if respective creditors' outcomes have in fact been worsened or not. The analysis will also identify if there are unencumbered assets/pockets of value that could be added to a security package to sweeten the deal.

Conditions for creditor compromise

Ultimately, creditor compromise requires sufficient information for stakeholders to make an informed assessment of a proposal. This is even more pronounced when a proposal is being progressed through a court process such as a scheme of arrangement. Demonstrating to the court and creditors that a proposal provides a more advantageous outcome than an alternative is critical. Justice Snowden, in sanctioning the

> Unlike a waterfall model, which often takes a view of consolidated business units' value allocation, an EPM is truly a 'bottom up' detailed analysis that seeks to articulate what drives creditor recovery at an entity level.

Van Gansewinkel Groep BV schemes of arrangement (VGG) in July 2015, handed down judgement with practical guidance for future schemes. In particular, Snowden provided some directional guidance in relation to future schemes, presented as an alternative to a formal insolvency procedure, including a detailed explanation with sufficient information to allow creditors to make an informed assessment of the proposal relative to an alternative outcome.

Ultimately the quality of the outcome depends upon the quality of negotiations between respective stakeholders, which depends upon the quality of the analysis.

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A rare find:

RAAs in pension scheme restructuring

The PPF's **Malcolm Weir** explains the checks and balances needed before an RAA can be agreed.

An agreement was signed in August 2017 to allow Tata Steel to restructure its British Steel Pension Scheme (BSPS), culminating in a regulated apportionment arrangement (RAA) after a series of lengthy engagements with a host of stakeholders. The talks for this agreement had begun in 2016 and it is one of only three RAAs to have been completed since December 2014, the other two being the Hoover pension scheme (April 2017) and the Halcrow pension scheme (May 2016). The rarity of these situations is deliberate.

What do the stakeholders need?

The Pensions Regulator (TPR) is focused on ensuring employers meet their pension commitments, while the Pension Protection Fund (PPF) wishes to minimise the impact of calls on our balance sheet to protect the levy payers who fund the organisation.

> "If the inevitable insolvency of the employer cannot be demonstrated, neither TPR nor the PPF will engage in RAA or restructuring discussions."

Accordingly the PPF will only agree, or more technically not object, to an RAA if it can be shown that an employer will become insolvent and a PPF assessment period will occur, ie the liability for the scheme will hit the PPF balance sheet whatever happens. Employers proposing an RAA must be prepared to publically acknowledge that their business will become insolvent within the next 12 months unless they deal with the pension scheme through an RAA.

If the inevitable insolvency of the employer cannot be demonstrated, neither TPR nor the PPF will engage in RAA or restructuring discussions. Attempts at financial restructuring with the main purpose of avoiding an expensive pension commitment will fail this test. We take a hard line on this and have been educating

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> We will need to be convinced that steps are being taken to address the weaknesses in the business and implement the changes that are necessary to make sure it has a fair chance of succeeding.

the industry in the last few years. Advisers are becoming better informed and we hope they will educate their clients not to attempt this.

Of course, it is rarely the case that a business is in difficulty solely as a result of its pension commitments. If we agree to a restructuring, we will need to be convinced that steps are being taken to address the weaknesses in the business and implement the changes that are necessary to make sure it has a fair chance of succeeding.

There are no guarantees of survival and we have seen a number of failures despite management's best endeavours. However, where management are properly engaged and open to imaginative ideas, we have seen significant value being delivered down the road for the benefit of many stakeholders who would have ended up losing most, if not all, of their value had an insolvency occurred. The key to preserving this value is admitting there are issues to be addressed and tackling them through early engagement with all stakeholders, including the pension scheme trustees.

What makes a business suitable for an RAA?

Both TPR and the PPF have issued guidance on their approach to RAAs, which is available on their respective websites. Assuming that the insolvency test has been passed, the other considerations from a PPF viewpoint include:

- The proposal offers a significantly better return than would be achieved through the insolvency – in assessing this we consider a number of factors including:
  - as a base line, what the proceeds from a going concern sale outcome would be
  - the level of liability that the employer is avoiding through the restructuring. This is measured by the full buyout liability of the pension scheme (section 75 Pensions Act 1995)
  - what the proposals for the business are going forward and the ongoing owners' ability to provide funds to pay mitigation either through their own resources or debt
- The scheme/PPF receives equity in the restructured commercial business. We hold this as an 'anti-embarrassment' stake. This is to ensure that if the business goes from strength to strength, having been relieved of its pension commitments, the scheme/ PPF benefits from a reasonable proportion of the value created by having released its pensions claims against that employer.

CASE STUDY

Halcrow – an RAA setting up a new robust scheme

Halcrow was acquired by CH2M in 2011. It had a number of defined benefit pension schemes, the most important of which had a buyout deficit of some £400m. The scheme was unaffordable to the employer who relied on funding from its parent to maintain its contributions to the scheme. In June 2015 court proceedings to implement a proposal to redesign the scheme's benefit structure started. However, the court decided that the proposal could not proceed without members' consent. Without the issue being resolved, the threat of imminent insolvency became very real.

Solution

The employer and its parent wished to honour the pension commitment as far as possible but could not afford the scheme as constituted. TPR and PPF were satisfied the insolvency test was met and that there were no grounds to take moral hazard action against any party.

A settlement was reached whereby members were offered a new scheme that had less generous inflation increases but provided benefits in excess of those offered by the PPF. The new scheme is eligible for PPF entry but the chances of this happening have been significantly reduced by a number of factors that greatly improved the strength of the scheme, namely a one-off cash contribution, a guarantee from the ultimate parent and an improved position in the repayment waterfall if an insolvency does ever occur. This mitigation provided a much better return than the impending insolvency. In addition, an equity holding was taken.

There are a number of other considerations the PPF take into account before approaching an RAA. These are listed under the numbered headings below.

1. Equity

The PPF has set minimum benchmarks on the equity stakes that are required. If any of the existing stakeholders, including shareholders or financiers, continue to own a stake in the business going forward, we expect an equity holding of at least 33 per cent. This may be considerably higher if the pension scheme is effectively the economic owner of the business at the time of the inevitable insolvency. If an unconnected party is proposing and funding the restructuring with no involvement of the 'old money', the PPF expects at least 10 per cent of the equity.

> If any of the existing stakeholders, including shareholders or financiers, continue to own a stake in the business going forward, we expect an equity holding of at least 33 per cent.

2. Required documents

The PPF has a suite of standard shareholder documents (available on our website) that it requires for anti-embarrassment equity. These have been carefully drafted to incorporate appropriate levels of protection for the trustee/PPF as minority shareholder » without the need to appoint a representative director. However, we do require the right to appoint a board observer, paid for by the company.

The use of standard documents has a number of purposes. In particular it controls costs and transaction risk for all parties, including risks that arise because of the involvement of TPR and the PPF as public bodies, such as state aid. Before proposing an RAA, an employer must review the documents to ensure they are prepared to agree to them in the standard form and, if not, seek an alternative solution. Minor changes may be possible if there are bespoke reasons relating to the specific employer but we will not accept wholesale changes. Attempts to rewrite the standard forms will result in unnecessary and ultimately avoidable wasted costs being incurred for the employer.

> "It is inappropriate for the pension scheme to be the only party expected to incur a loss."

No value is attributed to the equity stake at the time the RAA is completed because, by definition, the company is insolvent at that time.

3. Moral hazard powers

In order for an RAA to progress, the actions of the employer and associated parties must not have created circumstances whereby use of TPR's 'moral hazard' powers could deliver a better contribution to the scheme than is available through the RAA. For example, in situations where employers appear to have been run on a group, rather than entity, basis (with funds being provided to ensure the employer is just able to meet its commitments, including the pension scheme), the activity of the group may expose it to the 'moral hazard' regime and the funding obligations that may create.

4. Creditors at risk

The impending insolvency of the business means that all creditors, not only the pension scheme, are at risk of loss, the level of which will depend to a great extent on whether they hold any security. It is inappropriate for the pension scheme to be the only party expected to incur a loss and, while some accommodation might be made for essential trade creditors, other creditors will also be expected to write off a proportion of the amount due to them. In particular, intercompany debts and preference shares should be eliminated. It is also appropriate that debt owed to financial institutions that is not covered by their security is written down.

CASE STUDY

Hoover – a standard RAA

The Hoover business had dramatically changed, with production moved to the Far East and the UK operations essentially focused on sales and distribution. The company retained responsibility for the very substantial pension scheme liability as a legacy from when it was much larger. The triennial valuations showed an ever-growing deficit. The recovery plan proposed by the pension scheme trustee was far too long. Work was done to demonstrate that in the long run the scheme was unaffordable and that this could trigger an insolvency of the employer. In view of this, the company's directors explored all the options available to protect creditors as a whole, the biggest of which was the scheme.

Solution

The directors approached the PPF with an outline CVA proposal, predicated on the likelihood of the employer becoming insolvent unless there was a restructuring. The PPF accepted this analysis, even though it didn't consider that the insolvency would necessarily take place within 12 months as required by TPR's RAA criteria. However, the PPF rejected the proposal because, in its view, it failed to provide mitigation that was significantly better than the insolvency outcome.

Discussions took place over a significant period of time, during which the vote on the UK's membership of the European Union occurred. This had a significant adverse effect on trading and eroded the company's reserves to the point that insolvency of the business within the next 12 months was very likely unless a restructuring took place. This meant that the RAA solution could be reconsidered. Parental support for the ongoing business was only available if the pension issue was addressed.

An RAA was completed with a substantial cash payment being made to the scheme and a 33 per cent equity stake being taken in the business.

5. The cost of an RAA

An RAA is an expensive process both for the employer and the scheme/PPF. The scheme is likely to be seriously underfunded when the RAA is proposed, so it is important that the deficit is not increased as a result of the work needed to implement the RAA. Accordingly, all the costs incurred by the trustees and the PPF in delivering the proposal must be fully underwritten by the employer, whether or not the RAA proceeds to completion.

The costs will include the PPF and trustees' lawyers, financial/actuarial advisors required to appraise the proposals, public relations advisors needed to handle and advise on media activity and any other additional costs that may be incurred, such as TUPE costs relating to employer staff retained to administer the scheme and, in certain types of restructurings, the assessment period costs.

> "An RAA is an expensive process both for the employer and the scheme/PPF."

Unfortunately restructurings do not always proceed as planned, or are not successfully implemented. This may lead to commitments to pay costs not being honoured and the PPF or trustees being out of pocket. To ensure that this does not happen, in circumstances we deem appropriate, we reserve the right to request an advance payment of trustee/PPF costs.

If the RAA requires debt provision or refinancing, the cost of that financing and

CASE STUDY

Tata Steel UK – RAA as a final option

Against a backdrop of worldwide overcapacity and low steel prices, Tata Steel UK (part of Tata Steel Europe) faced a worsening trading position. Poor financial performance over a number of years had been offset by very substantial cash support from the ultimate parent, including funds to pay the pension deficit contributions in excess of £50m per year. An overall restructuring of the business was required, which the Tata Steel board resolved to do in early 2016.

Solution

At the outset Tata Steel Europe explored the potential sale of Tata Steel UK as a whole, including the obligations to the pension scheme. No offers capable of completion were received so an alternative approach was required. Non-core elements of the business were sold off. A pension solution requiring a change in legislation to allow changes to the indexation of benefits was explored but did not come to fruition. In order to prevent the parent from withdrawing financial support and causing an insolvency, an alternative solution involving the opportunity to move to a new scheme supported by Tata Steel UK was proposed.

TPR and PPF undertook detailed due diligence, including the use of external advisors, before supporting the inevitability of insolvency conclusion. The level of mitigation payment was extensively negotiated and a very substantial sum of £550m has been received by the pension scheme. The scheme also now owns a 33 per cent economic equity stake in Tata Steel UK.

Although the numbers in the Tata Steel UK scheme are eye-watering, with liabilities of £15 billion, it was very much a standard deal in terms of implementing the RAA guidance and followed on from the pattern established with Halcrow for a new scheme. It is important to note that the new schemes that have been created both rely on improved funding levels as a result of a share of the mitigation paid in the RAA and the stronger covenant provided by the restructured employer.

any associated fees and charges must be set at a reasonable level so as not to place an undue burden on the business going forward.

Alternatives to an RAA

If circumstances permit, alternative restructuring procedures to an RAA may be considered, such as a company voluntary arrangement (CVA). These may be less expensive to implement but the employer will suffer an insolvency event, which is avoided through an RAA. The principles outlined above will apply whatever procedure is chosen and TPR and the PPF work in close cooperation on all cases to ensure they are robustly adhered to and there is no abuse of the system.

You can read more about TPR's guidance for dealing with trustees and alternatives to an RAA in Mike Birch's article on page 30.

Recently the RAA concept has been used to facilitate what appears to be solely a pension restructuring, specifically on Halcrow and Tata. However, it is important to note that in both cases all the criteria set out above had to be satisfied. Although press comment may have focused on the pensions issue, both employers were required to demonstrate that they would become insolvent within 12 months without an arrangement addressing the pension scheme.

Halcrow and Tata are examples of a new scheme being supported by the covenant of an employer that is responsible for satisfying any subsequent claims to make good a pension deficit. The PPF stands behind the employer as a second line of defence in the hopefully remote circumstances that it becomes insolvent in the future.

Easing the burden on levy payers

Attempts have been made to use the RAA mechanism to set up a new pension scheme entirely separate from the employer. A special purpose vehicle is created to be the new employer but has no balance sheet strength and cannot provide the first line of support to the scheme. The risk to the PPF is that it is simply being asked to underwrite the actions of the trustees without any direct control. This places an unfair burden on the PPF levy payers who are financed by employers honouring their ongoing pension commitments.

“If circumstances permit, alternative restructuring procedures to an RAA may be considered, such as a company voluntary arrangement (CVA).”

A proposal on this basis would only be acceptable to the PPF if the new scheme was funded above PPF liability levels at the outset and included a mechanism to trigger PPF entry should a deficit creating a call on the PPF arise at some point in the future, in order to limit any increasing exposure. In March 2017 the PPF published a new rule for charging an appropriate levy to schemes without a substantive employer, which requires schemes to be fully funded on a PPF basis and not managed in a way that would result in an excessively high levy charge.

Conclusion

In summary, the PPF is primarily focused on being able to deliver compensation to its members and protecting some 11 million members of ongoing pension schemes should their employer become insolvent. It is funded by the levy on schemes, rather than the public purse, and seeks to minimise the levy burden. Accordingly, the PPF will become involved in restructurings where there is an opportunity to minimise the call on its resources, always provided that a real solution is presented, rather than postponing a problem to a later date and risking a significant claim in future or disadvantaging the PPF in the longer term. ◻

MALCOLM WEIR is head of restructuring and insolvency at the Pension Protection Fund.

Equal protection for pensions

Mike Birch explains TPR's role in business rescue and why it is important to have pension scheme trustees on board.

High profile business distress cases such as BHS, Tata Steel and Halcrow have thrown the spotlight on the often pivotal role pension schemes play in the success, or otherwise, of turnaround plans.

Our rarely used pension restructuring power, known as a regulated apportionment arrangement (RAA), has emerged from the shadows thanks to numerous articles in the national press.

In reality these arrangements are a last resort, which may follow months or years of funding negotiations between an employer in difficulty and its stakeholders.

Uncommon agreements

RAAs are rare. We have only ever approved 29 for very good reason. They allow a financially troubled employer to detach itself from its liabilities in respect of a defined benefit (DB) pension scheme.

For an RAA to succeed we need to be satisfied that the employer's insolvency is inevitable, that the RAA provides a better outcome for the scheme than could be achieved either through insolvency and/or through our anti-avoidance powers and that the scheme is being treated equitably with other creditors.

For more on RAAs, their criteria and consequences, see Malcolm Weir's article on page 26.

An RAA may indeed save a company from going bust, but it will also result in a significant hit to the lifetime pensions for potentially thousands of people, so we have to be absolutely sure it is the only alternative to best protect member outcomes. We do not approve RAAs lightly and they must be seen as a last resort for a company facing insolvency. There are a number of solutions that a sponsoring employer and its advisers can consider in relation to their pension scheme before the employer reaches the position where insolvency is inevitable.

For example, scheme trustees may agree to lower pension contributions or a longer recovery plan if the scheme is in deficit to allow a company to increase investment. Where schemes continue to accrue benefits, employers and trustees may also consider whether this remains affordable. These are solutions we are open to and form part of the DB funding framework that we believe is working as intended.

But there are a number of things employers, and those advising them, should consider when engaging with their pension scheme trustees board and TPR.

Don't ignore trustees

We see those running pension schemes as being a knowledgeable, empowered first line of defence for scheme members and so, as in a turnaround situation, scheme trustees are often one of the key stakeholders.

We expect an employer to engage with trustees early, openly and ensure they are well advised. Solutions are far more likely to be found where trustees are properly engaged. If you represent a company, you will be in a stronger position with well-advised trustees than those who are badly informed.

> "We see those running pension schemes as being a knowledgeable, empowered first line of defence for scheme members."

In smaller companies, trustees may only meet once a quarter. They are often unpaid and not always experienced in dealing with situations of corporate distress, which are complex. It is essential therefore they are well advised in order to reach the right decisions.

We expect trustees to be treated equitably too. Where an employer in turnaround is seeking to divert funds away from their pension scheme, trustees will want to know how these funds will be used and how other stakeholders are making similar commitments to the sustainability of the business.

For example, trustees will expect dividends to be switched off, and they will want reassurance that they are not simply funding pay down of debt. They will want evidence that other parties are helping to find the solution and that they are receiving sensible and equitable treatment in areas such as security sharing. They will want robust documentation.

As a former restructuring banker, I know first-hand that you are used to seeking support from a variety of stakeholders when dealing with a challenging trading situation. Trustees should be viewed no differently. They will take the same logical approach as any other financial creditor would do.

Trustees are not a notional creditor; they are real people, whose decisions have a real impact on peoples' lives if they take risks with the pension fund. They may well support a turnaround but only on sensible, equitable grounds.

When does TPR become involved?

It is right that turnaround or restructuring discussions that involve a pension scheme are channelled through the trustees. They are the ones with the obligation to scheme members but we will take an interest, particularly where the case is large or critical.

If we feel trustees are being kept in the dark, or are not being treated equitably, we are more likely to get involved and open a case to examine whether we need to use our anti-avoidance powers.

We are used to dealing with commercial pressure. We are able to move quickly and we are committed to being clearer and quicker, but also tougher. When we receive the information we need about a restructure, for example, we can give our view promptly on whether it is viable and, if not, what needs to be addressed. We'll tell you what we don't like, but also how to meet our expectations.

TPR's growth objective

In 2014, we implemented a new statutory objective to minimise any adverse impact on the sustainable growth of an employer. As a result, if an employer is genuinely seeking to invest in growth and other key stakeholders are playing their part and giving support, then we will be open to proposals to vary payments to the pension scheme. However, we are likely to intervene if we believe a pension scheme is not being treated fairly, for example if big dividends are being paid while little is being done to address a large scheme deficit.

So our recommendation is for employers to bring scheme trustees in as early as possible and treat them fairly and equitably. For out part, we are striving to be clearer, quicker and tougher so that when we do engage in turnaround situations employers will be clearer about what acceptable looks like.

MIKE BIRCH is director of case management at The Pensions Regulator (TPR).

Funding the road to recovery

Don Pritchard explains options for alternative lending for business recovery.

Businesses in need of finance have traditionally reached out to a wide variety of sources for funding, but several recent factors, including negative signs from the banks, slow service or the need for a different type of funding model, have fuelled the rise of alternative finance and comparison websites.

The businesses seeking funding may not necessarily be in financial distress, but could be anywhere on the spectrum of trading situations where alternative finance may be required. Many of the applicant businesses are thriving, with strong balance sheets, profit and cash generation.

> If the relationship between owner/director and primary banker has deteriorated, it is of course unlikely that the bank will take on other short-term lends that are behind the cash flow problem.

The typical scenario

But what if a business is struggling with cash flow problems or the challenge of mounting debts and is in desperate need of a recovery plan?

In a typical scenario, where a business owner is running out of options, there is generally a pattern for the way a company seeks finance while on the verge of financial distress. A business owner will call lenders or financial services professionals, including recovery specialists, to attempt to secure funds. If the relationship between owner/director and primary banker has deteriorated, it is of course unlikely that the bank will take on other short-term lends that are behind the cash flow problem.

Even though such consolidation and restructuring might enhance the chances of full repayment, the appetite of most high street funders to take on other outside debts is usually limited.

The option that remains is to approach non-bank lenders for assistance. While some are fairly conservative in their appetite for taking on outside debt – requiring strong security, good financials, good bank statements and a long trading history etc – others are prepared to take on situations where there are or have been problems, poor credit history, debt consolidation and so on.

Remember, however that such lenders will see a higher percentage of failures and their pricing will reflect this.

Using a funding search engine

If you are willing to consider higher pricing, a funding search engine, such as R3's Funder Finder, might be an option. These allow the administrator, or the business owner, to register the business and narrow down the options for financing.

Required details include the amount, purpose, sector, trading history and other information that is likely to be close to hand. At Alternative Business Funding (ABF) we use a traffic light system to classify lenders:

- Green signifies the lenders most likely for a successful outcome. You can either apply directly via the engine or ABF consultants are happy to add their experience and help via a 'phone conversation.
- Amber results are lenders who may require further information to confirm their willingness to engage with you.
- Lenders in red are unlikely to be able to assist, perhaps because of their risk appetite or perhaps because their products don't match what you are looking for.

What do alternative lenders require?

Lenders will of course need to see some documents before an agreement can be reached. This will usually include the most recent set of accounts for the business, three months' worth of bank statements, the last five VAT returns and the director's details, including date of birth and a three-year address history. They may also require a breakdown of an individual's assets and liabilities, and a schedule of the business' debts. Some lenders may ask you to complete their own specific forms.

There will be some variation in the process that has more to do with the preferences of different lenders, rather than the status of the applicant.

How soon can funding be secured?

Using an online funding portal, the process can take as little as an hour to complete. Unsurprisingly, complexity and larger sums required can impact the speed of response.

Lenders convey a decision for you to discuss with your client and, if there is a collective desire to proceed, the application can be brought to a speedy conclusion. Processes such as electronic signatures are commonplace and can make the process easier.

> Any lender with which you choose to progress will need to seek permission before carrying out a hard search, ensuring that you stay in control.

Most *RECOVERY* readers will be aware of the damage that multiple searches can cause to your client's credit profile, but services such as Funder Finder use a soft search, that doesn't leave a footprint. Any lender with which you choose to progress will need to seek permission before carrying out a hard search, ensuring that you stay in control.

Alternative finance and comparison sites are a good way to access many different potential lenders, quickly identify which of these are most likely to be able to assist in your client's individual situation and then progress single or multiple applications. Lenders' pricing may change for higher-risk cases, but this can be a good trade off where speed is so often of the essence in achieving a turnaround.

DON PRITCHARD is a former commercial banker and is currently a consultant for Alternative Business Funding.

Are CVAs facing eviction?

John Cook weighs up the differences between CVAs and consensual restructuring from a property standpoint.

Over the past ten years the growth in use of company voluntary arrangements (CVAs) to allow companies to rebalance their estate costs means that there are few landlords active in the retail and leisure sectors who have not had some exposure to the mechanism.

The now-standard practice is one of separating premises into 'pots', with each pot seeing different levels of compromise. These compromises can range from no impact through downward reviews of rent to immediate closure and surrender, something which has seen property owners take significant hits. While landlords do have the opportunity to vote in support of, or against, the proposal, the fact that all landlords are bound regardless of their vote, and that the store allocations are too often presented as a fait accompli, has seen the CVA mechanism increasingly lose favour with the property industry.

Consensual solution

This is where the consensual restructure steps in, giving a company the scope to review its portfolio with its landlords, while allowing the landlord flexibility and a negotiating position. In its simplest form, this is far from a new concept; many larger and institutional landlords have for some time been willing to compromise with smaller, independent retailers on matters such as varying the usual rent payment terms from quarterly in advance to monthly without inflicting penalty to assist the tenant cashflow. They may also be open to discussing rent and other lease terms to help the smaller retailer. There's often a win-win to be had here – in leisure and retail it can be the independents that offer a point of difference or community and attract footfall to a scheme, so support for such companies can benefit both sides.

It is not always clearly understood in a CVA proposal that landlords are key stakeholders in the rescue of most businesses and, particularly, the impact that the enforced loss of income can have on a landlord who needs to meet his own financial obligations. Consensual discussions between landlord and tenant, with the assumption that cooperation will prevent greater loss on both sides, are now on the increase.

Without formal process

From a landlord perspective, there can be a real preference to dealing with a restructure without the need for formal process. Stores can be considered on their individual merits and weaknesses, not just on their overall contribution within defined bands as in the CVA approach. For example, a landlord with several of a company's units within its portfolio may be willing to consider a reduction greater than directors may have thought to ask for on an undesirable store in return for a lease extension on an existing successful store. There have been successes in agreeing reduced rent with the discount repaid when turnover thresholds were achieved – a similar approach could be taken with reference to future profitability, akin to the CVA 'clawback' – and in redefining payment terms to achieve the same annual rental income, but on a seasonal basis. So, if a retailer sees 75 per cent of his trade in a particular three-month period, matching the rent liability such that 75 per cent is payable for that period is an easy win that can mean a successful retailer isn't forced to consider a formal process simply because of seasonal cash flow difficulties.

> "Recent years have seen a change in the landlord and tenant relationship, moving away from the historically adversarial one to a symbiotic one."

Cracks in the wall

The consensual restructure is not without its pitfalls – company directors may be open in good faith, only to see a landlord take aggressive steps he would not have made otherwise. There may be practical considerations where there are a large number of landlords who need to be approached, although the newly proposed moratorium could provide the breathing space needed. Businesses need to be prepared to hear some harsh realities about their own operations if negotiations are to benefit both sides, with owners and directors expected to demonstrate their own austerity steps when asking a landlord to support them. Directors should not see the consensual restructure as simply a way to boost profits by cutting rents – discussions with landlords should form part of an overall strategy for turnaround with the aim of avoiding a formal process. Landlords, however cooperative, will need to ensure their business models, financial structure and investor expectations are not compromised.

Crucially, any such discussions would need to remain confidential – something tenants may find attractive when compared to sometimes highly-publicised CVAs. Landlords may prefer to work directly with a tenant to achieve a mutually satisfactory estate restructure rather than within the enforced confines of a CVA.

Landlord and tenant united

Recent years have seen a change in the landlord and tenant relationship, moving away from the historically adversarial one to a symbiotic one. Increasing cooperation between property owners and occupiers to avoid greater losses or weaker positions than may arise from a formal process is a natural result of that shift. The popularity of consensual restructuring seems likely to grow as those relationships evolve. □

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Leveraging litigation finance for restructuring

Mark Beaumont explores how finance can be used for more than just legal fees.

Restructuring is a challenge, and one exacerbated by a lack of liquidity in a business. As with insolvency or liquidation, there may be funds that could be realised via legal action: this could be to recover monies from previous directors, reclaim an asset that was transferred under value or pursue a professional negligence matter, cartel claim or contractual dispute. The nature of the claim is not crucial.

> Put simply, a claim for damages can be viewed as a contingent asset.

There are numerous ways to finance disputes, and many of them have been covered here in previous issues of *RECOVERY* magazine, but few practitioners are aware that third-party funders provide capital beyond legal fees, and that will be the focus in this restructuring special.

Uses for extra funding

Third parties may invest in a litigation asset if the claim has strong merits and the economics stack up, but did you know they can also advance funds for:

- further investigation by the IP (such as interviewing former directors)
- asset tracing
- forensic accounting work to assess a potential claim
- mergers and acquisitions
- ongoing operational costs of the business
- restructuring or other business expenses, including redundancies?

If you think about it, this makes perfect sense: anyone investing in litigation is looking for a return on their investment. The more they invest, the greater their return is likely to be if the case is successfully resolved. Does it really matter to the investor what their money is used for? So long as the case itself has an appropriate level of funding to ensure it is correctly resourced, then it is simply a matter of whether any additional funding would be economic or not.

To put it another way, the typical third-party funder is seeking cases where the claim is pleaded at around ten times or more the likely costs budget. So, if the legal budget is less than a tenth of the claim size, then any 'headroom' can be used to finance other projects for the business, whatever they might be.

The same logic can be used for 'portfolios' of cases too, whether that be the entire litigation book of a firm being restructured or the contentious book of an insolvency practice.

The impact of legal fees

Invoices from solicitors, barristers and experts, together with other litigation costs, have a negative short-term impact on cash flow. What's less commonly discussed is the negative impact on that company's accounts generally: accounting rules treat legal costs differently than they treat any potential award or settlement, which means that even successful litigation can leave a firm with a lasting reduction in their EBITDA.

> Alternative finance should also be on your radar when a business is facing high legal costs in relation to either defending or pursuing litigation or arbitration.

Litigation funding has no negative impact on EBITDA. As discussed above, funding can also be released over and above what's needed to finance legal fees. This money could therefore have a positive impact on the accounts, bringing additional benefits in terms of share price, bonuses, M&A and financing etc.

Shifting risk

If a business is being sold, any savvy buyer will use potential disputes as a reason to drive down the purchase price. It may therefore be sensible for a seller to use insurance to crystallise any risks and ensure that a buyer cannot leverage uncertainty to reduce the price. Of course, the other side of this coin is that a buyer could use the uncertainty to reduce the purchase price, and then following completion they could shift the risk off balance sheet and perhaps see an immediate jump in the value of their purchase. Advantage to whoever is best informed then.

> In the specific area of M&A there are other benefits from litigation insurance and funding that can be useful.

Either way, there are certainly huge opportunities in this market, and at present only the most forward thinking of practitioners are making best use of them. Over the next few years we'll see others follow these early adopters, and I'm sure within a decade these tools will be very much the norm for the sector.

When properly understood, the benefits of using insurance and funding to support dispute resolution become more and more apparent. Being able to find innovative ways to source financing is of course central to performance in the restructuring space: next time the opportunity arises, do consider whether you could be leveraging litigation assets to explore all potential sources of funds.

MARK BEAUMONT is co-founder of Annecto Legal Ltd, an FSA regulated, full market broker accessing litigation funding and ATE insurance for a wide range of insolvency and commercial disputes.

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A way to fill an empty pot?

Rebecca Andrews-Walker and **James Davies** ask the question: could the MasterCard litigation be a windfall for insolvent businesses?

The raft of European and domestic litigation surrounding MasterCard fees has been long running and, frankly, brain-achingly complex. Shrouded in masses of litigation, it is unsurprising that the topic has sparked little interest in insolvency practitioners. However, it has the potential to generate realisations in liquidated estates where there may otherwise be nothing to offer creditors, and it warrants your attention as a result.

We look at how, and why, this will interest insolvency practitioners dealing with any insolvent business that accepted payment using a credit or debit card. Full coverage of the many years of litigation on this subject would require a book, rather than a brief article, given the complex and technical nature of the details, but below we will discuss the important recent conclusions and how they can be applied to insolvent estates.

> The argument runs that the setting of the MIF prevents negotiation of individual pricing policies and so, effectively, creates a pricing floor.

What's the story?

When businesses accept payment by credit or debit card, behind the seemingly simple, every-day transaction is a complex four-party structure. In simplified terms: the customer buys the goods using his/her card; the issuing bank then forwards payment to the retailer's bank minus an 'interchange fee'. The retailer receives the price of the goods less the interchange fee and a fee charged by the retailer's own bank.

The card service providers say that this interchange fee covers the costs of operating card services, security and innovation. An interchange fee can be agreed between the issuing bank and the retailer's bank, but in practice it is usually applied multilaterally by the card service provider – it is called a 'multilateral interchange fee', known as an MIF. As part of the card payment scheme covering MasterCard-branded card transactions, which binds all banks within the MasterCard payment card scheme in the UK, the MIF was 0.9 per cent during the period covered by the high profile litigation.

MasterCard's master plan

The litigation to date has involved the question of whether MasterCard's MIFs for transactions in the UK, Ireland and the EEA between c2006 and 2015, were anti-competitive and so in breach of UK, Irish and EU law. The argument runs that the setting of the MIF prevents negotiation of individual pricing policies and so, effectively, creates a pricing floor and restricts competition between acquiring banks.

Round one: Sainsburys

In July 2016 the competition appeal tribunal found that MasterCard's UK MIF was indeed a restriction of competition (*Sainsbury's Supermarkets Ltd* v. *MasterCard Incorporated & Ors*); a decision that followed years of European litigation that had reached the same conclusion. The decision's rationale was that, in the absence of the MIF, issuing banks could not have deducted an interchange fee without having agreed individual pricing policies with the retailers' banks. They would therefore have reached that agreement without the MasterCard scheme. Sainsbury's was entitled to recover the difference between the fees paid and the amount it would have paid (hypothetically) had it agreed the interchange fees bilaterally. Sainsbury's was awarded £69m in damages together with compound interest.

Round two: Asda

In 2017, however, it all changed. Asda, together with a group of prominent high street retailers, took on MasterCard for round two (*Asda & Ors* v. *MasterCard* [2017] EWCH 93 (Comm)), and a different result was reached by the High Court. It ruled that the MIF was indeed *prima facie* anti-competitive: if the MIFs were lower or zero, the retailers' banks could compete by offering overall charges below that floor. So far, so logical. However, the High Court then accepted what was termed the 'death spiral' argument.

> Some retailers who paid these interchange fees on transactions have, by now, become insolvent. Their claims therefore will be under the control of the office-holder.

This argument (which is less gripping than the name suggests) says that, in a hypothetical world with a MasterCard MIF of zero, while Visa MIFs were set at their actual levels, the MasterCard payment scheme would collapse as issuing banks would switch to rival operators such as Visa, in order to maximise their revenues from the interchange.

And why did that matter? Well, if the death spiral logic was applied, then the MIF was not anti-competitive, as in the alternative world MasterCard would have been driven out of business.

The High Court ruled that under what was known as the 'ancillary restraints' argument, the MIF was ancillary to the main operation of MasterCard, which was pro-competitive.

This conclusion was surprising to lawyers – as the court's analysis of the 'hypothetical world' was, shall we say, unusual. The court's 'hypothetical world' said that while the MasterCard MIF would have been lower, Visa's rival MIF would not have been. The court declined to hold that the MasterCard and Visa schemes were materially identical, which would have been logical given the similarity between the schemes, and the practical likelihood that if MasterCard lowered its MIF, then so too would Visa have done.

Round three: pending

In any event, the *Sainsbury's* and *Asda* decisions reached opposite conclusions, with one decision for, and one against, retailers. It is now expected that firstly, MasterCard will seek permission from the High Court to appeal the decision in respect of *Sainsbury's*, and that *Asda* and the other claimant high street retailers will also do the same with regard to the 2017 decision. The appeals will define whether retailers see their claims come to fruition, and may well also include an analysis of the similar Visa scheme and whether it too was anti-competitive. The focus has, to date, been on the retail giants; the potential impact of a claim on smaller retailers and, particularly for our purposes, insolvent ones, has received little attention until now. That needs to change and change before time runs out to take action.

> "Claims can be brought dating back six years from the date the claim was issued, *but* the period covered by the claim must stop on 9 December 2015."

Why should office-holders be interested?

Some retailers who paid these interchange fees on transactions have, by now, become insolvent. Their claims therefore will be under the control of the office-holder. There is a clear correlation here with previous PPI litigation and swaps mis-selling claims: if the retailers are successful on appeal it will not be a question of 'if' each retailer/office-holder had a claim, but

of how much the claim was worth. This should be of significant interest to office-holders as it could be an unexpected realisation.

These potential claims are surprisingly broad in their remit; in addition to any business utilising a traditional card machine, they could potentially include forms of online payment where the MasterCard payment scheme applied, which widens the net to online businesses. Equally, a consideration of claims under the similar (but as yet untested by the courts) Visa payment scheme must be kept in mind.

Time is of the essence

The appeals will not be decided for considerable time – possibly 2020 if not later. However, office-holders must not wait until the outcome of the appeals before considering their own claims – as by the time the appeals are concluded, individual claims will have diminished in value and, perhaps, disappeared altogether.

These claims are governed by the usual principles of 'limitation', and so an office-holder has just six years in which to bring a claim from the date of the cause of action. In practical terms, when a claim is issued, you can claim for six years of MIF payments ending with the date you issue the claim. However, these claims are also curtailed by the Payment Card Interchange Fee Regulations that came into force on 9 December 2015, which marked a change in how interchange fees were charged. This has a pincer effect – meaning claims can be brought dating back six years from the date the claim was issued, *but* the period covered by the claim must stop on 9 December 2015, the date on which the regulations came into force. The result: the size of the claim window is constantly decreasing. For example, a claim issued on 9 December 2017 could see only four years of fees included (December 2011 to December 2015), and the longer an office-holder waits, the smaller that window, and therefore the claim value, gets.

An office-holder needs to consider whether there is a potential claim and what steps should be taken to advance that claim. Some solicitors are developing models to evaluate office-holder claims, utilising relationships with third-party funders in order to provide insolvency practitioners with ways to protect their position, to enable them to bring a claim with minimal risk and cost to the estate. There is also the potential of claim assignment, which would see a speedy realisation for the estate with minimal costs risk.

Conclusion

Until the appeals are decided, the landscape for these claims remains unclear. What is clear, however, is that office-holders, and indeed all retailers affected by the litigation, currently have the very real possibility of a successful damages claim, which will lose its value if no action is taken to protect the claim while the appeals are pending.

> "Office-holders must not wait until the outcome of the appeals before considering their own claims."

A prudent office-holder should look to identify all potential matters where they may have a claim, and take legal advice in order to ascertain its potential value. That advice should include establishing whether funding or claim assignment is viable and/or desired. Only then can an office-holder decide, in the interests of the creditors, if the claim should be protected, and how. The time spent in establishing at least the value of a claim is well worth it for what is a time limited opportunity to maximise realisations.

It should also be mentioned that while the focus of this article is on the possible realisations for office-holders, these claims do apply equally to solvent businesses and could be pursued by any retailer who wishes to protect its potential claim pending the outcome of the appeals.

REBECCA ANDREWS-WALKER (LEFT) is a senior associate at Penningtons Manches.

JAMES DAVIES (RIGHT) is a barrister at 3PB.

Battling the old boys' club

David Costley-Wood reveals his findings on diversity and inclusion in the restructuring world.

There are two words that have been known to incite sneers and jeers among much of the white male majority of the restructuring profession. The words tend to provoke comments along the lines of 'Women aren't tough enough for turnaround or restructuring' and manage to transform otherwise intelligent, suit-wearing professionals into aged, obsolete dinosaurs. I'm talking, of course, about the words: 'diversity' and 'inclusion'.

While the good news is that more is being done across business and society generally to improve diversity and inclusion, unfortunately it appears that the restructuring profession is still lagging far behind.

Board stupid

According to new research undertaken by the Turnaround Management Association (TMA), a staggering 96 per cent of women working for organisations that specialise in turnaround, company restructuring and business transformation have never been appointed to a board position within the industry.

Yet an overwhelming 68 per cent of women said that they wanted to be considered for such roles. A 'dominant male culture' (71 per cent of respondents in the research) and a 'bias towards male candidates' (58 per cent) were two of the reasons cited in the TMA report as barriers to female progression.

Clare Grimes, partner at Kendra Sinclair, an executive search firm specialising in the restructuring sector, says: 'The TMA's research bears out our own experience. We have tracked senior hires across the industry for the last 15 years and, when we started, over 90 per cent of hires were male. While the figure for women in the industry has improved over the years, men still account for over 80 per cent of hires.'

The trend for male hires does not seem as problematic further down the hierarchy of the profession, Grimes suggests: 'Of course, we should acknowledge there are a number of firms across the industry that are actively trying to address the issue. However, while at more junior levels across the sector the male/female split is closer to 50:50, we have found that there is a significant shift in the ratios at senior manager level and above. The tail-off in the number of female workers as you move up the ranks really needs to be addressed as it is evidence that the industry is losing out on fantastic talent.'

> For the restructuring profession, poor diversity and inclusion is very much a legacy issue.

It's at this point that I must confess that within my own team at KPMG it's a similar picture. We also see the number of female and BAME (black, Asian and minority ethnic) candidates begin to fall significantly at senior management level and above.

Statistics for the wider industry backup Clare's anecdotal evidence. In June 2014, Liz Bingham (a former R3 president) noted that although 41 per cent of students that passed the JIEB exams in 2013 were female, only 20 per cent of R3's members were women. This brought Liz to the question 'Where are the women going ?'. At the time she made the unfavourable comparison to the solicitors' profession, where 49 per cent of UK solicitors are women.

Earlier this year our UK head of restructuring, Blair Nimmo, asked me to become head of diversity and inclusion within our restructuring practice, with the sole remit to tackle this issue head on.

Legacy of the white men

For the restructuring profession, poor diversity and inclusion is very much a legacy issue. Many of today's leaders in the field were practitioners in the early 90s, when most of us were expected to work long hours and seven-day weeks, moving from one insolvency to another – a dynamic that is clearly not ideal for those who work flexibly or who have family commitments.

However, the spectrum of restructuring work has evolved and broadened in recent years. Larger firms are now more frequently engaged on advisory projects, including those in the health and pensions spaces, which tend to be more predictable and thus suitable for working parents or flexible workers.

At the opposite end of the spectrum, smaller firms and boutiques see more liquidations or desk-based pre-packs. Generally speaking, there is less cash crisis work coming from lenders.

So, does this mean the male-orientated restructuring culture has changed with the evolving nature of the work itself? Not according to Tracey Pye, a former BDO Restructuring partner, now working as a successful interim: 'The culture of the "boys' club" is still very much alive and the gender gap is widening in senior management roles. The number of females reaching partnership is disappointing, and some who make it take on more of a strong 'male' role, resulting in a limited number of female role models to inspire and mentor the next generation of professional women,' Pye says.

Upon taking up the role as head of diversity and inclusion, my first action was to commission three independent workshops: one for female colleagues, one for BAME colleagues and one for partners. At these workshops we could discuss, debate and listen to people's views about the challenges we face as a practice and as a profession.

The conversations we had, while acknowledging recent progress, still bore the hallmarks of the TMA findings. We heard far too many tales of jobs involving long unsociable hours, not enough senior female and BAME role models for young talent to aspire to, and leaders who felt ill-equipped to talk about race-related issues.

Equally there remain issues in the workplace. Michelle Shean, head of non-contentious insolvency and restructuring at Fieldfisher, has strong views about the way that women are adopted into a firm: 'Subconsciously relaying to women that the only way they can break the glass ceiling is by behaving more like men is not bridging the diversity gap. Most law firms have a diversity policy, but the only firms that will succeed in bridging the gap are the ones who actually put it into practice,' she said. 'Until male partners see a "lawyer" rather than a "female lawyer" the diversity gap will remain.'

"We heard far too many tales of jobs involving long unsociable hours, not enough senior female and BAME role models for young talent to aspire to, and leaders who felt ill-equipped to talk about race-related issues."

Tackling the problem

All of these issues run deep, and there is no overnight solution to be found – it certainly can't be remedied by attempting to recruit our way to better diversity.

We need to acknowledge that the pipeline of diverse talent across the industry is very limited. And that this is not helped by the fact that many recruitment agencies tend to target men over women because they believe they are easier to unsettle from their current jobs.

Equally, nurturing existing talent also poses challenges. Evidence shows that some women will only apply for a promotion when they are absolutely confident that they are personally and professionally ready, whereas men will often take a more speculative 'why not?' approach.

Sadly, once a woman does reach a senior role in restructuring, it can often be a lonely and difficult place, particularly at functions where there is a sea of white male faces.

Where I think the penny is still to drop among many leaders within the profession is that the imperative for improving diversity and inclusion is there.

Our restructuring client base is becoming far more diverse, particularly in areas such as the public sector and NHS, and also in the pensions arena. Having a similarly diverse team allows us to give more rounded perspectives on client issues and leads to better relationships.

What can your firm do?

The general consensus is that inclusive and diverse organisations also prosper as well as, if not better than, their opposites and generally share four key characteristics:

- the CEO is committed publicly and internally to improving diversity;
- there are more women in executive positions;
- diversity goals are part of the business strategy and value chain;
- the definition of diversity was tailored to business strategy and local context.

So what can restructuring teams do to take those first few steps to achieving greater inclusivity?

There is ample evidence of how professional services firms as a whole, both large and small, are already grasping the nettle. Quite often, the restructuring functions of large and mid-tier accountancy firms need look no further than the rest of their firms for guidance.

To give you an example, here at KPMG, our Black and African-Caribbean Society recently offered reverse mentors to a number of partners.

My first meeting with my own mentor was absolutely enlightening – seeing the firm through the eyes of a black colleague, listening to and understanding their frustrations and aspirations, really made me question how I can personally be more inclusive.

However, embedding an effective culture of diversity and inclusion in restructuring can be like changing the course of an oil tanker, and sometimes a sharp turn is required to change direction. According to Pye, 'Professional services firms have historically appointed grey-haired men (due to the lack of women) who paid lip service and treated the gender gap as a tick-box programme, but what's needed is a complete overhaul, starting with open and honest conversations with our next generation rising stars.'

Having absorbed the findings of our own workshops, we will be implementing a series of far-reaching changes to promote, recruit and retain to promote diversity. We will also encourage people to actively challenge inappropriate behaviour. Of course, many professional firms, including KPMG, have been doing this for a long time already; it just feels that restructuring as a service line is still playing catch up.

Perhaps the most pressing issue, particularly for our more junior team members, is to challenge the culture and long hours that are seen as the norm by senior professionals. A significant number of up-and-coming juniors, both male and female, are not prepared to sacrifice a healthy work/life balance in order to get to the top, and firms risk losing them if they don't change.

There has to be an open dialogue about the pressures faced by, for example, working parents and staff with religious commitments, in order for a compromise to be reached that works for employee and employer. Many older partners are either unwilling or unable to engage in such conversations. However, one of our senior Leeds managers, Saiful Khan, bucks the trend, suggesting: 'Although it can be challenging, if managed well it is perfectly possible to be an effective restructuring professional and have a life outside work.'

I'll conclude by deferring to someone whom I view as a truly inspirational leader – KPMG's deputy chair Melanie Richards who was recently ranked as the *Financial Times*' HERoes Champion of Women in Business.

"Where I think the penny is still to drop among many leaders within the profession is that the imperative for improving diversity and inclusion is there."

Working with Melanie, I would frequently find that, within 20 minutes of walking into a room full of 'male, pale and stale' company directors, Melanie would be leading and driving conversations around difficult topics, and would quickly acquire trusted adviser status. She notes, 'If we are to make progress in the restructuring industry to attract and retain a group of professionals who more closely reflect our society, it will take more concerted and focused systemic action by individual firms and practitioners across the market.'

Ultimately, the restructuring industry should be no different in its need to keep up with the rest of society or professional life. Some in our industry have been valiantly trying to address this but no one has achieved the far-reaching change that is required industry-wide. As a profession, we need to, and should, change, before we start looking like dinosaurs, and at risk of a similar fate. □

Additional material sourced from *Private Equity Wire* article, 12 July 2017, titled: 'Women struggle to make their mark in the business of turnarounds, says new research'.

DAVID COSTLEY-WOOD is a partner at KPMG and is head of diversity and inclusion for the restructuring team.

Special effects: investment banks and the SAR

In light of new regulations in 2017, **Rebecca James** and **Stephen O'Grady** examine how the special administration regime functions for investment firms.

Lehman Brothers' collapse in September 2008 highlighted the deficiencies of applying the 'normal' corporate administration regime to investment banks, in particular around protecting client assets. This led to the introduction of the investment bank special administration regime (SAR) in 2011, to facilitate the speedy return of assets belonging to clients held by a failed investment firm.

Following an independent review into the operation of the SAR, The Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017 (2017 regulations) came into force on 6 April 2017. The 2017 regulations aim to extend and strengthen the existing regime. Despite being an 'investment bank' special administration regime, as a result of its focus on protecting client assets, the SAR has also applied to a wide range of other businesses including private client stockbrokers, foreign exchange traders and discretionary fund managers.

> The SAR has also applied to a wide range of other businesses including private client stockbrokers, foreign exchange traders and discretionary fund managers.

It is important for office-holders to understand the regime. While there have been only 15 special administrations under the SAR since its introduction in 2011, including *MF Global UK Limited* and *Worldspreads Limited*, the SAR covers a much wider range of investment firms than its name suggests and has a number of notable features, particularly since its recent amendment.

The detailed workings of the SAR are set out in the Investment Bank Special Administration Regulations 2011 (2011 regulations) and the Investment Bank Special Administration (England and Wales) Rules 2011 (2011 rules). The 2011 regulations and rules are not exhaustive, however – the regime interacts closely with the Financial Conduct Authority's (FCA) Client Asset Sourcebook (CASS), which sets out a detailed framework for the segregation and protection of client assets. This framework includes money held by investment banks and CASS includes rules dealing with an investment bank's failure. Ordinary insolvency principles and other competing regulations will also be relevant. Where the specific circumstances of a case do not fit neatly within the regime, flexible and creative solutions may be required and early advice should be sought.

Who does the regime apply to?

The SAR applies to an 'investment bank' – that is an institution incorporated in the UK that holds client assets and is authorised to conduct one of the following regulated activities:

- safeguarding and administering investments;
- dealing in investments as principal;
- dealing in investments as an agent; and
- (after the 2017 regulations) managing an alternative investment fund (AIF) or an undertaking for collective investments in transferable securities (UCITS); or
- acting as trustee or depositary of an AIF or a UCITS.

So the SAR applies to a much wider range of investment firms than just 'banks' in the sense of deposit takers. In fact, where an investment bank is a deposit-taking bank, it may not be eligible for special administration: further rules as to its eligibility for the SAR apply, as against other specially designated 'bank' insolvency procedures.

The SAR has applied to a broad range of businesses, including private client stockbrokers, foreign exchange brokers and discretionary fund managers.

The SAR appointment process

The appointment of a special administrator must be made by court order. As in a normal administration, the investment bank, its directors and/or creditors have standing to make a special administration application. In addition, the SAR provides the FCA, the Prudential Regulation Authority (PRA) and the Secretary of State with the right to make a special administration application, together with a contributory of the investment bank in certain circumstances.

The regulator of the investment bank has the right under the SAR to be heard at the hearing of the special administration application. In practice, it is important to engage with the regulator at an early stage in the contingency planning process. The regulator will expect to be kept updated on the circumstances necessitating the application and will want to be satisfied that the proposed special administrators have the right experience and CASS expertise, either in-house or outsourced, for the appointment.

> There have been only 15 special administrations under the SAR since its introduction in 2011.

There is no absolute bar to an investment bank entering into an 'ordinary' administration or liquidation. However, the SAR provides the FCA with a right to two weeks' notice of any preliminary steps taken to place an investment bank into administration or liquidation and the right to apply for a special administration of that investment bank. It will be a rare case where a special administration is not the most appropriate process for an investment bank.

Aims and objectives of the regime

The SAR is modelled on a normal administration, with specific provisions to reflect the regime's aims. The 2011 regulations adopt a number of provisions from the Insolvency Act 1986, including a substantial proportion of schedule B1, for special administrations, with certain modifications.

The objectives for a special administration are as follows:

- the return of client assets as soon as is reasonably practicable;
- the timely engagement with market infrastructure bodies and the Bank of England, the Treasury, the FCA and the PRA in accordance with the SAR; and
- either the rescue of the investment bank as a going concern or the winding up of the investment bank in the best interests of its creditors.

Unlike a normal administration, there is no hierarchy between these objectives. A

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special administrator must commence work on each objective immediately on their appointment, prioritising the objectives as they think fit in order to achieve the best result overall for clients and creditors. The 2011 regulations include detailed provisions in respect of the objectives, particularly the first, and we discuss some of these in the box on the right.

What special administrators should look out for

The FCA will certainly expect regular and timely updates both pre- and post-appointment. Additional regulatory or other statutory entities should be kept informed where they have a potential interest in the outcome of the special administration. This may include: The Financial Services Compensation Scheme, HMRC and The Pensions Regulator.

The obligation to undertake a reconciliation immediately upon appointment creates a potential issue where such a reconciliation is not possible: for example where access to critical IT infrastructure is removed prior to the commencement of the special administration. In that circumstance, it is

> Where the specific circumstances of a case do not fit neatly within the regime, flexible and creative solutions may be required and early advice should be sought.

necessary to obtain, as part of the special administration order, a direction that the special administrators will prioritise when taking steps to enable them to carry out the reconciliation, and that it is carried out as soon as it becomes possible.

Even though an investment bank may have significant client assets under its control, its own assets (at least those immediately available to the special administrators) may be minimal.

The special administrators may be left with significant obligations, but only minimal funds available to pay their costs in circumstances where there may be a significant amount of work to be done that cannot be recovered from client assets (because it does not relate to objective 1). This shortfall may potentially include pre-appointment work or occur as a result of the obligation to transfer from firm assets an amount to make up a shortfall in client money.

Features of the special administration regime

Perhaps most significantly, the SAR and the 2011 rules make clear that the special administrators will take control of effectively two separate sets of assets and money, the treatment of which is separate but related. These are: client money and client assets held for clients on their behalf in accordance with the CASS rules; and firm money and assets, which are the property of the firm.

Features of the SAR include that:

- It is the special administrators who have control of the distribution or transfer of client assets, and they are required to prioritise dealing with those assets;
- The special administrators are required 'immediately after being appointed' to carry out a client money reconciliation, and – if the amount does not reconcile – to transfer from the office account to the client account (or vice versa) any amount required to make up the difference, as described in regulation 10H of the 2011 regulations;
- The appointment of special administrators triggers a primary pooling event under the CASS rules, which creates a pool of client money that falls outside of the insolvency regime. The return of such client money to clients is determined on the basis of the reconciliation, the client money in fact available, and is subject to deduction for costs properly attributable to its return;
- The special administrators may set a bar date for claims to be submitted as to ownership or security over client assets. After that date, assets that have been returned are not affected by any later claims. The 2017 regulations now allow the special administrators in certain circumstances to return client assets without the need to first obtain court approval where a bar date has been set. They also provide for a hard bar date, after which the administrators may transfer unclaimed assets to the general estate;
- The special administrators are required to prepare a distribution plan that deals with the return of client assets, and how expenses of the special administration may be allocated. It must be approved by the creditors' committee and the court, and distributions may be made only after three months have elapsed from the bar date;
- The 2017 regulations have modified the distribution process to deal with issues that arose in the *MF Global* case. In that case, certain claimants in respect of client money had sought to maximise their returns by – instead of claiming for the return of client money (on which interest is not payable) – claiming as an unsecured creditor, including for interest. As a result of the 2017 regulations, a claimant is no longer permitted to claim for interest as an unsecured creditor where it has a client money claim, other than if there is a shortfall on such client money claim;
- To ensure the return of client assets as soon as is reasonably practicable, only costs, including remuneration and disbursements, which are 'properly incurred by the administrator in pursuing objective 1', may be deducted from client assets. Any costs that do not relate to the pursuit of objective 1 are recoverable only from the investment bank's own assets;
- A creditors' committee may be composed of both creditors and clients. Its composition should reflect the interests in the outcome of the special administration. So if there is unlikely to be any or any significant return to unsecured creditors, then the committee should be composed of clients primarily. Additionally, the FCA is entitled to attend and make representations at any such committee meetings;
- Certain key suppliers to the investment bank, in particular suppliers of critical IT services, may not terminate supply, provided that the special administrators pay for the supply incurred after the commencement of the special administration.

REBECCA JAMES (LEFT) is an associate at Pinsent Masons LLP.

STEPHEN O'GRADY (RIGHT) is an associate at Pinsent Masons LLP.

There's no such thing as a hassle-free annulment!

David Higgins looks at the result of *Safier* v. *Wardell* and its impact on annulment applications.

The annulment of a bankruptcy order sounds like such a clean process – press the reset button and return to the way things were before the order was made. However, the process has been slowly growing more complicated and this year has seen a particular flurry of activity around the annulment of bankruptcies.

The judgment in *Safier* v. *Wardell and others* [2017] EWHC 20 (Ch) (*Safier*) has been followed by the introduction of the Insolvency Proceedings (Fees) Order 2016 (fees order 2016), the publication of Dear IP 74 and Dear IP 77 and most recently *Yang* v. *Official Receiver, Manchester CC & Joanne Wright* [2017] EWCA Civ 1465.

Dear IP 77 'reaffirms the position regarding the payment of funds into the Insolvency Services Account (ISA) and the charging of fees', so below I will consider the operational challenges that arise for practitioners and the practical issues affecting the annulment process following this new guidance.

Annulment applications

It is common for an appointed trustee in bankruptcy to be asked to stay any further action while the bankrupt applies to annul the bankruptcy. The bankrupt wants to know how much is required to 'pay in full' and the trustee has to provide a figure so that a payment can be made. This is usually done with funds being introduced by a third party that are sufficient to pay the bankruptcy debts, costs and expenses in full.

Such an application would be made on the grounds set out in section 282 of the Insolvency Act 1986 (IA), whereby the court may annul the bankruptcy if:

> *'The bankruptcy debts and expenses have all… been either paid or secured for to the satisfaction of the court'* (section 282(1)(b), IA).

In order to exercise its discretion, the court relies upon the trustee's report confirming that the necessary payment has been made as per rule 10.133 of the Insolvency (England and Wales) Rules 2016 (IR 2016).

> **The decision of the Insolvency Service to withdraw the facility of the suspense account inevitably causes practitioners problems.**

When compiling the required calculation, the trustee has to consider the fees and charges due to the Official Receiver (OR) and the Secretary of State (SoS), while also considering the mechanism to receive payment. This latter point can be tricky because of the timing of the trustee's report to the court in advance of the hearing, as well as the requirements of the third party. The court's acceptance of security by way of a solicitor's undertaking provides a solution to avoid deadlock resulting if an annulment order cannot be made unless, and until, the creditors have been paid.

Third-party funds

The OR and the SoS fees and expenses are required to be paid in all bankruptcies for performing their statutory functions and duties under section 415 of IA. The current fees are outlined in the fees order 2016, which came into force on 21 July 2016 and which revoked The Insolvency Proceedings (Fees) Order 2004 (fees order 2004). For bankruptcies where the bankruptcy order was made following a bankruptcy petition presented before 21 July 2016, the fees order 2004 continues to apply, so practitioners are currently dealing with two regimes.

Safier was concerned with the extent of the expenses that the bankrupt had to pay. The judgment confirmed that the *ad*

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valorem or SoS fee was not chargeable on third-party monies when the trustees paid the funds into the Insolvency Services Account (ISA).

Practitioners and their solicitors will be very familiar with this situation: the bankrupt often attempts to negotiate and all the various elements that make up the debts, costs and expenses will be challenged. The fee, in particular, often represents a substantial sum that can be the difference between a third party being willing to assist and not.

> Where the bankruptcy order was made following a bankruptcy petition presented before 21 July 2016, the fees order 2004 continues to apply, so practitioners are currently dealing with two regimes.

The need for a suspense account

Importantly though, *Safier* reaffirmed the accepted working practice that the trustees were relying upon – the guidance provided by Dear IP 39 published in October 1997. This stated that, although regulation 20 of the Insolvency Regulations 1994 (IR 1994) required a trustee to pay all monies received in the course of carrying out their functions into the ISA, these functions should only relate to the bankrupt's estate. It acknowledged that, usually, monies received from third parties do not derive from assets in the bankrupt's estate; therefore they are not received in the course of a trustee's functions. The operation of suspense accounts in the ISA was justified on policy grounds to facilitate a benefit to the insolvent estate that it would not otherwise have received.

It became common working practice for trustees in bankruptcy to exclude the SoS fee when calculating the total amount required to pay in full using third-party funds. Trustees would request the opening of a suspense account when paying the monies into the ISA, without having to operate a client account.

This reduced the total amount required to annul the bankruptcy order where third-party funding was involved and, if an early application could be made, the costs involved would be kept to a minimum with a swifter return to creditors. This practice assisted the trustee as it provided certainty, so they could report to the court, and effectively 'ring-fenced' the funds to protect the third party in the event the order was not made.

This was a positive decision for all concerned, enabling practitioners and their advisers to be able to give definitive information to the bankrupt and ensuring that the annulment process could be concluded efficiently. Payment of the funds into a suspense account in the ISA was therefore a practical and essential part of this process.

Dear IP 74

Dear IP 74, published on 12 January 2017, a day before the judgment in *Safier*, introduced a change to how the Insolvency Service operated the ISA. Practitioners were informed that the SoS fee would be charged on all receipts regardless of the trustee's instructions on paying-in. The trustee would then have to apply for a rebate if he could establish that the monies were third-party funds.

Dear IP 77

The Insolvency Service then announced, with effect from 1 July 2017, that third-party funds would not be accepted into the ISA. It stated that the ISA cannot be used as a local bank account to facilitate third-party funds being paid to creditors, and suspense accounts will only be opened where there is some question as to the ownership of the funds.

Practical effects

So what does a trustee do when asked to receive monies from a third party so that he or she can report to the court that the requirements of section 282(1)(b) IA can be met?

Open a client account to receive the money? This is the best possible practical solution but does involve more cost and, with more stringent money laundering requirements being introduced, more risk. The operation of the account must be totally transparent and it is inevitable that some delay and resistance will be encountered from the third party when they are asked to submit to the usual checks.

But what if, as in *Safier*, the practitioner does not operate a client account and had always utilised the established, albeit 'extra-statutory practice', of paying such monies into an ISA suspense account?

One option would be to instruct their own solicitors to receive the money and then make the necessary payments. The risk effectively passes to the solicitors who will in turn have to be satisfied that they can comply with the strict and mandatory requirements in respect of money laundering and operating as a bank.

Another method would be to insist that the debtor's or third party's solicitor makes payments directly to creditors and then pays the practitioner his costs and expenses.

Third parties, however, are often reluctant to see their money dissipated without the guarantee of the annulment being granted, for which the court retains discretion.

If the bankruptcy debts and expenses are not paid before the application is heard, they will need to be secured for to the satisfaction of the court. Rule 10.138(7) of IR 2016 provides that security includes an undertaking given by a solicitor and accepted by the court. The solicitor for the bankrupt or third party can therefore undertake to the court that payments will be made to creditors and the costs paid, usually within seven days.

> The fee, in particular, often represents a substantial sum that can be the difference between a third party being willing to assist and not.

All these methods work but it must be taken into consideration that the process has to operate in conjunction with the ongoing court timetable. This often proves an extremely difficult task for the practitioner to manage when they have to rely upon creditors providing confirmation that their claim has been satisfied – all this in order for the practitioner to provide the necessary report to court, while keeping costs to a minimum!

Conclusion

The decision of the Insolvency Service to withdraw the facility of the suspense account inevitably causes practitioners problems. Ultimately, this could jeopardise the returns to creditors, as the more cumbersome and uncertain process may dissuade third parties, who will already be concerned about the amount they are paying, from getting involved.

While the fees order 2016 does away with the SoS fee and replaces it with a fixed general fee, payable regardless of where the funds are coming from for bankruptcies after 21 July 2017, this does not assist the trustee with how to receive and deal with the third-party monies.

DAVID HIGGINS is an insolvency partner at Turner Parkinson.

Save the date
22 March 2018
R3 Annual Dinner
8 Northumberland Avenue, London

R3 events, courses and conferences

Date	Event	Venue
	December	
4	**North West Regional Meeting**	EY, Manchester
4	**Technical Update – The 2016 Insolvency Rules and R3's work with HMRC (briefing)**	Squire Patton Boggs, Birmingham
5	**South West & Wales Christmas Event & AGM**	The Strawberry Thief, Bristol
5	**Southern Regional Meeting & AGM**	Jurys Inn, Southampton
5	**Technical Update – The 2016 Insolvency Rules and R3's work with HMRC (briefing)**	Farrer & Co, London
	January	
15	**Eastern Regional Meeting**	Bury St Edmunds
16	**Personal Insolvency Forum (full day)**	Manchester
24	**Personal Insolvency Forum (full day)**	London
	February	
7	**North East Regional Meeting & AGM**	Newcastle
27	**London & South East Regional Meeting**	London
	March	
7	**London & South East Women's Group Event**	London
9	**East Midlands Women's Group Excuse Me Lunch**	Nottingham
15-16	**Northern Conference 2018**	Oulton Hall, Leeds
22	**R3 Annual Dinner 2018**	8 Northumberland Avenue, London
	April	
19	**Midlands Women's Group Spring Ball**	Birmingham
	May	
23-25	**R3 Annual Conference 2018 (two days)**	Vilamoura, Portugal
	June	
29	**London & South East Ladies Lunch**	The Langham, London

Regional events
R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk** or call the Events team on 020 7566 4234 to request further details.

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Courses to look out for in 2018

(dates subject to change)

January	**Wrongful Trading – Where are we?**	Breakfast briefing
	Intellectual Property	Breakfast briefing
February	**Enforcement of Security**	Half day – back-to-back
	Partnership Insolvency	Half day – back-to-back
	Licensed Businesses	Half day
	Regulated Businesses	Breakfast briefing
	CRAR	Breakfast briefing
March	**Charities**	Half day
	Employment	Breakfast briefing/lunch briefing
April	**SPG Technical Review**	Full day
	Core Tax Issues	Half day
	Employment	Breakfast briefing
May	**SPG Technical Review**	Full day
	Energy and Renewables	Half day
June	**SPG Technical Review**	Full day
	Asset Tracing, Fraud & Forensics	Full day
	Restructuring Day	Full day
July	**R3 & INSOL Europe's International Restructuring Conference**	Two days
September	**International Insolvency**	Full day
	Practical Introduction to Insolvency series	Days 1 and 2 – full day
	Enforcement of Security	Half day back-to-back
	Partnership Insolvency	Half day back-to-back
	Receivables Financing	Half day
October	**Practical Introduction to Insolvency series**	Day 3 – full day
	Insolvency Litigation	Full day
	Core Tax Issues	Half day
November	**SPG Forum**	Two days
	Practical Introduction to Insolvency series	Days 4 and 5 – full day
	Insolvency Litigation	Full day
	Complex Restructuring	Full day
December	**Legal Issues in Sports Law**	Half day

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Turnaround: the SPG perspective

Caitlin Powell talks to Andrew Tate to get his expert opinion on turnaround work.

Q **There seems to be some crossover in understanding on the distinction between turnaround, advisory and restructuring. To set the scene, what are your thoughts on what actually constitutes turnaround work?**

A Over the years, different titles for our work go in and out of vogue. At the end of the day our focus is twofold: preserving the value in businesses to the greatest extent possible and ensuring a fair distribution of the available assets to the creditors of the company. In the minds of restructuring professionals there are different nuances between the words restructuring, advisory and turnaround, but these probably have little distinction in the minds of those who have little or no experience of ‘our world’.

Turnaround in my mind is a situation where a company that is underperforming (and possibly therefore getting into distress) implements a strategy to address the underperformance and bring this business back to profitable trading. The turnaround profession tends to be individuals who specialise in actively working in-house with the management of a business to implement a turnaround strategy. Due to the nature of this work, it is normal for such individuals to work either alone or in small organisations rather than the major accounting and legal practices.

Generally a broad distinction can be drawn between turnaround practitioners who, as mentioned above, tend to work alone or in smaller clusters and restructuring professionals who tend to work in accounting, legal or niche practices where there are significant resources to be able to address any particular assignment. For example, a restructuring may require insolvency, corporate finance, valuation and legal or financial skill sets.

Q **There is a lot of talk around at the moment that more and more work being undertaken by firms is restructuring/advisory rather than statutory insolvency. Outside of financial crises, has this always been the case or do you think that directors and indebted individuals are starting to realise the importance of seeking advice early, before the damage is irreparable?**

A The focus of those of us advising distressed businesses has always been to try and save businesses and

Andrew Tate is a former president of R3 and a partner and head of restructuring at Kreston Reeves LLP.

preserve value and jobs. However, over the last 20 years, there has been a further level of sophistication brought into our market, developing different solutions and different ways to preserve value. Furthermore, public perception has continued to rally against situations where an insolvency of a company takes place (leaving creditors unpaid), where it is perceived that professionals draw large fees. While we know that restructuring and insolvency practitioners work extremely hard for creditors and in very stressful situations, this continued public perception has led restructuring and insolvency professionals and lenders to seek alternative solutions.

Low interest rates have also led to a situation where investors are seeking new ways to invest funds profitably and investing in distressed businesses, which have the ability to restructure and turnaround back to profitability, can be an attractive proposition. The abundance of funding available has also driven the ability to restructure businesses successfully as compared to previous business cycles where that investment capital was not necessarily always available.

Q **Restructuring has perhaps traditionally been seen to be the domain of the larger firms, although R3’s member survey found smaller firms also perform a lot of restructuring work. Would you have any advice to SPG members who are considering more of a move towards restructuring, advisory, turnaround work? Is there a different skill set required?**

A I think that the perception that restructuring has been the domain of the larger firms is rather a misnomer. I do think that, over the last few years, the larger firms have recognised that the lenders they work with are seeking alternative solutions and that traditional insolvency work is risky and highly regulated, which drives up the cost of that work. It has therefore been a natural shift for those firms to undertake more consensual restructuring than formal insolvency.

However, it has always been the case that insolvency and restructuring professionals have been driven to preserve value in businesses and save them where possible. In the smaller business environment, it can be more challenging to suggest restructuring for a number of reasons: business owners tend to be less sophisticated and, in many situations, do not address the business issues at an early enough stage. Also, restructuring assignments can be quite intensive and it can be challenging for smaller businesses to afford the significant professional resources required to manage and negotiate with all the various stakeholders.

I really believe that R3 members have a natural affinity to the principles of restructuring. If anything, the challenge that professionals from smaller firms face is being able to discuss and understand the various restructuring techniques that can be used and how to implement these successfully in any given situation. Sometimes successful alternative strategies come from an open mind set and interaction with different personalities from across the spectrum. I’ve personally found that learning these different techniques has been immensely valuable for me in developing my own professional skill set and expertise, and has particularly helped me to keep pace with a market that has changed and become more sophisticated over the years.

R3 already provides training in the restructuring arena and I think it has a role to play in providing forums where creative discussions between professionals dealing with distressed businesses of all shapes and sizes can take place. ◻

CAITLIN POWELL is the policy and committee manager at R3.

What we learned from R3's Southern Conference 2017

Mike Pavitt shares the key findings from R3's Southern Conference in September 2017.

R3's first Southern Conference saw over 125 delegates gather in Bournemouth on 21 and 22 September 2017. Thankfully, however, none of the letters fell off the signs and there were no pranksters with P45s, coughing fits or lost voices. The conference provided an opportunity to discuss the key challenges for the profession as it seeks to deliver optimum value in an evolving economic and regulatory environment, with external factors such as Brexit adding to the demands on the profession. Here are eight key learnings I personally took away from our speakers:

1. Brexit is a key challenge

The UK has long been considered an international centre of excellence in insolvency and restructuring, underpinned by the mutual recognition of IPs' appointments across EU borders and the reciprocal enforceability of legal judgments in different jurisdictions. If, post-Brexit, mutual recognitions are no longer valid, cross-border insolvencies could become a lot more expensive and complicated, leading to smaller returns for creditors, and a downgrade in 'UK PLC's' reputation as an attractive location to do business. R3 is determined to protect the UK's international standing and, while the government's approach to post-Brexit cross-border insolvencies is encouraging, there's still a long journey ahead before we know what the final outcome will be.

2. The insolvency profession and the courts

His honour judge Rawlings and former chief registrar Baister attended, representing the judiciary and assisting our understanding of how we can get the most out of the court system. Delegates were advised to be mindful of our firms' reputations with the courts and to be patient as the business and property courts get to grips with their new systems, which are far from perfect but are being continuously improved.

3. Director's loan accounts and HMRC

Verisona Law, New Square Chambers and Lesley Hilton (evasion team leader at HMRC) steered delegates through director's loan accounts and dividends, and the interplay of defences offered by directors and their personal taxation liabilities. By understanding how the tax system works and collating and analysing evidence of what directors have suffered the company to do, and writing off unrecovered loans where appropriate, IPs can ensure that proper claims are pursued and appropriate tax recovered, benefiting the wider economy.

> "I have seen that if the profession works together it is capable of making a difference."

4. The IP's role in combatting fraud

Guildhall Chambers and R3 president Adrian Hyde helped to bring home the impact of systemic fraud on creditors and the vital role of the profession in combatting it, including how to identify some less obvious frauds. Delegates were also reminded of the availability of HMRC funding for investigations leading to improved tax recoveries.

5. Litigation funding and insurance backed recoveries

Credebt and Manolete reminded delegates that, for IPs who cannot command funds or liquid assets in an insolvency, help is accessible, and that these markets are constantly evolving. The potential for securing insurance-backed support to de-risk debtor book recoveries, as well as the potential for attracting expert third-party review, funding and/or purchase of claims-based recoveries, have been game changers for IPs recently. The funders added that IPs should be prepared to demonstrate that they have considered these avenues, so as to satisfy professional duties.

6. The Insolvency Rules 2016

Our rules session combined experts from R3, the Insolvency Service, the Compliance Alliance, and the Insolvency Practitioners Association. There was broad agreement that the rules have yet to bring many tangible benefits for creditor engagement. During this period of adjustment, the panel advised documenting the considerations behind every major decision assiduously, particularly where the new rules do not appear to contemplate a step being necessary. Encouragingly, there was also an indication that regulation of IPs is starting to move towards greater supportiveness.

7. Soft skills for IPs

Neil Taylor Insolvency's presentation demonstrated how the profession's managers can encourage best results from their staff. Increasingly, to deliver the desired service at desired budgets, IPs require well-trained and well-motivated staff, who are the public face of the profession in many instances.

8. Challenges on the horizon

Our future issues panel, comprising speakers from the judiciary, Deloitte, Kreston Reeves and 3 Paper Buildings, looked at the forthcoming challenges to be aware of over the coming months, including the impact of continuously rising professional fees, the limitations of IT within the profession, and issues with collective redundancy exposure and IP engagement with tribunals. There is also the significant need to promote faster rescue, improve understanding between IPs, stakeholders and the press, and to resolve inconsistent RPB guidance regarding SIP 9 and fees estimates.

As Southern Chair, I am pleased to say I have seen the issues brought to me by members being passed up the line at R3, receiving appropriate attention and resulting in valuable discussions and tangible results. I have seen that if the profession works together it is capable of making a difference, as demonstrated by the productive discussions at the Conference. My thanks go to everyone whose hard work made it such a success and of course to our speakers and panelists. We look forward to seeing even more delegates at the next Southern Conference; watch this space for details! ◻

MIKE PAVITT is chair of R3's Southern Committee and a partner at Paris Smith LLP.

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An interview with...

Adrian Hyde

Matt Jukes speaks to R3's president about his work on fraud, turnaround and dialogue with parliament since March.

Q This will be the penultimate issue of *RECOVERY* during your term as R3 president. What has been the highlight so far?

A It must be meeting members of the profession in different regions. Seeing the different concerns, the different issues and the wide variety of people that are involved in insolvency and restructuring has been a really interesting experience.

As R3 president, you have the opportunity to get out and meet people with influence over our profession. R3 gives you a lot of support as you do that.

> "Seeing the different concerns, the different issues and the wide variety of people that are involved in insolvency and restructuring has been a really interesting experience."

For instance, I've just had a a meeting with Ben Wallace MP (the Home Office fraud minister) and shortly after I had a meeting with Bill Esterson MP (the shadow insolvency minister). Someone from the R3 communications team is outside the building 20 minutes before with everything you need: they brief you with the important bullet points and what the MP wants from you and provide briefing packs for all parties. It's a really well-oiled machine. Being able to speak directly to policy-makers, pass on our members' concerns, and talk about the value of our profession is a real privilege.

Q Are there any key issues that you've seen as major concerns through meeting parts of the profession?

A I suppose there are two key issues at the moment. One is the power of the Official Receiver (OR) and the other is HMRC.

There's an issue with the OR, which is the OR saying 'We don't consider that the skills of an IP are required on this case because we have the skills ourselves and can do the job'. There are cases we come across where there is apparent support for an IP appointment, but the appointment isn't made. There is an allied issue where other government agencies may be the petitioning creditor and they may benefit from an IP appointment, especially when specialist investigation is required. The OR needs to ensure the other department's initial wishes are followed.

Adrian Hyde biography

● Adrian Hyde qualified first as a solicitor and worked for a number of different firms that specialised in insolvency work. In 2008, while helping CVR Global partners seek a replacement for a colleague who had left the firm, Adrian was invited to make the leap from lawyer to insolvency practitioner and fill the spot himself. He did so with enthusiasm, finally able to investigate the types of cases that he'd dealt with as a solicitor on a more forensic level. He now splits his time between the UK and Gibraltar, specialising in insolvency cases where fraud or criminal activity is suspected. When not working, he can be found walking his Staffordshire terriers in a small hamlet outside of Canterbury in the very early hours of the morning.

There have been a couple of Dear IPs issued. The first one wasn't very clear – in fact it gave something of a misleading impression, so it was corrected after R3 pushed back, hard. The issue for us is that the OR often says publicly that it is a fundamental principle that they respect the wishes of majority creditors where they indicate they want an IP appointed; however, in practice, that is not what's happening. R3 is now gathering substantive evidence from members and creditors and we plan to tackle these situations head on with the Insolvency Service.

There are various issues with HMRC around the calculation of statutory interest, particularly in members' voluntary liquidations, but we've done a lot of work over the last year to improve our communication with HMRC and it's become a lot easier for R3 to seek to resolve this sort of problem once we hear about it from members. R3 is meeting regularly with Mike Howe, director of business tax operations, HMRC as well as holding regular HMRC/R3 working party group meetings. HMRC doesn't always respond as quickly as we as a profession would like, but R3 is working hard on our behalf to get issues like this resolved.

Q Do you see a resolution to the OR issue in sight?

A There has got to be. There's a more fundamental issue at play here, which is that the ORs are not always equipped to do this work. They don't always have the specialist skills, experience and training that IPs have and they also aren't subject to the same very tight regulatory regime that we have to work in. Neither do they have the same reporting requirements that we have to work to. Creditors are telling R3 that they are concerned about the lack of transparency and reporting and there really isn't a level playing field here.

Q In your first column for *RECOVERY*, you mentioned fraud as a key topic this year. What have been some of the key developments in this field and why is it important for professionals to educate themselves and take an active role in fighting fraud?

A Fraud is a massive issue for the UK's economy. The estimate last year was a £193bn loss to the UK. The tax taken (income tax revenue) in the year »

2015/2016 was £178bn. Insolvency is not necessarily connected with fraud, but it is a great tool for dealing with it.

Speaking in a personal capacity, I've recently taken on a multi-million pound fraud case where government agencies have spent five years trying, unsuccessfully, to make progress with investigating the director of a collapsed half a billion pound

> Fraud is a massive issue for the UK's economy. The estimate last year was a £193bn loss to the UK. The tax taken (income tax revenue) in the year 2015/2016 was £178bn.

hedge fund. The fund's liquidators said to me 'if you can make the director bankrupt, we will support you.' I sued the director for dishonest assistance and his non-payment of that judgment has allowed me to make him bankrupt. Now I am able to investigate what actually happened to all the hedge fund's money using the powers available to me as trustee. Using insolvency in this way has given me a tool to investigate further.

Q Is it practical for smaller practitioners to chase up fraud cases?

A Smaller practitioners do go after fraudsters, taking on both big and smaller cases. It is important to remember that IPs operating in smaller practices have the same powers and skills sets as those working in larger practices. And what is a small case? A director that pockets £50,000 or pays for his or her home extension through invoices to the company is still committing fraud. Through the insolvency, you can speak to the builders, find out that payments made were for work at the director's home and instantly you can convert that into a director's loan account debt. You can go after that, otherwise he or she will have just concealed the work in the company's books and thought they were getting away with it.

Q What is R3's main role in the fight against fraud?

A R3 is here to engage various different government agencies who suffer from exactly the same thing. You've got people like the Environment Agency, who go after people for dumping waste into a river. They fine them, but then don't have any idea how to enforce it if the company refuses to pay. Well, we say it started as a criminal prosecution and make them bankrupt, or wind the company up and go after the directors personally!

A lot of what R3 does is education and awareness: education within the insolvency industry, but also increasing awareness publicly as to what value the profession can bring in the fight against fraud.

Q You mentioned that you wanted to pick up where Andrew Tate left off, examining the role of IPs in advisory work and restructuring/turnaround. What have been some of the biggest developments or achievements around this topic?

A R3 is embracing those parts of the profession that don't rely so heavily on formal insolvency. There are now a number of special administration processes that are designed for turnaround and rescue – higher education, for example, or healthcare trusts now have special processes.

Connected to this, the government has held or is holding consultations on 'breathing space' concepts for both personal and corporate insolvency. There's a realisation around the globe that something slightly more relaxed than formal insolvency, but still with a relative element of formality, is going to be needed to help people turnaround their businesses or personal finances. Unfortunately the reality is that, because of Brexit, there is so much legislation to get through that progress on the corporate insolvency proposals has been curiously muted.

Q We have to ask more about the controversial 'B' word. What's your view of the challenge that Brexit poses to cross-border insolvencies?

A When you look at how much business is international across Europe and how much trade there is, dispute resolution, restructuring, turnaround and insolvency are very important. We can't go back to the difficulties there were in the 70s and 80s, before harmonisation or recognition of judgments applied. If we lose all of that, it's going to put us behind the other member states in terms of doing business. We just have to keep getting the message out there about how important it is.

Q Over the last year, what impression have you formed of the future of the insolvency/restructuring profession?

A At the moment I think there's just a huge degree of uncertainty and people have found an upturn in enquiries and in requests for assistance. The Bank of England monetary policy committee have voted for a quarter of a per cent increase on inflation, which is double the current rate. Who knows what effect that and the Brexit negotiations are going to have? There are so many unknowns and big issues at the moment and with the pound being under pressure it's difficult to tell where it will go.

Q If you hadn't chosen to work in insolvency, what would you have done instead?

A Session musician – no question! I started playing the piano when I was about six, and the cello when I was about ten. One of my cello teachers was the bassist in The Communards and went on to write the orchestrations on Coldplay's X + Y album. I would have loved to do what she did.

> R3 is embracing those parts of the profession that don't rely so heavily on formal insolvency.

Q You're not the first R3 president with a love of music. Reading Andrew Tate's columns he always dropped a few rock and roll references in there.

A We actually both played in a band together called the Fabulous Baker Boys. We had Colin Hague, who was head of insolvency at Baker Tilly on bass, I played keyboards and sang backing vocals, and Andrew played guitar. We had a singer called Bruce Duncan who worked for Rabobank. We haven't talked of a reunion just yet.

Q Any message you'd like to leave to the profession?

A I've been involved with R3 since my first conference in 1993, and I've been pretty much every year since. R3 needs participation from younger members of the profession as well as the old fossils like me. It's a great experience and I'd really like to encourage everybody to participate. You have to give up some of your time but you get it back in spades. ◻

MATT JUKES is publishing manager of *RECOVERY* magazine.