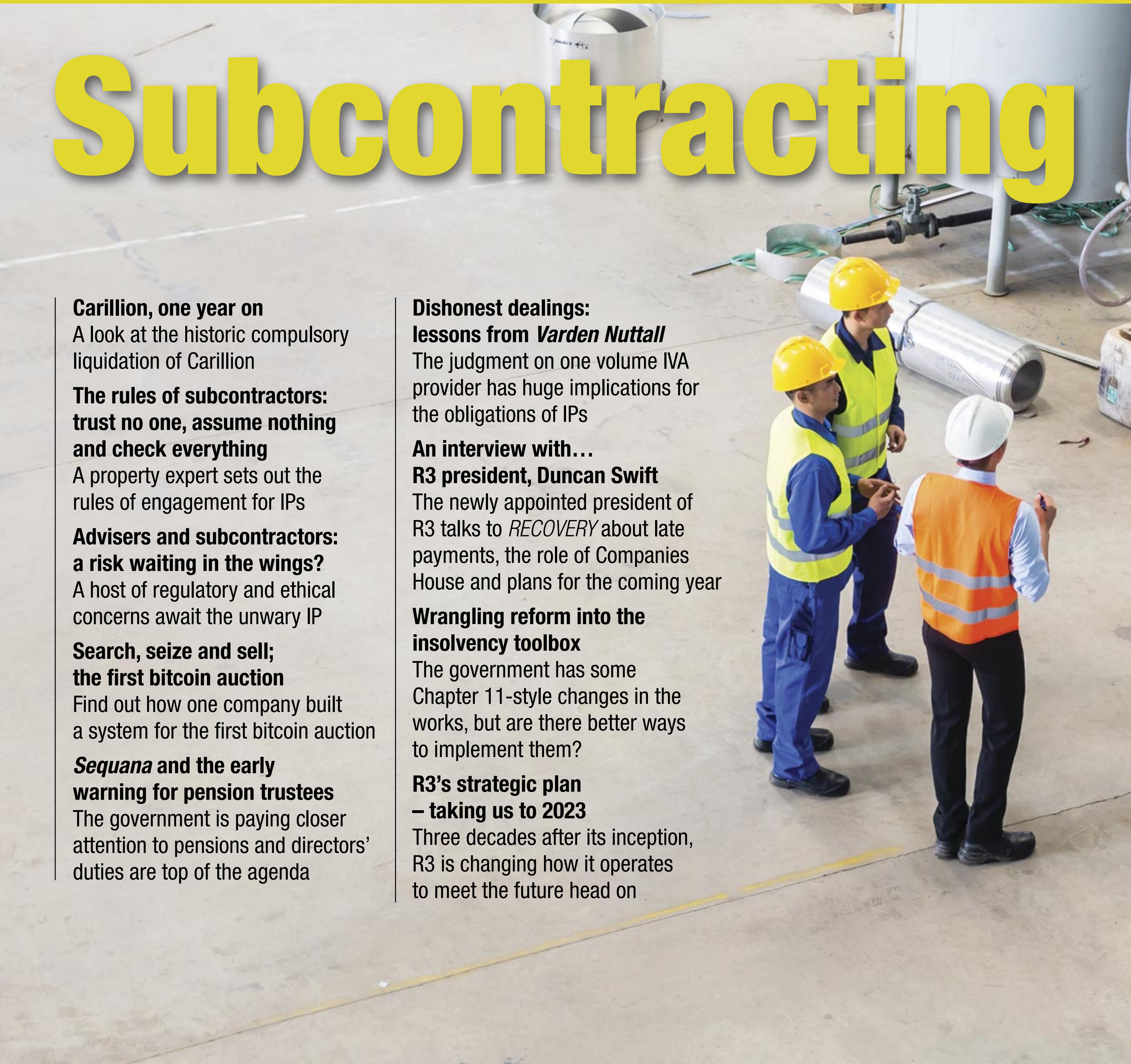
R3, the Association of Business Recovery Professionals | **www.r3.org.uk/recovery** **Summer 2019**

RECOVERY



Subcontracting

Carillion, one year on
A look at the historic compulsory liquidation of Carillion

The rules of subcontractors: trust no one, assume nothing and check everything
A property expert sets out the rules of engagement for IPs

Advisers and subcontractors: a risk waiting in the wings?
A host of regulatory and ethical concerns await the unwary IP

Search, seize and sell; the first bitcoin auction
Find out how one company built a system for the first bitcoin auction

***Sequana* and the early warning for pension trustees**
The government is paying closer attention to pensions and directors' duties are top of the agenda

Dishonest dealings: lessons from *Varden Nuttall*
The judgment on one volume IVA provider has huge implications for the obligations of IPs

An interview with… R3 president, Duncan Swift
The newly appointed president of R3 talks to *RECOVERY* about late payments, the role of Companies House and plans for the coming year

Wrangling reform into the insolvency toolbox
The government has some Chapter 11-style changes in the works, but are there better ways to implement them?

R3's strategic plan – taking us to 2023
Three decades after its inception, R3 is changing how it operates to meet the future head on

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What do you think? Readers' views are welcome. Have an opinion about a burning issue? Want to comment on articles or *RECOVERY* itself? Please contact me on **recovery@r3.org.uk**.

From the editor

Returning from R3's excellent Annual Conference in (genuinely) sunny Northumberland, I am struck by the commonality of themes between the conference and this issue of *RECOVERY*.

Varden Nuttall's secret profits and the case against the IP who extracted them are discussed by Olivia Robinson and Duncan Lole on pages 10–12. At the conference they were assisted by Hugo Groves, who explained, surprisingly, that the IP believed he had done nothing wrong. Hugo told me that the IP couldn't see the wood for the trees. It seems that he lost sight of his fundamental duty to act in the interests of creditors and certainly showed little sign of single-minded loyalty.

Conflicts of interest are the focus of the Core VCT case summary on page 13 and were the subject of a conference masterclass given by Phillip Sykes and Nick Pike. Have you read the Code of Ethics in the last three months? Might the insolvency profession emulate the New York Bar and implement compulsory annual CPD on ethics and professionalism?

Gareth Limb, on pages 22–23, sets out details of regulatory considerations for IPs when instructing professional advisers or subcontracting part of their work. It is important, however, to step back and consider IPs' duties, not least their fiduciary duties, duties of skill and care and duties to creditors. Get those right and the regulatory requirements should slip into place. Get them wrong and regulatory compliance won't help!

R3's strategic plan – taking us to 2023 – was launched at the conference and is available on the R3 website. Emma Lovell sets it out on page 37.

C. Laughton

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

Regulars

Legal update

Subcontracting

Dates for your diary

R3 matters

Advertising features

Themes of *RECOVERY* 2019

AUTUMN Regulation and risk
WINTER TBC

We do the best we can to keep you up to date with the main issues that affect the profession. In times of political uncertainty, such as Brexit, these themes may be subject to change.

Features

RECOVERY

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www.r3.org.uk/recovery

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President's column

Duncan Swift takes the helm at R3 as its strategic plan is launched, and explains why he wants to raise standards in the profession.

I have picked up the presidential baton at a really exciting time for R3: we've just published our strategic plan – setting out our path to 2023 – and the association, from staff to members, is brimming with ideas about R3's future.

A big part of my year as president will be focused on making sure we deliver on the plan, which we launched at this year's annual conference.

Valuable work

It can be easy for members to underestimate or take for granted the value of the work R3 does to represent the profession. I should know: I was one of those members ten years ago, but getting involved with R3 has opened my eyes to what goes on.

R3 has achieved a lot for its members since it was established in 1990 and, to continue that work, R3 needs to adapt to the changing world and profession. The strategic plan sets out how we are going to do that.

> "We have put everything under the microscope: who we represent, how we represent them and why we exist."

To put our plan together we launched a major listening and consultation exercise, during which we heard from hundreds of members and non-members from across the insolvency and restructuring world: lenders, investors, academics, turnaround and restructuring experts, insolvency practitioners, insolvency lawyers, and others.

We wanted to know what the profession needs from R3, and how we can make sure we're fit for the future. We have put everything under the microscope: who we represent, how we represent them and why we exist.

Now is the time for us to turn those conversations into action.

Our plan sets out how we're going to build on our existing work and lay the bedrock to enable us to support our members long into the future. It sets out the direction we're heading in, and how, over the next three years, we're going to be putting those key building blocks in place.

> "A thriving insolvency and restructuring profession is an integral part of any successful economy. A thriving R3 should be an integral part of the insolvency and restructuring profession."

Our plan sets out how we will represent everyone working in the profession, whether they're a licence-holding insolvency practitioner, a lender, a lawyer, a restructuring specialist, or anyone else; whether they're working at a global firm or running their own business; whether they have ten years' experience or ten days'.

Our plan sets out how we will ensure R3 is a diverse and representative organisation that helps the profession flourish as one community, learn throughout a career, speak with one voice and develop and share innovative new ways of supporting UK businesses and individuals.

Our plan is ambitious, but with R3 staff and members working together, everything in it is achievable.

A thriving insolvency and restructuring profession is an integral part of any successful economy. A thriving R3 should be an integral part of the insolvency and restructuring profession.

Please do read Emma Lovell's column later in this edition for details of the plan itself.

Raising standards

Beyond the strategic plan, I'll be looking at how we raise standards inside and outside our profession.

Our profession occupies a position of significant responsibility in the economy. We are personally responsible for protecting creditors' interests. We are personally responsible for protecting the interests of employees, consumers and individuals in debt. We are personally responsible for pursuing and rectifying governance and financial wrongdoings.

We invariably work in difficult situations. Different interests and statutory requirements need to be balanced. Speed and discretion are often required to achieve an outcome that works best for everyone, but which might leave some feeling like they've lost out.

Great trust is placed in us to uphold the law, and we need to make sure that trust is not misplaced. A lack of trust and confidence in our profession will lead to a lack of trust and confidence in our insolvency and restructuring framework. And, a lack of trust and confidence in our insolvency and restructuring framework will weaken our economy.

As a profession, we must reinforce our commitment to 'doing the right thing'. That means commitment to setting and maintaining high standards, commitment to making sure our colleagues maintain these standards and commitment to making sure the oversight of our profession is effective.

> "As a profession, we must reinforce our commitment to 'doing the right thing'."

Your voice in government

This year, with insolvencies rising, the spotlight will intensify on the work we do. At the same time, the government is expected to consult on the regulatory framework for insolvency practitioners. As president, I will work to make sure the value of our profession is recognised and understood, that we, as a profession, are doing our utmost to show we are carrying out our work ethically and professionally, and that the government listens to what we have to say about how regulation works.

At the same time, I will be working to make sure that standards are raised and maintained in other parts of the insolvency and restructuring framework too, and that organisations such as the Official Receiver and HMRC are acting fairly, transparently and accountably in the interests of creditors and the public generally as they go about their duties.

It is set to be a really exciting year, and I can't wait to get started. ◻

DUNCAN SWIFT is president of R3 and a partner at Moore Stephens.

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Legal Q&A

Simon Clarke answers your insolvency queries.

Q I've been notified that a retail customer of mine is considering proposing a company voluntary arrangement (CVA). What is the likely treatment to me as a supplier? The contract is quite uncompetitive from a pricing perspective – can I use this as an opportunity to terminate?

A Last year was dubbed by some the 'year of the CVA' due to the number of household name retailers and casual dining operators proposing an arrangement to restructure their leasehold portfolios with the aim of averting insolvency. While the terms and compromises of each CVA will differ, and independent legal advice should be sought as to the treatment of each class of creditor, the majority of CVAs (including the recently issued Debenhams CVA) do not impose any financial compromise on suppliers or other trade creditors.

> "Certain CVAs have recently looked to compromise outstanding amounts owing to 'non-critical creditors' (including certain suppliers) so the position must be verified in each case."

There is, of course, an indirect consequence for suppliers of a retailer closing large numbers of sites and it is always worth remembering that, as well as those sites within the 'red' exit category, those sites with a rent reduction are also at risk as landlords are given break rights post-CVA. The only direct consequence is that a supplier is prohibited from terminating the contract purely because of the CVA having been proposed, with there being a contractual moratorium on insolvency termination events being exercised by counterparties. The rationale behind this is that, with no compromise to suppliers, the continuity of the business and its operations should be protected and termination rights removed. However, the moratorium only takes effect from the date that the CVA becomes effective (typically when the CVA is voted on by creditors), so there is a short window of approximately 14 days between the CVA being proposed and becoming effective where the CVA moratorium is not in force. Advice should be taken as to whether the insolvency termination right can be exercised and implemented in that period. If so, a discussion could be had with the retail customer to the effect that termination is a serious consideration unless a change to the existing pricing mechanics can be agreed. It is also worth noting that certain CVAs have recently looked to compromise outstanding amounts owing to 'non-critical creditors' (including certain suppliers) so the position must be verified in each case.

Q I've seen a lot of press recently about certain high-profile businesses entering administration, such as Interserve, Debenhams and Four Seasons Healthcare. In contrast to other high-profile administrations such as House of Fraser and HMV where the assets of the underlying operating businesses were sold, communications received by the administrators confirm that the operating businesses are continuing to trade outside of administration. Can you explain why?

A Interserve, Debenhams and Four Seasons Healthcare are three examples where administrators are appointed only at the holding company level, with the underlying operating companies (which are subsidiaries of the holding company) remaining trading 'business as usual' outside of administration. With Interserve and Debenhams, the administrators effected a pre-packaged sale of the shares in these operating companies, among other assets, to a newly incorporated company owned by the lenders/bondholders. Notwithstanding that the holding companies were listed on the main market of the London Stock Exchange, the valuations commissioned by the administrators demonstrated that there was no equity value, as the underlying enterprise value of the business was in each case significantly lower than its financial liabilities to banks, bondholders and pension schemes. The respective administrators issued comprehensive 'Statement of Insolvency Practice (SIP) 16' reports detailing the background of the transaction and valuations to demonstrate to creditors that the pre-packaged sale was undertaken with due regard to the interests of creditors.

These administrations therefore demonstrate that, in circumstances where there is (i) sufficient debt in a group structure that there is no equity value and; (ii) an existing financial covenant breach or other event of default with a group's secured financial stakeholders, administration can be used to transfer control of an operating business without material disruption to the day-to-day operations of that business.

In the case of both Interserve and Debenhams, restructured facilities were provided following the pre-pack sale to give fresh liquidity to the operating companies to allow execution of a turnaround plan.

> "With Interserve and Debenhams, the administrators effected a pre-packaged sale of the shares in these operating companies..."

The administrators of Four Seasons Healthcare's holding companies will be initiating an independent sales process with the aim to complete that by the end of 2019. During that time *'the group's operating companies are unaffected by the appointment of administrators at the [holding company] levels and all businesses are continuing to trade as normal and maintain continuity of care'*.

Suppliers and other trade creditors of the operating companies should take advice as to whether they have any recourse as a result of the administration (eg a contract may have 'change of control' provisions which are engaged) and/or (sales process notwithstanding) that the operating subsidiary that is their contractual counterparty remains outside of administration. ◻

SIMON CLARKE is a senior associate at Bryan Cave Leighton Paisner LLP.

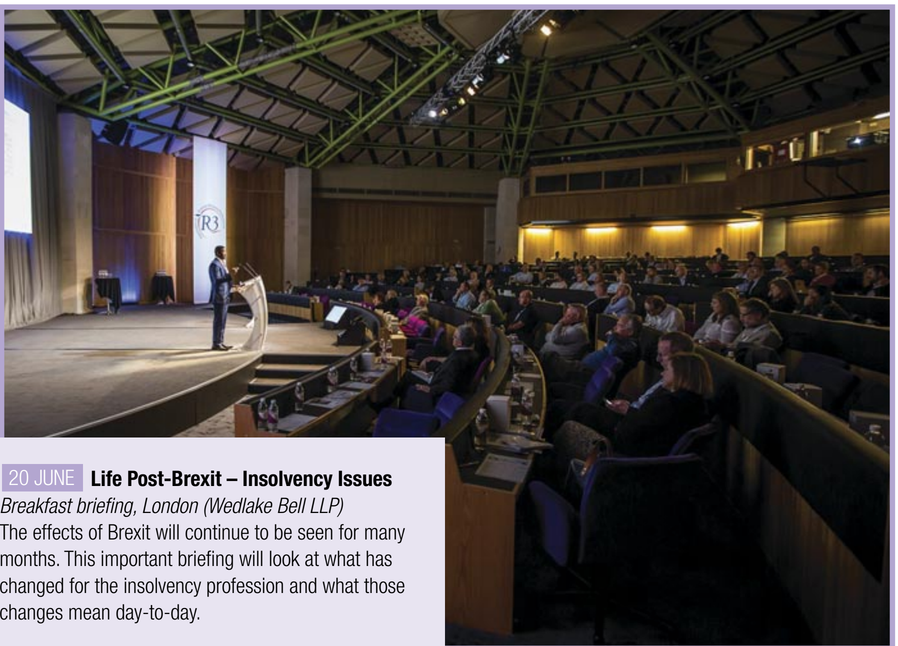
R3 events, courses and conferences

Your training needs, covered.

The R3 2019 programme is packed with training opportunities to suit all levels of experience and designed to fit in with busy schedules. Our highly regarded and valued courses are delivered by leading experts from in and around the insolvency, restructuring and turnaround world.

Don't miss the chance to attend a topical and informative breakfast briefing, a comprehensive half-day course or an in-depth full-day course.

JUNE



4 | 13 JUNE Practical Introduction to Insolvency Work Series (Days 1 & 2)
One-day course, Leeds (Doubletree by Hilton)
The R3 Practical Introduction to Insolvency Work Series provides essential training to ensure your junior staff are developing their core skills for the benefit of your practice. Unique to the R3 programme of events, this series draws on the knowledge and experience of speakers from the top of the profession who are working with the latest legislation and the most recent cases. Day 1 will focus on Personal Insolvency and Day 2 will focus on Rescue, including Administrations & CVAs.

5 JUNE Aviation Insolvencies
Breakfast briefing, London (Linklaters)
An overview of the recent high-profile airline failures, the critical issues arising and the lessons that can be learnt. This briefing brings together the experience of IPs who have dealt with recent failures such as Monarch, Silverjet and Cobalt Air.

18 JUNE Personal Insolvency Forum
Full-day course, Birmingham (Maple House)
The forum addresses the key issues and challenges facing insolvency practitioners in the personal insolvency cases market; offering practical insights, technical updates and personal experiences on the range of every day challenges faced by office holders in personal insolvency cases.

20 JUNE Life Post-Brexit – Insolvency Issues
Breakfast briefing, London (Wedlake Bell LLP)
The effects of Brexit will continue to be seen for many months. This important briefing will look at what has changed for the insolvency profession and what those changes mean day-to-day.

25 JUNE Personal Insolvency Forum
Full-day course, Huddersfield (Cedar Court)
The forum addresses the key issues and challenges facing insolvency practitioners in the personal insolvency cases market; offering practical insights, technical updates and personal experiences on the range of every day challenges faced by office holders in personal insolvency cases.

27 JUNE Environmental Issues in Insolvency
Breakfast briefing, Leeds (Eversheds Sutherland)
In two recent Scottish cases, *Dawson International* and *Doonin Plant*, the Scottish Court of Session has grappled with the thorny issue of the ranking (in the insolvency waterfall) of an entity's environmental liabilities. Are they debts? Are they expenses?

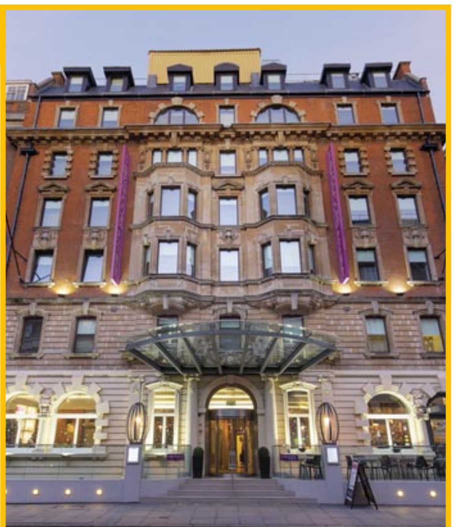
JULY

2 JULY Practical Introduction to Insolvency Work Series (Day 3)
One-day course, Leeds (Doubletree by Hilton Leeds)
The R3 Practical Introduction to Insolvency Work Series provides essential training to ensure your junior staff are developing their core skills for the benefit of your practice. Unique to the R3 programme of events, this series draws on the knowledge and experience of speakers from the top of the profession who are working with the latest legislation and the most recent cases. This day will focus on Liquidations.

4 JULY Aviation Insolvencies
Breakfast briefing, Manchester (Eversheds House)
An overview of the recent high-profile airline failures, the critical issues arising and the lessons that can be learnt. This briefing brings together the experience of IPs who have dealt with recent failures such as Monarch, Silverjet and Cobalt Air.

9 JULY Directors' Duties
Half-day course, London (Addleshaw Goddard)
Directors' duties in the twilight zone: advising on compliance and prosecuting breach. Practically-focused advice from the perspective of both directors and office-holders including a guide to dividends and disguised remuneration and defence strategies for misfeasance claims.

11 JULY R3 & INSOL Europe's International Restructuring Conference
London (Ambassadors Bloomsbury)
A truly international one-day conference with speakers from around the world who have first-hand experience of recent high-profile cross-border insolvencies and restructurings. They will provide an analysis of the 'cutting edge' cases and dynamics of this fast paced sector.



Ambassadors Bloomsbury will host R3 & INSOL Europe's International Restructuring Conference

For more information on our training, networking and social events please visit **www.r3.org.uk/events**

SEPTEMBER

12 SEPTEMBER
Environmental Issues in Insolvency
Breakfast briefing, London (Eversheds Sutherland)
In two recent Scottish cases, *Dawson International* and *Doonin Plant*, the Scottish Court of Session has grappled with the thorny issue of the ranking (in the insolvency waterfall) of an entity's environmental liabilities. Are they debts? Are they expenses?

17 SEPTEMBER
Life Post Brexit – Insolvency Issues
Breakfast briefing, Manchester (TLT Solicitors)
Hear from leading experts in their fields – a lawyer, a practising insolvency practitioner and a leading academic – as they present their unique and informed views on Life Post Brexit.

19 SEPTEMBER
Core Tax for Insolvency Professionals
Half-day course, London (Squire Patton Boggs)
A focused view on the world of tax as it interacts with the IP's world of restructuring and insolvency. Tax has never been more taxing with multiple changes in legislation and policy approaches.

26 SEPTEMBER
Practical Introduction to Insolvency (Day 1)
One-day course, London (etc.venues Prospero House)
This introductory series features practical 'real life' cases covering a range of corporate and personal insolvency procedures. Uniquely designed for junior administrators wishing to further their knowledge and those who have recently joined the profession. This session will focus on Personal Insolvency.

OCTOBER

3 OCTOBER **Directors' Duties**
Half-day course, Leeds (Gateley Plc)
A series of experts are brought together to discuss topical issues, technical updates and practical tips for those involved in advising directors or anyone whose work involves pursuing civil litigation against directors.

8 OCTOBER **Carillion – Reflections One Year On**
Breakfast briefing, London (CMS)
What lessons can be learnt from the largest ever trading liquidation in the UK?

10 OCTOBER
Practical Introduction to Insolvency (Day 2)
One-Day Course, London (etc.venues Prospero House)
This introductory series features practical 'real life' cases covering a range of corporate and personal insolvency procedures. Uniquely designed for junior administrators wishing to further their knowledge and those who have recently joined the profession. This session will focus on Rescue, including Administrations & CVAs.

17 OCTOBER
Blockchain & Cryptocurrencies
Half-day course, London (Pinsent Masons)
Introducing terms, concepts and practical management points, the course will consider existing regulation and caselaw. Asking applied questions; what is money, a creditor or an asset in the insolvency space? The course will conclude by pondering, 'can Blockchain and existing insolvency regimes coexist?' and 'what is the IP's future in the Smart Contract world?'.

29 OCTOBER
Restructuring Day
One-day course, Manchester
This provides an overview of the key issues involved in a restructuring from assessing the financial picture to understanding the impact of the security position. It covers some of the common tools used to achieve a restructuring from out-of-court approaches, the use of CVAs and Schemes, to pre-pack administrations.

What's on in your region…

LONDON AND THE SOUTH EAST

28 JUNE
R3 London & SE Women's Group Lunch at the Langham
12:00–17:00, London, The Langham Hotel
We have the pleasure in letting you know that bookings have now opened for the 2019 ladies-only 'Lunch at The Langham'. The lunch will commence with a drinks reception; there will then be a sumptuous three-course meal at the beautifully elegant Langham Hotel, along with a guest speaker after lunch is served.

YORKSHIRE

5 JULY
R3 Yorkshire Women's Group Ladies Lunch
12:00–18:00, Aspire, Leeds
Join us for this year's Yorkshire Ladies' Lunch, full of entertainment. Eat, drink and network with colleagues and clients in the wonderful style and spirit of 'The Greatest Showman'. This year there will be a raffle to support two great charities, the Candlelighters and Leeds Mind. There will also be a prize for the 'Greatest' Outfit.

EAST

11 JULY
R3 Eastern Region Annual Dinner
19:00–23:00, Downing College, Cambridge
The R3 Eastern Regional Annual Dinner to be held at Downing College, Regent Street, Cambridge CB2 1DQ commencing at 19.00 with a drinks reception followed by a three-course dinner at 19.30. After dinner guests are then welcome to have evening drinks in the Howard Drawing Room.

28 NOVEMBER
R3 Eastern Region Ladies' Lunch
12:30–17:00, The Assembly House, Norwich
R3 Eastern Region's Ladies' Lunch at The Assembly House, Norwich, NR2 1RQ. Ticket will include a three-course lunch, a welcome drink and entertainment. Invitation is open to men and women.

For more information on our training, networking and social events please visit **www.r3.org.uk/events**

Dishonest dealings: lessons from *Varden Nuttall*

Duncan Lole and **Olivia Robinson** examine an important decision regarding the duties and obligations of licensed insolvency practitioners.

In the landmark case of *Varden Nuttall Ltd and another* v. *Nuttall and another* [2018] EWHC 3868 (Ch)[1], the director and licensed insolvency practitioner (IP) of a top-ten volume provider of individual voluntary arrangements (IVAs) was found to have acted negligently in his capacity as director, and dishonestly in his capacity as supervisor in relation to schemes and arrangements entered into with third-party service providers.

The background

Varden Nuttall Limited (the company) employed IPs. It provided its IPs' services to individuals mainly in respect of proposals for (and then the administering of) IVAs in England and Wales and the procedure's Scottish equivalent. By the time the company entered administration in March 2016, its IPs were together administering almost 2,800 insolvency cases. Mr Nuttall was a director of the company, and a shareholder and director of the company's parent, Release Money Group (RMG) Limited. He was also an IP supervising over 1,600 insolvency cases as at the date of administration. He was replaced as supervisor and his licence to practise was later removed in June 2016.

> By the time the company entered administration in March 2016, its IPs were together administering almost 2,800 insolvency cases.

The monies forming the IVA estates were, or should have been, held in separate accounts or, later on, in a limited number of global trust accounts. At the date of administration, it was anticipated that there was a shortfall in the client monies held in the four global trust accounts to the sum of approximately £4.8m.

On 5 August 2016, HHJ Pelling QC, sitting in the High Court in Manchester, made an order allowing the joint administrators to commence a full reconciliation of the company client accounts. It was discovered that there was not only a shortfall of approximately £9m, but also evidence of fraudulent practices by Mr Nuttall leading to further losses to the creditors of the IVA estates.

A claim was subsequently brought in May 2017 by the joint administrators and the new supervisors (led by David Clements of Harrisons Business Recovery and Insolvency Limited) against Mr Nuttall and Mr Varden for breach of duties in their capacity as directors. A claim was also brought in the same proceedings against Mr Nuttall alleging that he had acted dishonestly in breach of his duties as former supervisor of certain IVAs. On the same date as the proceedings were issued, the court granted a freezing injunction order in favour of the claimants. Mr Varden did not appear and was not represented at trial, having indicated an intention not to defend the proceedings and having entered into an IVA in October 2017. The

> It was anticipated that there was a shortfall in the client monies held in the four global trust accounts to the sum of approximately £4.8m… It was discovered that there was not only a shortfall of approximately £9m, but also evidence of fraudulent practices.

trial, which took place in May 2018, therefore proceeded in relation to the claims against Mr Nuttall only and, upon conclusion of the trial, by way of an order dated 8 August 2018, Mr Nuttall is liable to pay the claimants the sum of £12.8m. Hugo Groves of Enterprise Chambers was counsel for the claimants.

The allegations

In addition to the shortfall issue, there were five substantial allegations made against Mr Nuttall, regarding the way in which the IVA estates were managed, and charged, by the company. Four of these concerned schemes and arrangements with third-party service providers. The claimants alleged that those schemes and arrangements were entered into for the purpose of transferring estate money to the company in fraud of those interested in the IVA estates by secret commission paid by the service providers concerned to RMG, ultimately for the benefit of Mr Nuttall and Mr Varden as its shareholders. It was principally in relation to those schemes and arrangements that the claimants maintained that Mr Nuttall was dishonest. They included:

- An arrangement concerning the provision of IT and document management services to each IVA with an IT company, controlled by a former employee of the company.
- An arrangement between Mr Nuttall on behalf of the company and two PPI mis-selling claims providers (PPI providers), by which the PPI Providers were engaged to pursue PPI mis-selling claims on behalf of the debtors of certain of the estates of which Mr Nuttall was supervisor – a scheme by which, the claimants alleged, money belonging to the estates was channelled to RMG because, additionally, there were side agreements between RMG and the PPI providers by which sums became payable to RMG in respect of any successful referrals to the PPI providers, purportedly for the provision of data by RMG to the PPI providers.
- An arrangement with a property appraisal service provider in similar terms to the schemes described above.

For clarity, the allegations of dishonesty were made against Mr Nuttall only and no claims were brought against the service providers who were not party to the proceedings.

Dishonesty

For dishonesty to be established, HHJ Pelling QC stated that it was necessary first to demonstrate subjectively the knowledge or belief of the person concerned as to the relevant facts, and then to determine objectively whether that person's conduct was honest by applying the standards of ordinary decent people. In this case, it required Mr Nuttall's knowledge of the agreement relied upon by the claimants to be such as to render his participation contrary to the ordinary standards of honest behaviour.

The legal and evidential burden rested on the claimants throughout to prove not merely the breaches on which they relied, but also in relation to the alleged breach of Mr Nuttall's duties as supervisor that they were dishonest. The standard of proof is always the balance of probabilities but the more serious the allegation or the more serious the consequences of an allegation

> It is difficult to think of a more serious allegation for a chartered accountant to face in a civil context than one of dishonesty in a professional capacity.

being true, the more cogent the evidence must be if the civil standard of proof is to be discharged. HHJ Pelling QC stated: *'It is difficult to think of a more serious allegation for a chartered accountant to face in a civil context than one of dishonesty in a professional capacity or one where the consequences of that allegation being proved could be more serious.'*

IT arrangements

The director of the IT company was a previous employee of Varden Nuttall, Limited who had been approached by Mr Varden and Mr Nuttall to offer exactly the same services as he did as an employee, but pursuant to an arrangement to be entered into between the company and the IT company. The IT company would not retain anything from the fees that the IT company would, seemingly, be entitled to receive, other than a sum equal to the director's salary and other direct costs incurred by the IT company. Ultimately, the cost that was levied against each estate as a sum, ostensibly payable to the IT company for the provision of services, was not paid over to the IT company in full, or

> Much more material to the honesty issue were paragraphs 1 and 6 of SIP9, where transparency and fairness are said to be of primary importance.

at all. Among other things, Mr Nuttall asserted that, although payments were made by the IT company to RMG, that was justified, fair and reasonable because RMG provided the IT company with servers, staff, office accommodation and support services, including the scanning of documents onto the server.

HHJ Pelling QC began by saying that it is common ground that estate monies are held by supervisors of IVAs on trust for the purposes of the IVA. The manner in which fees, disbursements and expenses are dealt with is governed primarily by the terms of the approved proposals. However, the way in which a supervisor of an IVA should conduct himself is also governed by Statement of Insolvency Practice 9 (SIP9). The judgment sets out the material sections of SIP9, including key compliance standards, the provision of information when fixing the bases of remuneration, disbursements and payment to associates.

In declining to acquit Mr Nuttall of dishonesty, HHJ Pelling QC made the following points, which provide helpful clarification on the application of SIP9 in the following circumstances:

Paragraph 18 of SIP9 did not apply, because the payments to the IT company were made directly from the estates (or at least were allocated in the books and records of the estates as a direct payment) and were therefore not costs met by and reimbursed to an office-holder. If that was wrong, and even if the payments were treated as category 1 payments, that was entirely beside the point. It was not the concept of a per-estate fee for IT services that was objectionable, but that the fee ostensibly payable for that service included a secret commission. It was inconceivable that anyone could consider such an arrangement to be honest in the absence of consent when viewed from the standpoint of the beneficiaries of the IVA, or someone occupying a trustee or fiduciary position in relation to the money from which the secret » commission was derived. Such an arrangement was one that could only be regarded as objectively honest if administered in accordance with paragraph 25 of SIP9.

Reliance on paragraph 24 of SIP9 also entirely missed the point – it was the secret commission element that was obviously objectionable. Much more material to the honesty issue were paragraphs 1 and 6 of SIP9, where transparency and fairness are said to be of primary importance. There was nothing transparent or fair about the arrangement. The secret commission mechanism was in truth a mechanism by which a sum in excess of the agreed supervisor's fee could be obtained from each estate.

> **It was inherently improbable that the institutional creditors' agent would have agreed if the information had been fully and frankly disclosed.**

Paragraph 6 of SIP9 requires an office-holder to disclose payments, remuneration or expenses paid to an office holder or his associates. There was no evidence that came close to demonstrating Mr Nuttall's original assertion that all, or a majority, of the creditors had consented to the arrangement. Even in relation to discussions that Mr Nuttall alleged took place, disclosure was not full and frank because a payment was being made to a holding company, which was not disclosed.

There was no evidence that services were being provided by RMG in return for the payment. No attempt was made to demonstrate any connection between the amount of the secret commission and the value of/cost of providing the alleged services. The reality was that this was a secret system for increasing fees, which was impermissible as expressly stated in paragraph 21(b) of SIP9.

Mr Nuttall knew: SIP9 and its contents; that the whole fee purportedly payable to the IT company was not in fact paid to it; that the sums paid over to RMG were at the expense of creditors and a secret means by which fees were being increased; that this was not permitted both by operation of the IVA terms and SIP9 and was inimical to the role of an IP as trustee of an IVA estate; that no attempt had been made to inform other than (at most) a single agent for institutional creditors; and that even then the disclosure had not been full and frank.

It was inherently improbable that the institutional creditors' agent would have agreed if the information had been fully and frankly disclosed. Such consent would have obviously defeated the admitted objection of such creditors to supervisor fees in excess of 15% of realisations. In those circumstances, right thinking people would conclude that entering into and then giving effect to the arrangement was a dishonest breach of the duties owed by a supervisor, being those identified in SIP9 and arising by reason of the supervisor's role as a trustee of the IVA estate.

PPI arrangements

HHJ Pelling QC concluded that the claimants had every reason to be suspicious of the PPI provider arrangements:

The fee payable to RMG was described in a letter as being a 'referral fee' of 25% of the net fee payable to the PPI provider – the letter made no attempt to justify the fee on any other basis. If a referral fee is payable in respect of instructions given by or on behalf of the supervisor of an IVA, then it is obvious that the fee ought to benefit the estate and therefore its creditors and, ultimately, the debtor, and not RMG, or for that matter the company or the supervisor of the IVA concerned.

The fee was described differently in a written agreement, as an 'admin payment'. RMG was a holding company – it did not provide services or employ IPs. It did not and could not perform the services of a referrer – Varden Nuttall was the operating company. In those circumstances, the payment by the PPI provider was in substance a referral fee paid to RMG, which served to enhance the fees payable in respect of each IVA where a successful PPI claim was made on behalf of the debtor.

In substance the comments made in relation to the IT arrangements applied with equal force to the PPI arrangements; however Mr Nuttall asserted that the existence of the PPI arrangements had been disclosed in a way that the IT arrangements had not.

HHJ Pelling QC reminded himself of the terms of SIP9, including paragraph 25, which provides that payments that could reasonably be perceived as presenting a threat to an office-holder's objectivity by virtue of a professional or personal relationship should not be made unless approved in the same manner as office-holder's remuneration or category 2 disbursements.

A typical example of disclosure contained in a supervisor report to creditors was a paragraph stating that Mr Nuttall had instructed a third party to recover PPI premiums and that [£x] had been recovered. A further paragraph said: *'Third-party fees in relation to obtaining the payment protection insurance amounts to [£x]. They have been paid to RMG, the holding company of Varden Nuttall for assistance given in making the claim.'*

HHJ Pelling QC labelled this disclosure as *'woefully inadequate'* because: it was after the event; did not attempt to explain what services RMG was providing, what sums had been paid to RMG, why it represented best value or otherwise the basis on which the charge had been made; or any other information that enabled the recipient of the report to make an informed judgment as to whether the payment or amount was appropriate in principle.

> **This case has triggered growing scrutiny and concern over regulation in the sector generally.**

In relation to the arrangements made with the property appraisal service provider, Mr Nuttall was found liable to the same extent and on the same basis as for the payments made to the IT company and the PPI providers.

Conclusion

This case has triggered growing scrutiny and concern over regulation in the sector generally. As we have seen, the judgment in this case contains useful commentary surrounding contraventions of SIP9 and serves as a valuable reminder to practitioners of their duties and obligations.

The authors acted on behalf of Harrisons Business Recovery and Insolvency Limited in Varden Nuttall Ltd and another v. Nuttall and another.

[1] Please note Philip Nuttall from Varden Nuttall has no association with Philip Nuttall at Barton Buckle.

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Recent case summaries

Latest insolvency update from **Matthew McGhee** and **Tony Beswetherick**.

PERSONAL INSOLVENCY

***Surjit Singh Ardawa* v. *Rajvinder Kaur Uppal & Adam Jordan (as trustee in bankruptcy of Mr Ardawa)* [2019] EWHC 456 (Ch)**

This case confirms that permission to serve a bankruptcy petition by substituted service must be obtained *before* such service takes place (and cannot be obtained retrospectively), and confirms that the creditor must fully inform the court of any known contact details for the debtor so as to best enable service of the petition.

'A' and 'U' were divorced in 2011. A failed to pay ancillary relief to U under a court order, giving rise to a debt of nearly £9,000. U instructed a process server to serve A with a statutory demand for this sum to the residential address of A's second wife. After letters sent to this address went unanswered, the process server posted the bankruptcy petition through the letter box.

The court made an order for substituted service of the petition upon A at the address of A's second wife. The order was said to have retrospective effect (thereby validating the posting of the petition through the letter box). The court then proceeded to make a bankruptcy order against A.

A subsequently applied to annul the bankruptcy order. He claimed that he was estranged from his second wife and not living with her. He argued that U was aware that he had a different correspondence (his parent's address) and had his email address and mobile phone number, but no attempt had been made to contact him by those means, which had not been disclosed to the court. A district judge refused to annul the bankruptcy order on the basis that U had been entitled to effect substituted service. A appealed.

On appeal, Roth J partially allowed A's appeal: first, the judge held that the statutory demand had been properly served. Although U was aware that A was using his parents' address, that did not make it A's residence. U also had email and mobile phone contact details for A, but the address of A's second wife was a proper address for service and had brought the statutory demand to A's attention. IR r.6.3(2) requires that a creditor must do *'all that is reasonable for the purpose of bringing the statutory demand to the debtor's attention'*; this is a high threshold, but whether it is met is a fact sensitive question for the judge.

Second, the judge waived a limited defect in the petition. U had failed to provide previous addresses for A on the face of the petition. However, this fell within IR r.7.55 because it could not possibly have caused prejudice to A.

Third, the judge held that the service of the bankruptcy petition was defective. Permission was sought retrospectively under IR r.6.14. However, Roth J confirmed earlier *obiter dicta* that IR r.6.14 only permitted prospective substituted service. The court had no power to authorise substituted service retrospectively, so the bankruptcy petition had not been properly served.

Fourth, the judge nevertheless declined to exercise his discretion to annul the bankruptcy order. The debt was undisputed, A had not provided any reason why it had not been paid and was aware of the petition but had sought to evade service by providing false evidence of his residential address.

CORPORATE INSOLVENCY

***Re Core VCT Plc (in Liquidation)* [2019] EWHC 540 (Ch)**

In this case the court provided guidance as to the practice and principles involved in restoring a company to the register for the purposes of a further liquidation.

Three Core VCT companies were previously fund vehicles for investments that had, while solvent, been placed into members' voluntary liquidation. The liquidators of the companies caused the dissolution, but former shareholders subsequently applied to restore the companies to the register pursuant to section 1029 of the Companies Act 2006 and for the appointment of new liquidators pursuant to section 108, alleging that the companies' affairs – both before and during the liquidation – had been improperly conducted.

The applications before the judge were made (a) by the new liquidators, for the court's assistance in obtaining information and documents from the companies' former managers and liquidators; and (b) by those former managers and liquidators, seeking to impugn the earlier applications to restore the companies to the register and/or the appointment of the new liquidators.

First, the judge recognised that there was no real dispute between the parties as to whether there were serious issues to be investigated.

Second, the judge rejected the former managers and liquidators' submission that the decision of the companies' members to appoint then later release the former liquidators was binding and precluded the restoration of the companies and appointment of new liquidators. The court recognised that the principle of majority rule and corporate autonomy was the correct starting point, but that it could not be conclusive.

Third, the judge held that an application to restore a company is effectively made *ex parte*, such that the applicant bears a duty of full and frank disclosure. In this instance, the judge who made the restoration order was: (a) incorrectly informed that the Registrar of Companies had been informed of and consented to the shareholders' intention not to provide notice to the former liquidators; and (b) not informed that the former liquidators were released as a result of shareholder meetings. The judge did not find these items material to the application, or that their correction would have caused the previous judge to make a different order.

Fourth, the judge confirmed that there was no injustice in the former liquidators not being given the opportunity to attend the previous hearing. They had no entitlement to appear at that hearing, and established authority precludes intervention by third parties where the third parties merely wish to argue that the proceedings proposed by the to-be-restored company have no prospect of success.

Fifth, in circumstances where the companies were properly restored and the new liquidators properly appointed, the parties seeking to remove the new liquidators must show cause for their removal. The former liquidators could not be appointed because of the conflict of interest involved in their investigation of their own previous conduct in the first liquidation.

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Wrangling reform into the insolvency toolbox

Sarah Paterson and **Mike Pink** outline the history behind the latest government insolvency and corporate governance proposals and suggest a different way the new tools might be adopted.

Administration is generally regarded as a business rescue tool. The business continues, but the corporate entity is ultimately dissolved – notwithstanding the Enterprise Act reforms of 2002, which inserted *company* rescue as the first purpose of the administration – and insolvency practitioners are used to thinking of themselves as the architects of business rescue transactions.

> The IP and insolvency law have typically provided business, not company, rescue tools if a restructuring could not be agreed contractually.

In small companies keeping competitors at bay, calming customers, coping with expense and framing a transaction acceptable to the directors (who may be the only group practically willing to continue the business) may make a company rescue impracticable. Until recently, large companies were typically reliant on loan debt as their principal source of external finance and rescue from financial difficulty would be negotiated with the banks out of court. Legal process was reserved for cases where a restructuring agreement could not be reached. As a result, it was unusual for a rescue transaction to involve a legal procedure in England, so that the IP and insolvency law have typically provided business, not company, rescue tools if a restructuring could not be agreed contractually.

It has become more difficult to restructure large companies out of court for a host of reasons: globalisation and a wider finance sector; highly liquid secondary markets for debt in which new investors trade into the situation; different types of loan investor; and the growth of a European high-yield bond market. As a result, large companies have increasingly mobilised the scheme of arrangement procedure or, in a small number of cases, the scheme coupled with a pre-pack administration sale, to restructure their balance sheets. This machinery has proved adaptable and effective, as it drags along hold-out or disengaged parties, but it also leaves the IP on the sidelines, largely involving the investment banking community and restructuring boutiques.

Reforms to corporate governance

The government is now proposing several far-reaching reforms to the corporate insolvency regime under its *Response to the Insolvency and Corporate Governance Consultation* published in August 2018 (the government response). These reforms propose the introduction of tools available in US Chapter 11 proceedings to facilitate company rescue that are currently not in

> A scheme of arrangement has proved adaptable and effective, as it drags along hold-out or disengaged parties, but it also leaves the IP on the sidelines, largely involving the investment banking community and restructuring boutiques.

the English toolbox: a moratorium banning the operation of insolvency–related termination rights in non-finance contracts (so-called ipso facto clauses); and the ability to impose a restructuring plan on a dissenting class of creditors.

However, the government response dedicates almost no space to the policy reasons behind implementation. This article aims to examine (i) the case for implementing the tools in England; and (ii) what that analysis tells us about implementation. The argument will be advanced that the tools should not be free-standing and available to directors of financially distressed companies, but should instead be folded into the current administration regime by the addition of a new schedule – applicable only where the administrator is pursuing the first purpose of company rescue. This approach could balance the adequate protection of creditors by administrators and the courts with concerns that more powerful company rescue tools may be needed for large corporate restructurings in the next decade.

> The government response proposes a new, strong pre-insolvency moratorium and a separate restructuring plan proposal closely modelled on the scheme of arrangement but offering a cross-class cram down power.

The government response indicates that the tools are to be available for large and SME companies seeking a rescue transaction. However, the tools are likely to be too complex and disproportionately expensive for widespread use by SMEs, which are likely to continue to rely on other parts of the insolvency toolbox. As a result, this article will focus on the proposed new tools and large company rescue.

Rescue by contract

Developments in the last decade have made it increasingly challenging to agree a large company rescue by contract around the board table. At the same time, many large company groups have struggled with high leverage, which leaves them more susceptible to financial distress if they suffer any reduction in operating cash flow as they must continue to meet significant debt service costs.

The scheme of arrangement procedure has proved particularly well-adapted to support restructuring the balance sheets of these highly leveraged borrowers. The debt has typically been raised in a finance holding company (or can be pushed back up to the finance holding company level if it has been on-lent through the group), so that it has been possible to propose a scheme in the finance holding company without affecting the operating companies. Crucially, although the operating companies will typically have guaranteed the finance holding company debt and granted security over their assets for the guarantee obligation, it is possible to release the guarantees in the finance holding company scheme. Overall, the features of the scheme of arrangement, including the early hearing at which the court confirms the way in which the finance holding company has organised voting on the scheme, minimising the risk of disruption later; the Companies Act nature of the procedure reducing negative connotations for customers and suppliers; the relatively rapid timetable for the scheme; and the ability to release operating company guarantees, have all made it extremely well-adapted to the problem at hand. The principal issue in these transactions is the negotiation of the revised capital structure, and this is something which the scheme of arrangement has made its own.

The scheme of arrangement lacks two features commonly associated with company rescue: a moratorium to keep the assets together while the restructuring is negotiated; and the power to impose a restructuring plan on an entire class of dissenting creditors or shareholders. Creditors and shareholders voting on a scheme of arrangement are divided into classes for the purposes of voting according to their rights going into the scheme and the rights which they will acquire under it. Only a majority in number and 75% of those voting by value is needed in each class for the scheme to be capable of sanction by the court at the final hearing to approve the scheme. But if an entire class votes down the scheme there is no power for the court to approve it over the wishes of that class. This contrasts with Chapter 11, which offers both a strong automatic stay and a cross-class cram down power. The government response proposes a new, strong pre-insolvency moratorium and a separate restructuring plan proposal closely modelled on the scheme of arrangement but offering a cross-class cram down power. However, as already discussed, it offers no analysis of the policy behind the introduction of these tools.

Missing toolkit?

Limited issues have arisen with the absence of a moratorium, and a workaround has been developed for the cross-class cram down by coupling the scheme with a pre-packaged administration sale. However, it is worth pausing to consider why this has been the case. The leveraged debt has largely been raised on Loan Market Association terms. These loans typically contained a detailed negotiated suite of financial maintenance covenants. Financial maintenance covenants test, on an ongoing basis or periodically, a financial threshold or ratio by reference to the borrower's most recent set of accounts (such as the ratio of debt to earnings). If the covenant is breached when tested, the lenders have the same rights which they would have on a payment default, including the right to stop further drawings, or to accelerate (or demand immediate repayment of) the loan.

These covenants have typically operated to bring borrowers and lenders together at a sufficiently early stage, when the group still has sufficient liquidity to maintain its operating expenses. This has enabled the restructuring to be confined within the finance holding company and facilitates a restructuring transaction, which offers some consideration to all classes of debt in the majority of cases. At the same time, because only finance creditors are implicated at the finance holding company level, the inter-creditor agreement in the suite of debt documents has provided a contractual moratorium.

> If the policy reasons for importing these tools are related to the need for more thorough-going operational restructurings, there are serious implementation issues.

None of this suggests a pressing need to import tools from Chapter 11, which has arguably proved less effective for these financial restructuring transactions because of its cost, timetable and complexity. But there are reasons to suspect that things might change. There has been an explosion of high-yield bonds and covenant-lite loans in leveraged financing in England and Wales. High-yield bonds are held by a large number of bondholders who are not easily identifiable by the borrower, so that renegotiation costs can be high on default. As a result, the high-yield bond market relies on incurrence covenants, rather than financial maintenance covenants. An incurrence covenant often includes a financial ratio test, but crucially it is only tested if the borrower raises further debt outside some fairly generous permitted indebtedness provisions. As a result, there is no formal, ongoing testing of financial condition. For complex reasons, the loan market has also recently adopted incurrence covenants in so-called covenant-lite loans, so that many of the leveraged loans that have been written in recent years lack the early warning trigger that has forced the parties together to negotiate since the crisis.

The concern is that borrowers and lenders will only come to the table much later, when the group is facing a more severe liquidity crisis. At best, this may mean that purely financial restructurings become deeper, so that consensus is harder » to strike and it becomes more common to need to impose a plan against the wishes of an entire class. While there is a workaround utilising a pre-packaged administration, this is not an easy transaction, involving accounting, tax and contract concerns amongst others. At worst, it may mean that the liquidity difficulties that the finance holding company has faced in servicing the debt burden have spread to liquidity difficulties for the group operating companies in meeting operating liabilities, so that a financial and operational restructuring is required. At the same time, the leveraged debt market may tighten if monetary policy conditions change.

Policy

These are some of the policy reasons why a number of market participants, including the Insolvency Lawyers' Association and the City of London Law Society in their joint paper on the government response (the ILA/CLLS response), support importing a wider range of tools into the English corporate rescue toolbox.[1] But if the policy reasons for importing these tools are related to the need for more thorough-

> **The UK proposals appear to be a freewheeling set of powerful bargaining tools available to relatively unsupervised directors, while there are some serious design flaws such as the proposal to limit the moratorium to solvent companies.**

going operational restructurings, there are serious implementation issues. This is because it is far more likely these tools will be mobilised when trade creditors, as well as finance creditors and shareholders, are involved. While fairness issues do, of course, arise in a financial restructuring impacting only sophisticated financial creditors with the full range of investment opportunities, they are less acute given that these creditors can be expected to understand and price risk; to have hedged, diversified investment portfolios; and to have negotiated detailed contracts which carefully allocate control rights in distress.

Entirely different issues are raised for non-financial creditors: a non-financial creditor who is owed pre-filing liabilities and is prevented from terminating contractual supply may face very serious cash flow difficulties; questions arise as to contracting for healthy companies if insolvency termination events no longer operate; and even with a ban on insolvency termination clauses it may be necessary to pay ransom creditors who are owed pre-filing liabilities in order, practically, to be sure of supply. Similarly, there are different considerations in cramming a restructuring compromise down onto unsecured trade creditors than onto sophisticated, strongly adjusting financial creditors in junior debt tranches. For example, how are these types of creditor supposed to understand and evaluate their options, and how are they to negotiate with sophisticated distressed fund investors? Once we are clear about the policy reasons for introducing the new tools, we can see the complex issues around their implementation.

Learning from the Americans?

Chapter 11 has a series of complex protections that attempt to balance these considerations. At the same time, a practice has grown up facilitating the payment of so-called critical vendors, and the court closely supervises all aspects of the case. As currently contemplated, the UK proposals appear to be a freewheeling set of powerful bargaining tools available to relatively unsupervised directors, while there are some serious design flaws such as the proposal to limit the moratorium to solvent companies.

One idea which has been put forward in the ILA/CLLS joint response, which one of the authors of this article was involved with and which we both support, is folding these tools firmly into the administration process. This would facilitate some supervision of the use of these tools while reflecting the traditional division of labour between an actively engaged IP (for commercial issues) and the court (for legal questions) in the English corporate insolvency regime. It could be achieved without any damage to the existing uses of administration by including a new schedule with the new tools, which would only be available where the administrator was pursuing the company rescue purpose in paragraph 3(1)(a) of schedule B1 to the Insolvency Act 1986.

One issue which arises is the management-displacing nature of administration, which may not be attractive to the directors when the purpose of the process is to rescue the company. Paragraph 64 of schedule B1 currently allows the administrator to delegate his powers of management to a company's directors. Some variation of this could be included in the new schedule, leaving powers with management and subject to the supervision of the administrator, except where the administrator or the court otherwise directs.

Change on the horizon

There are reasons to suspect change may be on the horizon, and that we may see the need for large company financial *and* operational restructurings in the next decade using some form of legal process to facilitate the transaction. It is crucial that we are clear about the case for reform because this will help us to see clearly the design issues that arise. When we

> **Implementing these tools could be achieved without any damage to the existing uses of administration by including a new schedule with the new tools.**

understand the policy argument for the new tools, we can see that the tools may be used in circumstances involving not only strongly adjusting finance creditors but also weakly adjusting trade creditors, raising a whole host of supervision and balancing concerns. This is the natural homeland of the IP in the English system, and it would be a relatively straightforward matter to fold the new powers into a new schedule to the Insolvency Act 1986, available only where the administrator is pursuing company rescue. Instead of risking the free-wheeling use of powerful tools by relatively unsupervised management, this would neatly build the tools into our existing framework of supervision and control. English IPs would thus have a *more* serious role in company, as well as business, rescue transactions.

The views expressed in this article are those of the authors, not their employers.

[1] Available at: https://www.ilauk.com/docs/Joint_ILA_and_CLLS_issued_paper_on_legislative_reforms.Feb_2109_.pdf

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Carillion: one year on

David Kelly and **David Chapman** attempt to summarise some of the events around the historic Carillion compulsory liquidation.

At 6.40 am on Monday 15 January 2018, Mr Justice Nugee made an order that would change the face of the UK corporate restructuring and insolvency market. With that one order Carillion plc, a global FTSE-listed conglomerate with 40,000 employees worldwide, and consisting of 375 legal entities, was placed into compulsory liquidation. That order appointed the Official Receiver as liquidator and no fewer than six partners from PwC as special managers to support the Official Receiver to deliver the liquidation strategy.

> It is virtually impossible to describe adequately the size, scale and reach of Carillion's 24/7 operation and the challenges involved in delivering the liquidation strategy.

It brought to a close one of the most challenging corporate restructurings in the UK, with the lenders that supported a £140m package in October 2017 unable to agree a wider restructuring with the company and its other key stakeholders. The Official Receiver was asked to step in as there was no other viable alternative available to the directors.

On the surface the liquidation strategy was perceived to be relatively simple:

- maintaining essential public services; and
- preserving value for creditors.

What did Carillion do?

It is virtually impossible to describe adequately the size, scale and reach of Carillion's 24/7 operation and the challenges involved in delivering the liquidation strategy. At the date of appointment Carillion's trading activities encompassed facilities management, construction, legal services, technical design, fleet management and recruitment, and placement services. It was immersed in all aspects of the fabric of UK plc.

Carillion provided critical services to ten acute NHS hospitals. If we had not been able to continue, operations would have been cancelled and patient care at a time of a flu epidemic would have been challenging. It also provided maintenance and track upgrade support to Network Rail, without which rail services would have been disrupted. Disruption would also have occurred to motorway gritting and maintenance on some of the UK's most important networks, including the M40 and M6.

Through various joint ventures Carillion also provided essential maintenance services to the homes of 50,000 military personnel and their families. It was also responsible for the day-to-day facilities management at all the prisons in the South of England. At the date of liquidation, it was involved in 52 active construction projects in the UK and, through its subsidiaries and joint ventures, many more in the Middle East and Canada.

With great support from the Carillion team (whose support and commitment throughout the process has been incredible), PwC deployed over 200 people that Monday morning alongside a team from the Insolvency Service, Cabinet Office, UK Government Investments and numerous other government departments. The teams set about the Herculean task of

> PwC deployed over 200 people that Monday morning alongside a team from the Insolvency Service, Cabinet Office, UK Government Investments and numerous other government departments.

ensuring that the key facilities management contracts were able to continue. This task involved establishing new supplier arrangements with over 3,000 suppliers, determining the terms on which services would be provided to Carillion's customers and asking employees to continue to work with the liquidator to turn up to work and deliver services on the contracts. This was against the backdrop of limited contingency planning, given the

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sudden nature of the group's failure. Since the date of liquidation we have processed in excess of 120,000 individual payments to suppliers and others.

Brokering information

In addition to ensuring that these essential services were maintained we also had to deal with all the requests for information from the various stakeholders affected by the liquidation so they could understand the consequences of the liquidation on them and what was being asked of them by the liquidators and special managers. The interest in the liquidation was immense, with Carillion touching so many parts of the UK plc and attracting significant parliamentary interest, which in part was driven by the financial support being provided to the Official Receiver by the government. The challenge of communicating with all these parties was significant and could have easily derailed the strategy if we had not been able to put effective systems in place. To cope with the demand and ensure we delivered a clear and consistent message to all parties, we established a dedicated helpline that took over 10,000 calls and created a standalone website that received in excess of 200,000 hits over the course of the liquidation.

> Since the date of liquidation we have processed in excess of 120,000 individual payments to suppliers and others.

The first seven months of the liquidation were frenetic, as we sought to trade contracts, sell businesses and help transition those contracts to new providers while trying to maintain the morale and commitment of the retained Carillion team who knew that, ultimately, they would be facing redundancy. Over the course of that period in excess of 25 business sales were negotiated and 255 contracts were transitioned. Each sale and transfer required complex documentation to support the commercial agreements reached.

During this initial phase of the liquidation all the construction projects ceased and Carillion's interest in the majority of those contracts was disclaimed. Regular support was provided to suppliers to the construction arm of Carillion and a government task force was established in the main to understand and provide a forum to understand the impact of the liquidation on suppliers and in particular those in the construction supply chain.

Once we had sold or transitioned the [facilities management] contracts we focused our efforts on the provision of transitional services to a number of customers to provide them with sufficient time to develop their own capabilities progressively to manage the contracts and wean themselves off Carillion's support.

Operations home and away

The overseas operations have presented their own unique challenges. Much of the work Carillion undertook prior to liquidation was undertaken through local legal entities with local partners. These businesses were dependent on Carillion for funding, and a consequence of the liquidation was that this funding was no longer available. The Official Receiver had no jurisdiction over those foreign entities and we have been supporting the local directors and management teams to place those companies into local insolvency processes. While the Middle East is developing its insolvency legislation at a rapid pace, the existing processes do not lend themselves to a speedy implementation.

Immediately after liquidation the Canadian businesses were placed into the local CCAA (Companies' Creditors Arrangement Act) process with the court-appointed monitor working with management to try to realise value from the sale of the businesses and contracts through Canada. The services business was sold relatively quickly and at regular stages subsequently the Canadian Court has assisted and sanctioned these disposals.

> Carillion was the biggest PFI participant in projects and a significant amount of work and time has been spent unwinding a number of these structures and realising value from the investments.

Carillion was the biggest PFI participant in projects and a significant amount of work and time has been spent unwinding a number of these structures and realising value from the investments. PFI projects are complex ecosystems of shareholders, which makes unpicking them as a consequence of insolvency both complex and challenging. Carillion's PFI projects were not just in the UK and there were numerous projects in Canada that the team had to deal with.

> While the bulk of the work has been done and over 15,000 jobs have been saved, there is still a lot of work to do before this chapter in UK insolvency history can be closed.

Present day

Today the liquidation continues, and we are at a stage of trying to resolve some of the residual trading and pre-appointment debt obligations. A downside of the construction industry is that projects often go wrong and litigation ensues. We are still progressing some of that litigation. The complexity has also meant the need to draw on support from numerous different law firms including Freshfields, Slaughter & May, DLA Piper and Dentons.

While the bulk of the work has been done and over 15,000 jobs have been saved, there is still a lot of work to do before this chapter in UK insolvency history can be closed.

Carillion has been a unique case in the course of UK corporate history and the success of the liquidation strategy has been a testament to the spirit of collaboration and teamwork from the Carillion workforce, the Insolvency Service, PwC and a number of other professional advisers who have supported us since 15 January 2018. ◻

DAVE CHAPMAN (LEFT) is Senior Official Receiver at the Insolvency Service and is liquidator of Carillion Plc and connected companies.

DAVID KELLY (RIGHT) is a partner at PwC.

The rules of subcontractors: trust no one, assume nothing and check everything

Blane Perrotton lists the warning signs for a contractor in distress and offers insights on retaining value.

Amid the sound and fury of the Brexit process it can be easy to overlook businesses' primal fear of sudden, jarring change and uncertainty. And few sectors suffer more in uncertain times than construction.

Ours is an industry built on a complex web of suppliers in which developers, contractors and subcontractors all work together on a playing field built on confidence and underpinned by trust in one another.

> "Developers, contractors and subcontractors all work together on a playing field built on confidence and underpinned by trust in one another."

Yet the current threat is highlighted when developers – who pride themselves on having built their businesses through astute insight into the market – are overtaken by events once construction work actually gets underway.

Grim picture

If a contractor or subcontractor goes bust halfway through a project, the developer will face significant consequences, both in terms of cost and delays.

Of course, it's all optimism and certainty during the tender process, as bidding contractors spar for contracts and everyone psyches themselves up for the upcoming endeavour. Sadly, official statistics paint a much grimmer picture of the fragility of Britain's construction sector. The industry has the highest insolvency rate of any corporate sector. In the 12 months to the end of Q1 2019, more than 3,000 construction firms shut up shop for good, up 0.6% from the 12 months ending Q4 2018.

While last year's rise in the Bank of England base rate has yet to significantly increase the cost of borrowing for contractor firms, those with debts will be placed under growing pressure in coming months as lenders show less forbearance with SME borrowers who fall behind on their repayments.

Despite the eagerness to crack on with the job, any developer or lender worth their salt will carry out a thorough risk assessment of any contractors – and possibly subcontractors – that they have in mind.

From the very get-go, diligence should be the name of the game and should remain so far beyond the tender process. There is no room for complacency in such a volatile environment, and it would require just one link in the chain of lenders, developers, contractors and subcontractors to break for an entire project to be placed in jeopardy.

> "It's all optimism and certainty during the tender process... sadly, official statistics paint a much grimmer picture."

If the original subcontractor walks because the lead contractor goes bust, a new subcontractor would need to be drafted in; a task that is likely to be easier said than done because the new subcontractor would be unwilling to accept responsibility for work done by a previous supplier. If the new subcontractor was to put its name to the project, it could be accepting liability for any poor workmanship completed before it was even involved.

> "Diligence should be the name of the game and should remain so far beyond the tender process. There is no room for complacency in such a volatile environment."

As a result, contractors should be upfront about their sub-contracting arrangements right from the start. The disclosure must include how much they are planning on paying the subcontractors, what agreements have been made and, crucially, what warranties are in place.

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For funders especially, knowing the specifics of any contractor or subcontractor collateral warranty is of the utmost importance. If something were to go wrong with the project, clearly the funder would not want to have to pay out for the mistake. So, a watertight warranty should insulate from this risk and place the liability squarely at the feet of whoever was directly responsible.

Worst case scenario

Should the worst happen and a contractor does fail, clearly the first thing to check is how much has been paid to them so far, and if they have been overpaid. Developers should also conduct an audit to ensure all on-site plant, equipment and materials cannot be removed.

The initial contract should include a retention clause – a sum, typically 5% of the total cost, that the client need not pay to the contractor until the project's certification. But it's worth checking there's also an abatement in place. This is the common law right to reduce the price or value of work if the work delivered is defective or incomplete.

> “If a contractor begins to flounder, the best way for a developer to limit their risk is a simple ‘ABC’ – assume nothing, believe nobody and check everything.”

It's also essential to check all insurance obligations have been met, as well as who has rights over designs. Developers should obtain copies of any design files or documents, including those from subcontractors and consultants.

As cynical as it may sound, if a contractor begins to flounder, the best way for a developer to limit their risk is a simple 'ABC' – assume nothing, believe nobody and check everything. □

BLANE PERROTTON is managing director at the property consultancy and surveyors Naismiths.

The ten red flags that a contractor/subcontractor is in financial trouble

Have the main contractor's direct employees not turned up for work or is there a decrease in labour on site? This could suggest the contractor has burnt through its initial tranche of payments and is thus cutting manpower to reduce costs. Such a problem could be exacerbated by the project hitting initial speed bumps, which then force the contractor to spend more, and more quickly than expected. If the contractor has insufficient cash reserves to even out these unexpected costs, it may have to cut corners throughout the project to claw back these early costs.

Is building work slowing down substantially or have plant, equipment and materials 'disappeared' from site? Again, this could be indicative of cash flow problems and a poorly managed project. Construction equipment can be expensive to hire, and by cutting these costs, construction firms can seek to shore up fragile finances by working more slowly and without the use of machinery.

Have subcontractors such as electricians, carpenters and plasterers not been paid? Employees not being paid raises a number of red flags from the outset. Experienced construction firms can also come across this problem, and once a party has hit problems, this can cause a domino effect through subcontractors, construction partners and all other parties.

Is completed work increasingly defective or of a substandard quality? Alarm bells should definitely be ringing out in this scenario. In all likelihood, this means corners are being cut to get the project over the line as quickly as possible or as cheaply as possible.

Has the contractor attempted to negotiate further payments, release retentions or seek changes in payment patterns? Any out-of-the-blue requests or demands like this could mean something has gone awry – or is about to – with the cash flow and should be investigated immediately.

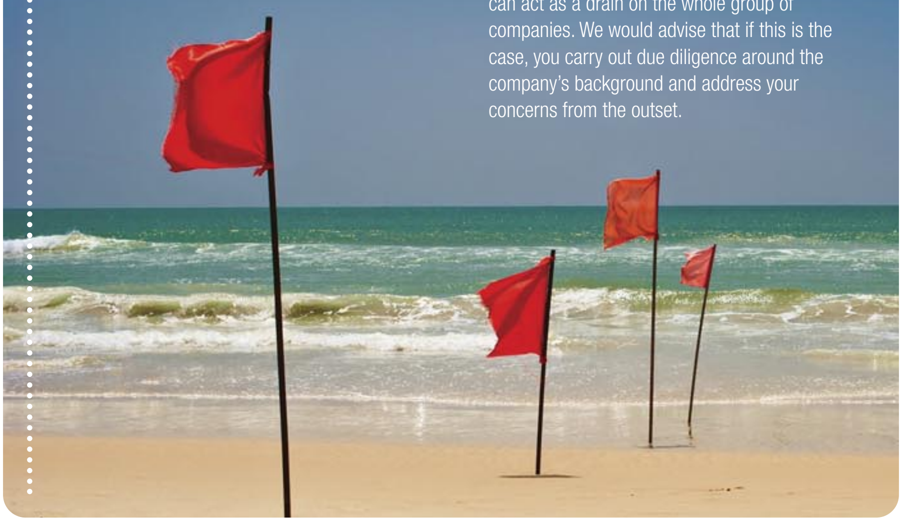
Did they make spurious or unjustified claims to hike up the contract cost? Should the subcontractor approach the lead contractor to dispute the cost of something, the lead contractor could well try to pass on the additional cost to the developer. Such an outcome can be prevented with proper oversight of relevant, watertight contracts between parties.

Have they assigned, or attempted to assign, the proceeds of the building contract to a bank or other creditor? This would be a massive red flag if spotted during a construction project. For a construction firm to assign or attempt to sign the proceeds of the building contract to a bank or another creditor would hint strongly that the company is coming up against some financial difficulties.

Are they late filing accounts or annual returns at Companies House? Again, this could be indicative of cash flow problems and should be investigated immediately on discovery. We advise that construction firms should carry out due diligence around their subcontractors, and one of the basic things to do would be to check Companies House for any alarm bells. Professional construction firms that are in a good financial state will have nothing to hide, so it's important that you partner with lead contractors who operate with a high level of transparency.

Does the contractor have unsatisfied court judgments or is there anecdotal evidence about their financial position? The construction industry is one in which reputations matter and gossip is rife. If you happen to hear anything spurious-sounding on the grapevine about a particular contractor or subcontractor that you have in mind, it would certainly be worth investigating.

Has the contractor's parent company, or other companies in the same group, displayed the warning signs listed above? If any of these alarm bells begin ringing, the financial strains of a struggling parent company can act as a drain on the whole group of companies. We would advise that if this is the case, you carry out due diligence around the company's background and address your concerns from the outset.



Advisers and subcontractors – a risk waiting in the wings?

Gareth Limb examines some of the considerations for IPs that 'outsource' work or seek advice.

IPs cannot survive in practice without calling upon the services or the expertise of their professional advisers. There is also an increasing use of subcontractors to undertake routine administrative functions on cases to free up staff to undertake more complex work. Counter-intuitively there are ethical issues and threats associated with using both professional advisers and subcontractors – some of these will be explored in this article.

> "The Code of Ethics requires an IP to evaluate whether reliance on advice is warranted, which means considering whether it is appropriate to instruct professional advisers in the first place."

Adviser or subcontractor?

The first thing to consider is the difference between a professional adviser and a subcontractor. The only insolvency-specific reference I can find is in SIP 9, which refers to an instance where an IP '… subcontracts out work that could otherwise be carried out by the office-holder or his or her staff …'. Since SIP 9 requires the IP to explain why they are subcontracting the work and SIP 7 requires separate disclosure of amounts paid to subcontractors, the distinction is important.

I think that a firm employed to undertake routine administrative work on an IP's behalf, such as closing cases or undertaking a cashiering function, would certainly be a subcontractor. In contrast, a lawyer instructed to take legal action on behalf of an IP would be a professional adviser. The position of Employment Protection Act or pension specialists is less certain. Their categorisation may well depend on whether they are undertaking routine administrative work such as processing claims for the IP or providing the IP with advice on the technical treatment of a claim or a pension. Perhaps the safest approach is to always treat them as subcontractors rather than professional advisers.

While it may be tempting for an IP to turn straight to professional advisers every time they have a problem, it is not that simple. The Code of Ethics (code) requires an IP to evaluate whether reliance on such advice is warranted, which means considering whether it is appropriate to instruct professional advisers in the first place. Underpinning it all is whether using a professional adviser represents value for money and is in the interests of creditors.

The code sets out the factors that an IP needs to consider when relying on professional advice, which are: 'reputation, expertise, resources available and applicable professional and ethical standards'. Those same factors should also apply when considering whether to instruct them in the first place. Remember that an IP is responsible for the actions of the professional advisers they instruct, and for their fitness and propriety, so such considerations are an important form of protection.

> "Remember that an IP is responsible for the actions of the professional advisers they instruct, and for their fitness and propriety, so such considerations are an important form of protection."

Not just who, why?

In a busy practice it is difficult to stop and prepare a file note to justify why, for example, it is necessary to take legal advice on a particular issue. Why is that firm of solicitors being used for the advice? And why is it appropriate to rely on their advice? Instead, the firm will just be instructed. The problem with that is the need to comply not only with the code, but also with Regulation 13 of the Insolvency Practitioners Regulations 2005 and SIP 1.

> There will be certain circumstances where the relationship between the IP and the professional adviser is so close that it would be safest for the IP to seek positive approval for the professional adviser's fees.

Regulation 13 requires the IP to record the reasons for material decisions made on a case, while SIP 1 extends that to decision making and justifying actions generally. A contemporaneous file note is ideal, but an alternative is to follow up initial discussions with the professional adviser by email or written letter. Set out what it is they are being asked to do before using that letter as a record of the decision-making process. Set out why professional advice is required and why that particular professional adviser is being instructed, ie commenting on the factors set out in the code.

Variety is ethical

An IP has to be objective in deciding whether it is appropriate to instruct a professional adviser and in ensuring that the decision represents the best value and service for creditors in the case they are dealing with. Where a professional adviser is used regularly, there are additional threats under the code, particularly in respect of familiarity and self-interest. IPs will always develop relationships with professional advisers, but it is dangerous, from an ethical perspective, to use just one in any given field – say just one firm of solicitors, or one valuation agent. Care must be taken to ensure that the relationship between the IP and their professional adviser remains a proper business relationship, and that is more likely if an IP has a number of different professional advisers to call upon as necessary.

Something else to consider is the impact of paragraphs 26 and 27 of SIP 9:

'26. Where services are provided from within the practice or by a party with whom the practice, or an individual within the practice, has a business or personal relationship, an office-holder should take particular care to ensure that the best value and service is being provided.

27. Payments that could reasonably be perceived as presenting a threat to the office-holder's objectivity by virtue of a professional or personal relationship should not be made unless disclosed and approved in the same manner as an office-holder's remuneration or category 2 disbursements.'

The meaning of these paragraphs is not clear cut, but on their strictest interpretation it could mean that, since an IP will always have a business relationship with their professional advisers, the IP should always seek positive approval for their fees. To my mind such an interpretation is not appropriate, as it would mean that SIP 9 modified the legislation, which only requires disclosure of the anticipated level of the costs of professional advisers on a case when an IP seeks fee approval. I do, however, consider that there will be certain circumstances where the relationship between the IP and the professional adviser is so close that it would be safest for the IP to seek positive approval for the professional adviser's fees. Such a relationship is unlikely to be a purely business one, but more likely personal – using a relative who happens to be a qualified solicitor, for instance. Care also needs to be taken where the relationship moves from being purely a business one and the professional adviser becomes a personal friend. That is certainly where IPs have come unstuck in the past.

As a form of protection, IPs should review their relationships with the professional advisers they use and do so at least annually. That should involve obtaining evidence of continuing professional indemnity insurance cover and getting fitness and propriety declarations completed.

The special nature of insolvency means that it is the IP personally who is the office-holder and is hence responsible for the conduct of the appointment. While an IP can seek advice about a case, it must be the IP themselves that makes the final decision on the matter. Decision making is not something that can be delegated to a professional adviser. It is not enough for an IP to just make a decision though, they have to justify and record the reasons for that decision to comply with Regulation 13 and SIP 1.

Under the regulatory spotlight

Case progression is a current hot topic for the regulators, and they are looking for all cases to be progressed without delay. Where professional advisers have been instructed, it means ensuring and evidencing that they are undertaking their work without delay and obtaining regular updates from them. One thing to consider when instructing a professional adviser is to set out the frequency with which they should be providing reports and updates.

Exactly the same issues and principles apply to the decision to use subcontractors, but with the added caveat that there are far fewer providers in the market, particularly in areas such as employee and pensions services. The shortage makes it more difficult for an IP to have more than one provider they can use. In turn, that makes it more important to ensure that the relationship with the subcontractor remains purely business and that the relationship is reviewed on a regular basis.

It would be perfectly possible for an IP to accept an appointment, but then instruct subcontractors to undertake all of the routine administrative work on the case, from the initial notice of appointment through to closing the case. Such an extreme approach would certainly attract regulatory attention though. In particular, the regulators would be concerned about any disputes arising with the subcontractor, any decision to cease the provision of services to the IP and the impact that would have on the ability of the IP to administer and progress the case.

> While professional advisers and subcontractors have an important role to play in assisting an IP, it is important to ensure that the decision making regarding their use is clearly evidenced.

While professional advisers and subcontractors have an important role to play in assisting an IP, it is important to ensure that: the decision making regarding their use is clearly evidenced; they are not responsible for making decisions on the case; they are not just left to their own devices to do the work; and the IP ensures that matters are progressed. ◻

GARETH LIMB is a director of Compliance on Call and an R3 council member.

Construction contracts: a complex latticework

Pippa Hill, **Sue Ryan** and **Lindsay Hammond** attempt to demystify construction contracts for those appointed in the sector.

It is not news to *RECOVERY* readers that the construction sector is volatile and under pressure. The number of construction insolvencies remains high in 2019, with companies falling victim to fluctuating workloads driven by external factors (for example, 2018's 'Beast from the East' storm), late payments from employers, HMRC and Construction Industry Scheme arrears coming home to roost, and project specific issues and disputes – to name just some of the problems faced.

Many of *RECOVERY*'s readers will be called upon to take on appointments as administrator or liquidator within the sector. With that in mind, in this article we want to set about demystifying some of the key legal issues specific to construction contracts.

Many, many layers

The layers and structures of contractors and subcontractors involved in a construction project can be as complex as the structure that's being built.

If appointed in the construction sector, your first task will be to identify where the company you're dealing with sits within the structure of any project(s) it is working on. Is it the employer that commissioned the works (and in contract with the main contractor)? Or the main contractor, project managing, possibly carrying out the works itself and subcontracting out other elements (in contract with both the employer and the subcontractor levels)? Is it a subcontractor, brought in by the main contractor for a specific element of the works (in contract with the main contractor employing it, and any sub-subcontractors it may need to use)? Or even the sub-subcontractor, employed by the subcontractor to provide specific services?

Once you've established where in the structure the company sits, next on the agenda will be establishing the contractual terms on which it is operating.

Standard form building contracts

The vast majority of construction projects are contracted on standard form contracts. The most common of those for construction projects ongoing at present are the JCT design and build contract 2016 (JCT DB 16) and the NEC3 engineering and construction contract (NEC3). The NEC4 suite of contracts was published in June 2017, but it will take some time for this to become the predominant form of contract in use.

The first thing to look at will be the immediate effect of insolvency on the contract.

> "The layers and structures of contractors and subcontractors involved in a construction project can be as complex as the structure that's being built."

Effect of insolvency

As with any contractual relationship, insolvency in and of itself does not automatically cause the contract to terminate – it will depend on the contractual provisions. While standard form construction contracts generally do not automatically terminate on contractor insolvency, they often provide the employer with a right to terminate.

There are two questions you need to ask: (1) how is insolvency defined in the contract, ie does your appointment actually constitute an insolvency event?; and, assuming it does (2) what effect does that insolvency event have on the contract?

Looking at the JCT DB 16, the net is cast wide as to what constitutes insolvency of a contractor and includes:

- *for companies*: entry into administration; appointment of an administrative receiver or a receiver or manager; passing of a resolution for voluntary winding-up; making of a winding-up order; entry into an arrangement, compromise or composition in satisfaction of debts (which would include a CVA, but expressly excludes a solvent scheme of arrangement for reorganisation purposes);
- *for individuals*: making of a bankruptcy order partnership; sequestration of the estate or grant of a trust deed for creditors; entry into an arrangement, compromise or composition in satisfaction of debts (including an IVA);
- *for partnerships*: making of a winding-up order; sequestration of the estate or grant of a trust deed for creditors; each partner being subject to any of the individual insolvency events listed above.

Where a contractor insolvency occurs, the contractor's works obligations are suspended from the date of the insolvency and the employer can terminate the contractor's employment at any time. Whether or not termination occurs, payment stops until after completion of the works and making good defects. If the employer terminates, it may take possession of the site and employ others to carry out and complete the works. The contractor cannot hinder or delay the taking of these measures. The employer

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will have to pay the contractor the balance due, if any, upon completion of the works by others.

What constitutes insolvency under NEC3 is very similar and includes:

- *for companies or partnerships*: making of a winding-up order; appointment of a provisional liquidator; passing of a winding-up resolution (other than for reasons of reorganisation or amalgamation); making of an administration order; appointment of a receiver, manager or administrative receiver over all or a substantial part of its assets; making of an arrangement with creditors;
- *for individuals*: presentation of a debtor bankruptcy petition; making of a bankruptcy order; appointment of a receiver over their assets; making of an arrangement with creditors.

The employer may terminate for any reason under the NEC3. Where a termination occurs on the basis of a contractor insolvency, the employer may terminate and pay a third party to complete the works. It can also instruct the contractor to leave the site, assign the benefit of subcontracts and use any equipment to which it has title that remains on-site.

Employer step-in rights

Where a company has provided collateral warranties, these may include step-in rights for the employer (or, in the case of a subcontractor, step-in rights for the contractor – its employer). These may allow the employer to 'step in' to the shoes of the contractor for the remainder of the contract.

You should check whether any step-in rights are applicable and liaise with the employer to establish whether the employer intends to use them.

Materials and intellectual property

While terms of a contract may not always be conclusive as to ownership of materials or equipment on-site, steps should be taken to ensure that materials are not unlawfully removed by unpaid contractors or other creditors – eg securing the site.

Most contracts provide that payment for unfixed materials on the site will pass ownership to the employer. However, be aware that:

- title to materials from supply chain members cannot pass to the employer if the title has not passed up the chain. You should check that subcontracts are 'back to back' with the main contract and whether the subcontracts contain any retention of title clauses;
- assets (particularly equipment) on-site may be leased, rather than owned by the insolvent company and so may be recovered by the lessor on the terms of the lease.

The position may be less clear when it comes to unfixed materials off-site. Simply providing that ownership of off-site materials passes to the employer on payment will be of limited practical protection if the materials are in a supplier's or subcontractor's warehouse. A better position is found in contracts which provide that:

- the contractor must provide reasonable proof that ownership of off-site materials is vested in the contractor;
- it must be identified clearly where the materials are to be manufactured or kept that they are held to the order of the employer and that their destination is the project site.

> "Where a company has provided collateral warranties, these may include step-in rights for the employer."

Undertake an audit of on-site plant, equipment and materials and ensure that these are secured to the fullest extent possible.

You should check who has rights over design and copyright relating to the project and, if required, obtain copies of any drawings or documents that are not already in your possession.

Insurance

Any construction contracts pursuant to which the company is employed are likely to require insurance to be in place. You should check at the outset what insurances are required, and that premiums are paid up to date etc if ongoing insurance is required.

Dispute resolution

It is conceivable that the company over which you are appointed is in dispute with its employer or subcontractor about amounts payable under the relevant contract. Determining any such dispute could be crucial to establishing whether a party has a debt to prove for in the insolvency and the quantum of such debt.

Where a contract qualifies as a 'construction contract' under the Housing Grants, Construction and Regeneration Act 1996, the parties have a statutory right at any time to refer a dispute to adjudication. Adjudication is a swift dispute resolution process, under which an appointed third party takes representations from both sides and makes a determination, which is binding until overturned by the court or in arbitration. It is of course far less costly and time consuming than arbitration or the courts.

Recent case law, in particular the Court of Appeal decision in *Bresco Electrical Services Ltd (in liquidation)* v. *Michael J Lonsdale (Electrical) Ltd* [2019] EWCA Civ 27, has determined that the adjudication process has very limited application once a company has entered a formal insolvency process (in that case liquidation).

It will generally be for insolvency practitioners to determine proofs of debt in the normal manner. If a contractual counterparty commences an adjudication process, there will in most cases be grounds for an injunction to be obtained to prevent the adjudication continuing.

As can be seen from the above, notwithstanding that construction contracts are generally standardised, the contractual matrix surrounding a company in the sector remains complex. With distress in the sector showing no signs of abating, practitioners are well advised to familiarise themselves with the issues it presents. ◻

Contractual questions

- Work out where the company sits within the structure. Is it the employer, main contractor, subcontractor, sub-subcontractor etc?
- Locate the construction contracts! Have you seen copies of the main contract that your client is party to, plus any subcontracts?
- Does your appointment constitute an insolvency event under the contract? If so, what rights does this give to the contractual counterparties (termination, employer step in etc)?
- Are there any other possible termination events?
- Consider the location and ownership of materials and ask: do these need to be secured?
- Establish whether any materials are subject to retention of title and find out if any equipment is leased (if so, locate a copy of the lease).
- Are all insurances required by the contract under which your client is employed in place?

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Reduce costs and optimise with your CMS

John Smith writes that stopping to think can sometimes be the best course of action.

Achieving efficiency does not happen overnight. It takes time to put the foundations in place to allow a practice to increase productivity and business performance levels. Steve Jobs once said: 'Simple can be harder than complex: you have to work hard to get your thinking clean to make it simple. But it's worth it in the end because once you get there, you can move mountains.' Spotting inefficient processes is not always easy. It requires us to take a step back from our day-to-day activities and try to view them from an outsider's perspective.

Clearing workloads

We can find ourselves becoming snowed under with work and our sole focus is clearing off what we currently have on our plate. Our first instinct may be to just dive in head first and hope that we can get through it as soon as possible. This approach will get you through one pile of work just in time for the next pile to land in front of you, a cycle which can become difficult to break and can impact on potential growth.

> Spotting inefficient processes is not always easy. It requires us to take a step back from our day-to-day activities and try to view them from an outsider's perspective.

Something that I've been guilty of is thinking that I'm too busy to take that step back. Thinking logically, that makes no sense at all. The reason for taking a step back is to consider ideas that would decrease time spent on administrative tasks and increase levels of productivity. How could I be too busy to at least think about that? This can apply to all areas of a business but as someone who has worked in the insolvency industry for over 20 years, I'm going to explore this with the example of an insolvency case management system.

Out of the box, a case management system (CMS) is a tool that can help a practice achieve efficiency. However, remember that no two practices, large or small, will process cases in the exact same way. A regular first mistake is taking a CMS in its 'out-of-the-box' state and determining that it is not the right fit. The second mistake is not taking the time to review and understand how to amend the CMS to meet with the practice's processes.

> I believe that CMS providers must always look to ensure that their clients are getting the most from their system.

Not just an IT provider

We sometimes hear that a practice 'is not getting the most out of the system'. Often, this can be attributed to the CMS' provider being viewed simply as an IT software provider and not a trusted partner. I believe that CMS providers must always look to ensure that their clients are getting the most from their system. To do so, an open channel of communication between client and provider must be sustained. This ensures that resolutions to pain points can be found, whether that is through existing functionality or new enhancements.

These pain points can be as straightforward as diary lines not appearing in line with a practice's requirements, documents not being formatted to the company's standards and core brand values or reports not meeting with the firm's KPIs. Speaking from the viewpoint of a provider with many years' experience in supplying solutions to the insolvency industry, we enjoy nothing more than working with a customer to try to heal these areas of pain. What we cannot do, however, is fix something that we do not know about. Having a customer who has made the time to take a step back to think about their process and problem, and who then provides us with their initial thoughts and requirements, is invaluable. From there, we can plan and develop a solution together.

It's worth it... we promise!

A new customer has two options when engaging with an 'off-the-shelf' solution. The first is to hope that the standard solution will fulfil your requirements. The second is to take the standard and look for ways to tailor it so that it works for your specific needs with respect to your diaries, your documents and your KPI reports.

I'm not declaring that settling for an out-of-the-box solution will decrease productivity, but it is comparable to buying a Ferrari and driving it like a Fiesta – you're just not getting your money's worth! The tragedy of this approach is that a level of efficiency that is within a practice's reach is never attained.

> As Jobs said, 'You have to work hard to get your thinking clean to make it simple'.

Fortunately, it's never too late to take that step back and begin to lay the foundations.

As Jobs said, 'You have to work hard to get your thinking clean to make it simple'. Investing time and resources to tailor your CMS to your needs will result in your practice achieving efficiency and avoiding disruption – allowing you to go forth and move mountains. □

JOHN SMITH is technical director at Vision Blue Solutions.

John worked in practice for 12 years prior to joining Vision Blue Solutions in 2009. As technical director, John is involved in ensuring efficiency is achieved throughout standard functionalities as well as customer-specific adaptations to documents and diaries.

Search, seize and sell; the first bitcoin auction

Rebecca Wilson and **Aidan Larkin** explain how the first bitcoin realisation required a lot more than a smartphone and an unsecured crypto exchange.

Bitcoin remains a nebulous term for an asset that many IPs are still trying to get to grips with and companies, while willing to adopt blockchain technology, have remained cautious about adopting cryptocurrency as a method of doing business. Instead cryptocurrency has often made itself at home in the shadows – a resource that those who operate outside the law are all too willing to abuse. That is until they get caught and someone needs to realise the assets.

Our company, Wilsons Auctions, held its first bitcoin auction in February 2019 – a world-first for a private auction company, having won a significant contract with the Belgium federal government. The contract required us to store and sell cryptocurrency on behalf of a law enforcement agency or government body but, before that could take place, a lot of work was required.

Storage and identification

We first established, through communication with IPs, receivers and law enforcement agencies, that a storage facility was likely to prove the most challenging aspect of any bitcoin transaction. Over one year we have researched and developed a fully insured storage and sale facility for crypto assets.

The initial research uncovered that clients across the world were storing private keys, which controlled cryptocurrency assets worth millions of pounds, inadequately and without insurance.

If an attempt was made to realise this asset in an insolvency scenario, the use of virtual currency exchanges (VCEs) would open up exposure to risks associated with not obtaining the best returns for creditors and failing to undertake adequate anti-money laundering or know your customer checks – this was in addition to the exchanges being an uninsured and unregulated process.

Law enforcement agencies were aware of the risks around using virtual currency exchanges but even two years ago there were no viable alternatives available to 'cash in' seized cryptocurrency assets. The various scandals that have rocked VCEs – ranging from data breaches, hacking and internal corruption surrounding billions of dollars of clients' funds, to lost or stolen assets and the prosecution of senior

executives of VCEs – have been well documented in the specialist technology press and mainstream newspapers.

We invested heavily in our IT systems beyond the Ministry of Defence's 'cyber essentials' scheme (the government-recommended cyber security standard), and further tested the systems already in place.

> We first established, through communication with IPs, receivers and law enforcement agencies, that a storage facility was likely to prove the most challenging aspect of any bitcoin transaction.

Building the system

The IT infrastructure had already evolved to allow for the sale of varied assets as well as other online solutions, but improvements were needed to allow the company to accommodate the sale of another specialist asset.

Infrastructure and web application penetration testing was carried out to mitigate or remove any vulnerabilities, and a web application firewall was introduced to protect our website applications. Further investment was made in new WatchGuard internal firewalls with an advanced threat protection suite and Backupify to look after the Office 365 backups.

The company worked in partnership with Nick Furneaux to develop a method to manage seized crypto assets and put them to auction. Nick is the author of *Investigating Cryptocurrency* and one of the most renowned global experts on the topic. He also frequently assists law enforcement agencies on matters relating to cryptocurrency. The system we now have access to allows crypto assets that are recovered or seized to be disposed of via public auction.

Bitcoin auctioneers

The first auction resulted in a realisation of approximately 315 units of seized bitcoin, which achieved over the market value – attracting over 6,400 bids and interest from 100 countries.

The crypto offering now forms part of a suite of tools for managing the asset realisation process for all categories of assets. This technology allows us to take responsibility for managing crypto assets immediately at the point of seizure – previously this was a process that would require creating digital wallets, employing costly experts, storing assets uninsured and then realising the assets in a non-secure manner, potentially at an undervalue.

We now have confirmed planned sales of £1.5m of bitcoin with a further £1.5m awaiting release by UK and European police forces. These figures are a fraction of the seized bitcoin held by police forces and an indication of how this market is set to grow rapidly towards the end of 2019.

REBECCA WILSON is head of corporate services at Wilsons Auctions.

AIDAN LARKIN is head of asset recovery at Wilsons Auctions.

No bad apples in *Devon Commercial*

Simon Davenport QC, **Daniel Lewis** and **Martin Chesher** explain *Devon Commercial Property Ltd* v. *Barnett & Anor* [2019] EWHC 700 (Ch), with clarification on receivers' duties, conflict of interest and fair dealing.

The defendants were LPA receivers appointed over a factory belonging to the claimant company. The claimant alleged that the receivers were guilty of various breaches of duty, including allegations of bad faith, conflict of interest and preferring the interests of the mortgagee by which they were appointed. In delivering judgment dismissing the claims on all bases, HHJ Paul Matthews gave detailed consideration to a number of issues of significance both to the duties owed by receivers and also to the prosecution and defence of claims against them.

The factual background

The claimant was a property holding company that owned the freehold of a substantial bottling factory in Devon. The claimant leased the factory to the operating company, Devon Cider Company (DCC), which ran a cider production, bottling and distribution business on the site. The claimant later mortgaged the factory. DCC went into administration and its business and assets were sold to Aston Manor (AM) – a competitor of DCC – together with a licence to use the factory. AM obtained an assignment of the mortgage that had been granted by the claimant. The claimant defaulted on the payment of interest due under the mortgage and AM then appointed the defendants as LPA receivers.

The receivers granted AM a new lease of three years, on the basis that they wished to ensure continued occupation and income from the factory. After an extended period of marketing, and notwithstanding expressions of interest from certain parties, AM was the only confirmed bidder for the property. On the sale to a subsidiary of AM, the purchase price was insufficient to result in a surplus for return to the claimant.

> "The judgment is perhaps most significant for its rejection of the claimant's attempt to extend arguments as to conflict of interest and reversal of the burden of proof to these facts."

The claimant alleged that, because of their breaches of duty, the receivers did not achieve a high enough price for the property. They alleged that the receivers were in breach of duty: (a) by placing themselves in a position where their duty and interest conflicted, and by acting under the direction or control of their appointor; (b) by granting the new lease to AM on terms that prevented a sale of the property with vacant possession or the power to obtain vacant possession at short notice; and (c) by failing to achieve a proper price for the property and in particular by failing to recognise AM as a special purchaser (as the current occupier of the factory with an interest in the continuation of its business from that site).

Conflict of interest

The judgment is perhaps most significant for its rejection of the claimant's attempt to extend arguments as to conflict of interest and reversal of the burden of proof to these facts. There was no authority addressing the situation faced by the receivers in this case.

The claimant argued that the receivers were in a position of conflict in selling to AM and that the burden of proof was therefore reversed, requiring them to demonstrate that best endeavours were taken to ensure that the price paid was the best price reasonably obtainable. The receivers, it was argued, were subject to the same duties applicable to mortgagees and that: (a) under the 'self-dealing' rule they were not permitted to sell to themselves; and (b) under a 'fair dealing' rule the onus was upon them to show that the sale was at full market value. The claimant submitted that these rules should be extended to the receivers in this case since a receiver exercising a power of sale under a mortgage owes the same equitable duties to the mortgagor as are owed by the mortgagee (relying upon *Silven Properties Ltd* v. *Royal Bank of Scotland Plc* [2004] 1 WLR 997).

The judge rejected the extension of *Silven* to the facts of the case. He ruled that the burden of proof can be reversed where the sale is to a party connected to the party conducting the sale (as where a mortgagee exercises its rights to sell). Here, however, the receivers were not selling to a party to which *they* (the receivers) were connected or to themselves. The sale was to a party connected to their appointor, from which they were to be treated as separate. There was therefore no 'self-dealing' such that the burden of proof should be reversed. Where bad faith is alleged in respect of the management functions undertaken by the receiver (except where the sale is to an associate) the burden firmly remains on the claimant.

> Put simply, the judge ruled that there was no self-dealing because the receivers did not deal with themselves.

On the question of conflict more generally, it was held that a receiver is not precluded from placing him or herself in a position where the mortgagee's and the mortgagor's interests conflict or may conflict. Those interests are present and may be in conflict from the outset of the receiver's appointment, and the receiver will be entitled (and is in fact required) to exercise the powers in the interests of the mortgagee.

Put simply, the judge ruled that there was no self-dealing because the receivers did not deal with themselves. Nor was there a conflict of interest to justify the imposition of a fair dealing rule that went as far as requiring the receiver to show that every act they undertook was in good faith.

Bad faith and dishonesty

The claimant alleged that the receivers had failed to act in good faith or had acted in bad faith. There was argument as to whether this required the court to make a finding of dishonesty. The receivers contended that it was not clear from the statement of case that this was intended, although the claimant subsequently confirmed that it was not the intention to allege dishonesty. The judge held that a

breach of the duty of good faith owed by a receiver to the mortgagor must involve intentional conduct amounting to more than mere negligence, and might encompass either an improper motive or an element of bad faith, but it need not amount to dishonesty.

The duties of receivers

The parties had permission to rely upon expert evidence as to the duties of receivers. The judge did not find this evidence helpful, observing that the experts in question did not have experience of acting in a case where the receivers had sold property to an associate of the appointor. The judge also doubted that acting as an LPA receiver was a recognised field of expertise governed by standards and rules of conduct. The function of an LPA receiver was a 'management function' of the sort many people are required to perform and one which the court is capable of assessing without expert evidence. The judge did not see that the court required (in the ordinary run of cases) expert assistance where somebody is alleged to have managed or sold an interest in land badly.

The use of email correspondence

In dismissing the claims, the judge found that the claim was '(over-optimistically) bolstered by the judicious hewing of extracts from emails and other correspondence, to create an impression of some kind of conspiracy between the trade rival and the defendants' when 'there was nothing of that kind here'. Where (as in this case) the receivers are working from different offices and communicating by email, the claimant has the advantage of being privy to their thinking in a way that would not be available if their discussions took place around a water cooler. The judge recognised this in discounting the evidential value of unguarded comments in emails. In fact, as the judge recognised, the evidential value of those comments was in tending to support the good faith of the parties to those communications, rather than the contrary, in that they tended to support an open and honest exchange of views.

The burden of proof on loss

The claimant also submitted that the burden of proof should be adjusted in recognition of the receiver's status as fiduciaries – not only on the question of liability (which was rejected), but also in proving loss. It was argued that, where the evidence of loss was absent or sparse, the court should presume against the defendant that the loss is to be 'the highest value'. This argument was also rejected. Only where the claimant has proved a breach of duty and the actions of the defendant have prevented the claimant from being able to adduce evidence to prove loss is the burden of proof to be reversed.

> The judge found that the claim was '(over-optimistically) bolstered by the judicious hewing of extracts from emails and other correspondence'.

The result

At trial the claimant had identified a number of facts and matters that it said demonstrated that the receivers had failed to act in good faith and for a proper purpose. To a large extent the disposal of the case depended upon the judge's findings as to the meaning and effect of the matters relied upon. Of more general significance is the refusal to extend the reversal of the burden of proof applicable to mortgagees to the receivers, and the refusal to extend the principles of self-dealing and fair dealing to a sale by the receivers to a party connected with the mortgagees but not the receivers. □

The authors represented the defendant in this case.

SIMON DAVENPORT QC (LEFT) is a barrister and joint head of chambers at 3 Hare Court.

DANIEL LEWIS (MIDDLE) is a barrister at 3 Hare Court.

MARTIN CHESHER (RIGHT) is a partner at Kennedys.

Sequana and the early warning for pension trustees

Alasdair Smith examines directors' duties in the wake of Sequana and the government's white paper.

The collapses of BHS, Tata Steel and Carillion, the select committees and the associated media clamour have put the spark to the powder keg of pensions. After all that, the government was always going to need to act, to douse the blaze and make a statement that pension schemes would be protected in the UK. A green paper was duly prepared with wide-ranging proposals; then a white paper on strengthening the role of the Pensions Regulator (TPR). Amber Rudd went on to stoke the flames with her message to those that behaved 'recklessly' with pension schemes: 'We're coming for you!'

> "The government was always going to need to act, to douse the blaze and make a statement that pension schemes would be protected in the UK."

In February 2019 the government published its long-awaited consultation response setting out its proposed changes. Shortly before the response was published, just along the Strand, the Court of Appeal was considering the case of *BTI 2014 LLC* v. *Sequana and others* [2019] EWCA Civ 112 (*Sequana*). The case examined when directors must have regard to creditors as opposed to shareholders in taking decisions that affect their company.

Under the proposals, directors will need to notify the TPR and pension trustees in certain circumstances where other creditors will not be informed. TPR is to be given new powers. How do these changes sit alongside a director's duties to other creditors as set out in *Sequana* and how else might creditors be affected?

Sequana: directors' duties clarified

In the case of *Sequana*, the court considered whether the directors should have had regard to creditors when paying dividends. The court decided that, even with a real risk of insolvency, this did not mean that the directors had to act in the interests of creditors in carrying out their duties. It went so far as to say that this would have a 'chilling effect' on business activity.

The 'creditors' interests duty' is triggered when the directors know or should know that the company is:

- actually cash flow or balance sheet insolvent – this has never been in doubt; or
- likely (as in probable) to become insolvent – that something less than actual insolvency would trigger the duty has long been assumed, but the 'what' has been unclear.

Previous cases had not been clear as to this second limb, focusing on vague statements such as the company being in a 'parlous financial state'. In *Sequana*, the court dismissed these as unhelpful – even if they were correct descriptions of a particular company's situation.

The court said that, once the duty is triggered, creditors' interests should become paramount (rather than simply being considered without being decisive). In most cases this will be a sliding scale as companies move closer to insolvency. Much to the disappointment of creditors who could be detrimentally affected by the payment of dividends, the court said that the duty had not arisen in the case of *Sequana* as the company was not insolvent or likely to become insolvent at the time of the payment of dividends.

> "If the directors get that decision wrong, or if trustees do not feel that the employer is giving sufficient attention to their concerns, trustees are already able to call upon TPR for support."

Pensions: the proposals

TPR has always been clear that it expects directors to share information regarding an employer's financial health with pension trustees. This may be through attendance at trustee meetings, informal information sharing or more detailed information-sharing protocols.

Indeed, there are fundamental differences between pension creditors and other creditors:

- first, any credit that has been 'extended' to an employer by reason of a deficit in a pension scheme has arisen not as a result of a decision by trustees, but instead as a result of external factors such as increased life expectancy or poorer than expected investment returns;
- secondly, in many cases trustees will not have negotiated consent requirements

to take certain corporate actions or early triggers for information, as are common in secured bank facilities.

Given these fundamental differences and recent corporate failures resulting in members losing out, the government has suggested changes to better protect pension trustees so that by law they are considered by directors earlier in the process, and certainly far in advance of the timing for acting in creditors' interests in *Sequana*. The government has sought to do this in two key ways: through the introduction of the requirement for a declaration of intent; and by introducing new notifiable events.

> Irrespective of uncertainties, the changes do seem to require earlier consideration of pension scheme creditors than is the case for other creditors following *Sequana*.

Declaration of intent

One of the proposals is a requirement for 'corporate transaction planners' to prepare a 'declaration of intent' on the sale of a controlling interest in an employer, sale of the business or assets of an employer and the granting of security in priority to the scheme.

The detailed content has yet to be finalised, but the government has suggested it will include an explanation of the transaction, confirmation that the trustee board has been consulted, whether the trustees agree with the proposals and how any detriment is to be mitigated. It will be addressed to the trustees and shared with TPR.

Currently, in such circumstances, directors will usually engage with the trustees of pension schemes and will agree mitigation as part of the transaction or the next valuation if necessary. However, there is flexibility for directors either not to do so in advance of the transaction or to conclude that the scheme will not be detrimentally affected and so engagement with the trustees is not required. If the directors get that decision wrong, or if trustees do not feel that the employer is giving sufficient attention to their concerns, trustees are already able to call upon TPR for support and TPR may use its moral hazard powers.

Although engagement with trustees is to be welcomed, there are two elements to the proposals that might give rise to issues for creditors, especially in light of the clarity in the *Sequana* case about when directors must flip to prioritising creditors' interests.

First, the government has said that the directors must seek to agree the declaration of interest with trustees. If they cannot do so, then this must be included in the declaration. While secured creditors may include certain information and consultation requirements in their agreements with borrowers, unsecured creditors (of which the pension trustee is one) will not generally have such rights. In requiring agreement to be sought, companies may be required to act in a fundamentally different way to pension scheme creditors than they do in relation to other unsecured creditors. Given the nature of pension deficits, this is not necessarily unwelcome, but other creditors will need to be aware of trustees' further enhanced rights when considering their own position.

Secondly, the requirements introduce additional administrative complexity at a time when speed may be essential. Where time is critical, requiring further discussions and preparation could be detrimental to all creditors, including pension trustees.

This is particularly likely to be so in the case of a 'pre-pack' sale – there may not be sufficient time to consult meaningfully with the trustees (although TPR has said that to avoid subsequent 'moral hazard' actions, it expects such consultation, especially where a purchaser is connected with the employer in administration). In such circumstances, it would seem better for all parties to rely on the insolvency office-holder's SIP 16 report, which sets out the background to, and details of, the sale for the benefit of all creditors, rather than to introduce a new requirement for engagement with trustees prior to the sale taking place. If there are delays, this risks the successful completion of the pre-pack itself without any upside.

More information for TPR

In addition to the declaration of intent, the government has suggested changes to the 'notifiable events' regime. As originally proposed, directors were required to notify TPR of, among other things, the employer taking independent pre-appointment insolvency/restructuring advice. This may have discouraged companies from doing so, and clearly would have placed TPR (acting to protect the interests of the trustees and Pension Protection Fund) in a better position than other unsecured creditors. These proposals have been dropped. There are, however, two new events which must be notified:

- the sale of a material proportion of the business or assets of an employer which has funding responsibility for at least 20% of the scheme's liabilities; and
- where the employer grants security on a debt to give it priority over a debt to the scheme.

Interestingly in its consultation paper the government considered whether payment of dividend (as was the case in *Sequana*) should be added as a notifiable event, but decided against this because of concerns over how this might affect business growth.

The government has recognised that there is significant lack of clarity in the proposals (for example, on what basis are the habits to be assessed?). But, irrespective of uncertainties, the changes do seem to require earlier consideration of pension scheme creditors than is the case for other creditors following *Sequana*.

In addition, it is not clear why the second event is required at all. The government does not explain why the existing requirement to act in the interests of creditors as a whole (as considered in *Sequana*) and the protections against 'preferences' in the Insolvency Act are not sufficient.

> Pension scheme creditors are often seen as in some way 'different' from other unsecured creditors.

Away from *Sequana*

The *Sequana* case provided guidance on when directors must turn from shareholders to creditors. But, pension scheme creditors are often seen as in some way 'different' from other unsecured creditors. The government has sought to deal with this by formalising further the time at which information needs to be provided to trustees, putting them on a different footing from other unsecured creditors.

The early notification proposals and the requirement for directors to actively set out their intention on certain corporate activity to the pension scheme trustees may be seen as giving TPR and trustees the opportunity to enter into a dialogue with the employer before other creditors have been made aware of the existence of a potential issue and even influence the next steps of the process. In finalising its proposals, care must be taken by the government to balance the interests of TPR and pension scheme trustees with the legitimate interests and expectations of other stakeholders, especially in light of the guidance provided by *Sequana* on when creditors' interests trump those of shareholders.

ALASDAIR SMITH is a senior associate at Linklaters LLP.

Insolvency litigation is risky and expensive:

but what is the cost of the alternative?

Mark Beaumont writes that sometimes costly litigation is better than no litigation at all.

Litigation is risky and expensive, and for that reason is often best avoided. However, for an insolvency practitioner, making the decision *not* to litigate could prove to be even more risky and expensive: it is therefore vital to assess risks in an appropriate fashion, and not just rule out litigation on an *ad hoc* basis.

If there was ever any doubt, a couple of recent cases should act as a warning to IPs that don't feel they need to explore the value of litigation assets in full:

- *LF2 Ltd* v. *Supperstone & Anor (Administrators of Pennyfeathers Ltd)* [2018] EWHC 1776 (Ch) - the judge noted that 'a viable claim by the company against a third party is an asset of the company. A claim that is arguably viable is a potential asset of the company. In principle, an administrator ought to be ready to investigate whether such an asset should be preserved and pursued… If the administrator has no funds to investigate a possible claim against a third party and he receives an offer from a potential assignee of the claim to pay for an assignment, that offer will potentially constitute an asset of the company.'
- *Brewer & Anor* v. *Iqbal* [2019] EWHC 182 (Ch) – where the liquidators of ARY Digital UK Ltd successfully brought breach of duty claims against the former administrator. The original administrator had sold the company's business and assets (EPGs) back to the directors in a pre-pack. The court noted the failure to (i) take specialist advice from a person in the EPG industry; (ii) advertise in publications or websites likely to attract purchasers of EPGs and not plant and machinery; and (iii) expose the assets to a proper market for a reasonable period of time. The court awarded £743,750 plus legal costs, providing a reminder to IPs to 'to act with "single-minded" loyalty to the company'.

A duty to creditors

It is abundantly clear that IPs have a duty to creditors to explore 'possible litigation assets' and seek to maximise value for them, and the ARY Digital case also makes clear that such a duty truly is to creditors (and not to your client, the former directors, your preferred lawyers, funder or anyone else). It is hard to see how ignoring a claim or just putting it to one possible buyer/investor would satisfy a court that the creditors' best interests have been looked after.

IPs have a duty to either understand the full market and options available for funding and insuring disputes, or to have access to specialists in this field that can provide feedback on the wider market, rather than just one or two funders or insurers.

> **It is abundantly clear that IPs have a duty to creditors to explore 'possible litigation assets' and seek to maximise value for them.**

Litigation funders would of course prefer to be approached directly, putting them in a position to invest in a case without competitive pressure on pricing. The same is true with any other asset in an insolvency: any buyer would prefer to be the sole bidder with zero competition! IPs of course recognise this and strive to secure value for creditors by marketing assets widely and seeking quotes from multiple interested parties.

Given that there are now dozens of litigation funders in the market, and around 20 after-the-event (ATE) legal expenses insurers, many of whom offer multiple products, it's tough to see how an IP could justify approaching only one or two possible options (*could an IP escape this duty by leaving it to the solicitors to handle funding and insurance? I'll let you answer that!*).

Maximum value

On the flip side, by properly assessing claims and exploring a wide range of options, IPs can ensure they are securing maximum value and not missing opportunities. By considering funding, ATE insurance or even assignment, it should be possible to extract as much as possible from any 'litigation assets'. If necessary, administrations can even be closed prior to recoveries being made, as some funders are able to take care of distributions to creditors.

In short, there are many reasons to explore the options around possible claims, and real risks associated with a failure to do so. Consider whether your practice might benefit from being able to run cases past an independent, regulated broker that can give helpful insight and feedback, as well as saving your team the time of dealing with multiple funders and insurers directly. Alternatively, consider what training and processes you need to put in place to ensure your team is exploring the market and can justify the approach taken, if necessary, to creditors and regulators.

Annecto Legal offers a free review service on cases, using our in-house expertise of former ATE underwriters. We provide feedback on what interest there is likely to be in cases, whether further work is necessary on cases before going to market and what difference such work might make to the terms available.

As a broker, we are typically paid by funders/insurers upon successful recovery of damages. Our fees are transparent and, ultimately, clients will only instruct us if we access better deals for them, including our fees. Our experience of working with IPs is that they come back to us time and again because we provide a service that has real value, and saves time and money. □

MARK BEAUMONT is co-founder of Annecto Legal Ltd, a broker for a wide range of funding and after-the-event (ATE) legal expenses insurance. With over fifty different funders and insurers available, there are options for smaller claims under £100k as well as mid-market, large-scale and complex claims. Contact Annecto Legal on 0800 612 6587 or Mark Beaumont personally on 07730 217 643 or at mark.beaumont@annectolegal.co.uk.

R3 – the voice of its members

James Jeffreys and **Stuart McBride** explain R3's lobbying work in Spring 2019.

Crown preference has continued to be a priority. The government's consultation on the policy proposal closed at the end of May, and we've been busy sourcing input from members to ensure that our response is as reflective of their opinion and the wider profession's opinion as possible. If you responded to our member survey – thank you!

We think the government's proposal will hinder business rescue in the UK, and the gains the Treasury expects to make from it will be greatly outweighed by the long-term damage the proposals will cause. However, we remain hopeful the government will take into account the views of the profession and reverse or adapt its position – particularly when it realises the broader consequences of its plans.

"We've been working to ensure journalists, MPs and all political and industry stakeholders are aware of our views and fully understand the potential consequences of what's being proposed."

R3 has met a number of parliamentarians, including the shadow insolvency minister Bill Esterson MP, to discuss the government's proposals. We've been working to ensure journalists, MPs and all political and industry stakeholders are aware of our views and fully understand the potential consequences of what's being proposed. In May, we brought together over 30 representatives from our profession, creditor bodies, and the lending and investment community, for a roundtable with HMRC, sponsored by Squire Patton Boggs. It's fair to say that opposition to the proposal at this meeting was widespread, and that HMRC has a lot to think about.

R3 has also been raising Crown Preference in the press, with the *Sunday Telegraph*, *The Times* and the *Financial Times* reporting on R3's concerns.

Busy behind the scenes

Frustratingly, the Brexit-inspired deadlock in Westminster has meant that many

"We said 2019 would be another busy year for the insolvency and restructuring profession – we were right."

insolvency and restructuring-related policy issues have yet to make progress. At the time of writing, the government has yet to formally begin its expected single regulator review; we are still waiting for the outcome of the government's review of the 2016 *Graham Review into Pre-Pack Administration*; and we are still to receive any indication of when it plans on bringing forward legislation to introduce its proposed corporate insolvency framework reforms.

We continue to meet regularly with journalists and parliamentarians to promote and defend the role of the insolvency and restructuring profession. Once the focus of the parliamentary agenda turns back to national business and economic issues, we hope these efforts will mean we're well-placed to advise government on the best approach to revising legislation that affects the insolvency profession and the people and businesses it supports.

R3 in the media

It has also been a busy few months for R3's press team. A mixture of high-profile insolvencies, requests for comment and briefings on issues such as CVAs, pre-packs and Crown preference, and the most recent insolvency statistics, has meant that there have been lots of opportunities for R3 to share members' insights and to provide clear information on insolvency procedures that those outside of the profession find complex.

Recent months have seen R3 quoted in a number of pieces in the national media – including the *Daily Mail*, the *Daily Telegraph*, *The Times*, Reuters and the *FT* – on a wide range of issues from IVAs, CVAs and Brexit stockpiling to corporate insolvencies and pre-packs.

Our comments on the latest insolvency statistics were covered by PA, *The Times*, *Scotland on Sunday* and *The Scotsman*, Reuters, *The Guardian* and Sky News.

Looking ahead

We said 2019 would be another busy year for the insolvency and restructuring profession – we were right. As well as Brexit developments and the publication of the Crown preference consultation, the debate around the prospect of a single regulator for the insolvency profession is expected to start very soon.

"This year the trend of rising insolvencies is expected to continue. This will put the spotlight squarely on the insolvency and restructuring profession."

This year the trend of rising insolvencies is expected to continue. This will put the spotlight squarely on the insolvency and restructuring profession, the way it carries out its work, and the economic value it protects and creates. To help respond to increased interest in the profession, R3 has projects in the pipeline which will look at ethics in insolvency and restructuring, and which will pinpoint the economic contribution the profession makes every year.

We still need and want your help to make sure our focus is correct. Join one of our roundtables; become a member of one of our committees; Tweet us (**@R3PressOffice**) or send us a message on LinkedIn (**R3 Association of Business Recovery Professionals**); or email us (see R3 contacts on page 36). We're very grateful to those members who share their thoughts and expertise with us. If you'd like to join them, we'd love to hear from you.

JAMES JEFFREYS (LEFT) is public affairs manager at R3.

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R3's strategic plan – taking us to 2023

Emma Lovell, R3 chief executive, outlines the next steps in R3's strategic future.

If you've seen me at an R3 event over the last year or read my contributions to *RECOVERY*, you'll know that one of the key facets of R3's activities in the past 12 months has been to work on our strategic review and finalise our new strategic plan. I'm delighted to say, our plan has now been launched!

R3 has been a part of the UK's insolvency and restructuring framework for almost three decades since its foundation as the Society of Practitioners of Insolvency in 1990. Both members and staff should be proud of what we have achieved on behalf of the insolvency and restructuring profession since then. To keep supporting the profession for the next 30 years, R3 also needs to change. Our new strategic plan sets out our direction and roadmap for the next three years, taking us to 2023.

As Duncan Swift says in his column in this edition, our plan – which you can find on the R3 website – sets out how we're going to continue our journey with our members. It sets out how we'll make sure we represent *everyone* in our profession, regardless of their specialism, their background, or their level of experience.

Our plan is the result of over a year's worth of consultation with individuals and practices inside and outside the profession, and inside and outside of R3's membership. Its development has been a collaborative project, and we're excited to share it with you.

Our purpose and vision

An important element of our plan is a redefined purpose and vision for R3. These will form the foundations of R3's work, capture the reasons why R3 exists and what we're striving to achieve. Everything we do will be tied back to these two statements. These words resonate with the R3 team and R3's Council, and we hope that they will resonate with you too, as members.

You can see our purpose and vision statements in the box to the right.

Our five pillars

Standing on the foundations of our restated purpose and vision are five key themes, which we call 'pillars' and which support the different elements of our plan and provide value for our members. These pillars are: community; voice; learning; innovation and insight; and building a thriving organisation.

Our *community* pillar will underpin our work to build a broad, diverse, expanded and active membership base, and make sure R3 is the home for the insolvency and restructuring community. It will support our push towards increasing representation, spanning all professional disciplines related to insolvency and restructuring. It will push us to clarify our membership pathways and to make it easier to start careers with R3, as well as make sure R3 membership is accessible throughout a career. We also want to ensure that participating in our activities, whether via our Council, committee membership or at our events and conferences, is effective, rewarding and, most importantly, fun!

We recognise that R3's press, policy and lobbying activities are one of the most valued aspects of our work. Our *voice* pillar is designed to cement and define R3's role as the collective voice of the restructuring and insolvency profession, actively promoting and protecting the value of our members' work. This means we'll be building a positive market and a positive legislative and regulatory environment for our members. We'll be working to enhance and expand members' influence, campaign for progressive changes to the UK's insolvency and restructuring policy framework, and use the expertise of our members to shape policy that has an impact on the UK's economy and society.

Our *learning* pillar will guide our work to continue to deliver practical educational and technical support, delivered by the profession for the profession, spanning disciplines and the length of a member's career. It will support our work to make sure learning and technical support is accessible – whether delivered in-person or provided remotely. It will also guide us towards tailored learning opportunities, with modules and courses built around the needs of individual practices, stakeholders and practitioners.

As CEO, it's very important to me that R3 takes the lead in helping to shape the future of our profession. Our innovation and insight pillar will help us to do just that, and to initiate innovation and thought leadership. It will drive us to produce and promote fresh, insightful and market-leading research, and help us establish R3 as a forum through which others – from academics to practices – can share and promote their own research and thought leadership.

Of course, we can't deliver the first four pillars unless we're a *thriving organisation*, and our plan also sets out the steps we'll be taking to make sure this is the case.

What's next?

We've set out our purpose, vision and the pillars underpinning it with a statement of our milestones and timelines. But we'll also be adapting our plans, objectives and activities to match the world around us as time moves on. We'll also be publishing details of more specific tasks and activities, based on this plan.

While this plan sets out our future, it doesn't mean we're letting go of our past: the services and support you've come to expect from R3 – from dedicated support for smaller practices, to technical bulletins and alerts, events and conferences – will all continue.

We can't wait to hear what you think. R3 is your membership association. This plan is your plan. Just as its development was a collaborative process, so will its implementation require R3 and members to work together. The R3 team and I are looking forward to delivering it alongside you.

I do hope you'll take the opportunity to visit our website and read over the plan. If you would like to discuss any aspect of it, please don't hesitate to get in touch with me.

R3's purpose

Members of the insolvency and restructuring profession protect and restore value at all levels of the UK's economy. Their expertise promotes economic regeneration, resolves financial distress for businesses and individuals, saves jobs, and creates the confidence and public trust which underpin trading, lending and investment.

R3 protects and promotes the environment and strong restructuring and insolvency framework required to enable our members to fulfil their vital role in the economy and in society.

The R3 vision is to be…

The thriving, inclusive organisation at the heart of the UK's insolvency and restructuring profession. We are the association that embraces the entire community of professionals within the UK restructuring and insolvency world, whatever the size of their practice, their experience or their specialism. We play a leading role in ensuring the UK remains a global centre for resolving financial distress, promoting economic regeneration and maintaining integrity in our framework.

EMMA LOVELL is chief executive at R3.

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An interview with…

Duncan Swift

The **new R3 president** talks about tackling late payments, R3's mission to educate and what the privilege of limited liability is worth.

Q You've just taken office as R3 president. How long have you been a member of R3 and why did you join?

A I've been an R3 member since about 1991, when it was the Society of Practitioners of Insolvency. It's a good trade association to have around to compare notes on current events, best practice and policy development.

I had a wake-up moment some years ago about the need for high professional standards. R3 is the only trade association that has a focus on maintaining and improving standards, and articulates the case for improvement to legislators and policy influencers. I decided to become more involved to press the point that the profession needs to stand together, educate policy makers, maintain high standards and see that the more knee-jerk policy initiatives driven by the malpractice of directors and others doesn't diminish the ability of the profession to do what it does.

> "R3 is the only trade association that has a focus on maintaining and improving standards, and articulates the case for improvement to legislators and policy influencers."

Q One of the points that you've picked up for your year in office is to tackle late payments to suppliers. Why is this such a focus?

A I was invited as R3 vice president to a late payments workshop hosted by Bill Esterson MP, and I was articulating the late payment perspective from the food processing and construction sectors, where late payments are often the trigger leading to financial distress.

I have a reputation for keeping food production and processing businesses going, which goes right back to my work at Grant Thornton. At the time, it chimed with the supermarket sector being under review by the Competition Commission (now the Competition and Markets Authority, CMA). In my experience, there's no one really speaking up for the food suppliers.

It is far easier as an IP dealing with a financially distressed supplier if you know what the true trading terms are with its key customers, but when those terms keep being moved it becomes very difficult to rescue a supplier's business as a going concern.

There are two parts to the debate: the main part and the important bit that gets downplayed is that it's not the price that suppliers contract at, it's the uncertainty that the price they contract at *will actually be paid in full and on time*. I was interviewed by the CMA that set up the new grocery supply code of practice and the Groceries Code Adjudicator (GCA). If you read recent GCA investigation reports, they are littered with examples of late paying or not paying at all.

Q Is there something that can be done about this? From past articles and experience, this appears to be treated as a normal facet of business?

A Any government likes to think that it's doing what it can to give businesses the tools to tackle late payments themselves, such as interest on late payments, which is little used, or segregation of JCT retentions, which never get paid and can often be the profit margin for many SME contractors.

These measures are all largely voluntary and lack 'teeth'. What small supplier is going to stand up to its largest customer and say 'I'm charging you interest on this bill' when it risks losing all of its orders from that large customer?

A big part of my plan on late payments with R3 is education. For the politicians and the regulators, it's about understanding the working capital benefit that comes to the customer in making late payments, and that the current situation is not something readily reversable. »

Duncan Swift biography

- Duncan's family moved often for his father's job with the Navy but, after attending six primary schools between Malta and Hampshire, they eventually settled three miles out of Okehampton in rural Devon. The family-friendly tranquillity of West Devon wasn't enough for an aspiring young businessman, so after some time harvesting potatoes for neighbouring farms, Duncan set his sights on the City, through the lens of a management sciences degree at the University of Manchester.
- Duncan came to understand that chartered accountancy offered a swifter pathway to London and the cut and thrust of business, and he joined Price Waterhouse in 1983 to begin qualification, transferring to the insolvency department one year before qualifying. Within four weeks of passing the chartered accountancy exams he was on his first receivership at Coventry Climax's parts division.
- He went on to be part of the newly formed restructuring team for Price Waterhouse in Southampton, later moving to KPMG and Grant Thornton where he became a partner. It was there he started specialising in food processing and production, not only helping those businesses that still harvest potatoes in West Devon, but also going up against major supermarkets on late payments and treatment of suppliers. He has since been quoted in government reports, the national press and Andrew Simms' *Tescopoly: how one shop came out on top and why it matters*. Duncan now continues his 30-year career in insolvency and restructuring at Moore Stephens.

Q What else have you got at the top of your agenda this year?

A I have three principle aims for my term: the launch of the strategic plan to confirm what R3 does for its members, how it does it and to ensure that it does it sustainably; late payments and explaining how business rescue flows from attacking late payment; the third is raising standards, something that is essential with both the ethical code under revision and the single regulator review approaching.

> "The current proposals should not be about needing more regulation – this is about needing better enforcement of existing regulation and sharper teeth for regulators looking at corporate governance issues."

Q And a part of raising standards must be to respond to the government's insolvency and corporate governance reforms?

A If the legislation currently in place had been better applied, the government would not have seen the need for change that it did. The current proposals should not be about needing more regulation – this is about needing better enforcement of existing regulation and sharper teeth for regulators looking at corporate governance issues. One example is the Financial Reporting Council, which even though it has the power to fine professionals has been slow to confirm it will investigate, even slower to investigate and has upheld fairly paltry fines.

A lot of the proposals the government has made in relation to the insolvency framework are unnecessary: antecedent recovery powers are all there for insolvency office-holders already. If the government does want to introduce insolvency reforms, we'd rather see progress with the 2016 corporate insolvency framework proposals rather than the 2018 corporate governance proposals.

Q What about the ongoing work with R3 relating to the position of the Official Receiver (OR) and HMRC in liquidation and bankruptcy?

A We had the introduction of the Insolvency Rules 2016, which came into force in 2017 ostensibly to bring methods of creditor engagement up to the 21st century. We've got rules running through numbers and letters of the alphabet, and you can bet that creditors don't understand it and feel disenfranchised by the process. There are inconsistencies in that rule book, such as the 10/10/10 rule to convene a physical meeting whereas the Insolvency Service's Official Receiver in compulsory liquidation or bankruptcy requires a majority of creditors by value.

You've got highly aggrieved creditors that aren't the majority by value trying to get their IP appointed to chase directors and individuals; who may have failed to account for all the assets, to hold them to account that cannot do so. This is a loss to the public purse. HMRC has often chosen to not engage, where it's often the majority creditor, instead leaving it with the OR. The OR doesn't always tap into the knowledge available in that community of creditors and their IPs seeking to recover assets.

This has been the message that R3 has been pressing both the Insolvency Service and HMRC on over the last 18 months – opening constructive dialogue on the areas and evidence that need attention. There are relatively simple changes that can be made that don't require wholesale statute changes to improve the overall performance of getting a better recovery.

Q Is there anything else that you'd like to tackle during your term?

A The latest issue to come up is the role and powers of Companies House. It has long been treated just as a registry, which to my mind devalues what it provides. Companies House provides the ability to incorporate companies and to give the individuals who form them the privilege of limited liability. It costs £12 to get that limited liability privilege, without any 'know your customer' requirements, and as little as £10 for a strike-off. Why are we surprised that it is abused, either by money launderers setting up thousands of fake LLPs or by directors or shareholders with unregulated investment schemes who seek to deceive investors out of many millions of pounds?

> "We've got rules running through numbers and letters of the alphabet, and you can bet that creditors don't understand it and feel disenfranchised by the process."

My answer is that we shouldn't be. The privilege of limited liability shouldn't be available for the paltry price of £12. If you set the bar at £500 or £1,000, most businesses that are sensibly formed with the idea of making profit on a regular basis wouldn't find that cost to be unrealistically out of the ballpark. This falls into the same category as any other government service where action needs to be taken to 'up their game'. It's part of a culture that we need to challenge.

Q We always like to end on a lighter note. How do you occupy your free time?

A Our two dogs, a springer spaniel and border terrier, do plenty to keep us fit. My partner and I also like to know where our food comes from so we spend a lot of time sourcing our own food products. She's great at food preparation, and I was a director in an organic meat processing business locally for a while, helping them grow their business and deal with larger corporates as customers as they expanded.

> "The privilege of limited liability shouldn't be available for the paltry price of £12."

I have also been a fundraiser for the charity Medical Detection Dogs. They have two sets of work that they do to use dogs' power of smell to help humans: firstly in lab settings to detect cancer cells in urine samples (with a higher accuracy rate than NHS tests) and the other in partnering dogs with individuals with chronic illnesses. There is one lady in the New Forest with type 1-diabetes who historically went into a diabetic coma once a month. Since she has been partnered with a dog, she has had no emergency calls into hospital, getting a c20 min warning from the dog awake or asleep. She and her mother, who used to have to perform blood tests on the hour 24/7, now have a far better quality of life. □

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