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Winter 2014

RECOVERY

The Leisure Industry

Licensed brand rights in insolvency
There are two sides to the licensing coin

The REAL story of a business
Considering metrics in the leisure sector

Solutions in the licensed trade
What to do when time is called on licensed premises

The final whistle
Community sports and social clubs in distress

Arms, IPs and the sea
Dealing with licensed weaponry when a private maritime security company fails

The challenges facing IPs
In the glare of the spotlight

What's to come in the year ahead?
President Giles Frampton on ensuring the UK insolvency regime remains world leading and trusted

Interview with Duncan Grubb
The chair of the British Property Federation's Insolvency Committee talks landlords, CVAs and maintaining goodwill towards all IPs

What do you think?

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

From the editor

Why on earth are a company's creditors going to be made to lose out twice when the directors steal their money? If the insolvency 'Jackson exemption' under LASPO 2012 is withdrawn, creditors will not only suffer the loss of having their money stolen, they will also have to pay, out of the recoveries that should be their compensation, the additional risk management costs arising from the directors having denuded the company of assets.

This is not a litigation costs issue: it is a point about the consequential loss to creditors when an estate is left with insufficient assets to fund the litigation and with the potential adverse costs if the claim is unsuccessful.

Bob Pinder of the ICAEW makes the point on page 7 that withdrawing the exemption is anti-business and rewards fraud; while Giles Frampton (page 6) reminds us of the huge level of support there is from a variety of business groups for retaining the exemption and Victoria Jonson (page 34) notes the hundreds of millions of pounds at risk from this reform.

Another ill-conceived legislative proposal is the abolition of physical creditors' meetings in the absence of significant creditor support – in direct contravention of the government's stated aim of enhancing creditor involvement in insolvencies. This is the worst of the deficiencies in the Small Business, Enterprise and Employment Bill, not least because it demonstrates a complete lack of understanding of the comparative costs of convening meetings and responding to the disgruntled enquiries of creditors who feel disenfranchised.

There is much more to this issue, you will be pleased to know, than legislative train wrecks. Articles from ABFA, The Insolvency Service and the BPF emphasise communication. As a profession we are getting better at listening and at explaining things clearly, both collectively and individually, but we must continue to improve. The pre-pack debacle, where – as evidenced by the BPIF piece at page 41 – we failed to persuade those outside the profession that pre-packs are constructive tools that add or preserve value, is a stark reminder of what can happen if our communication falls short.

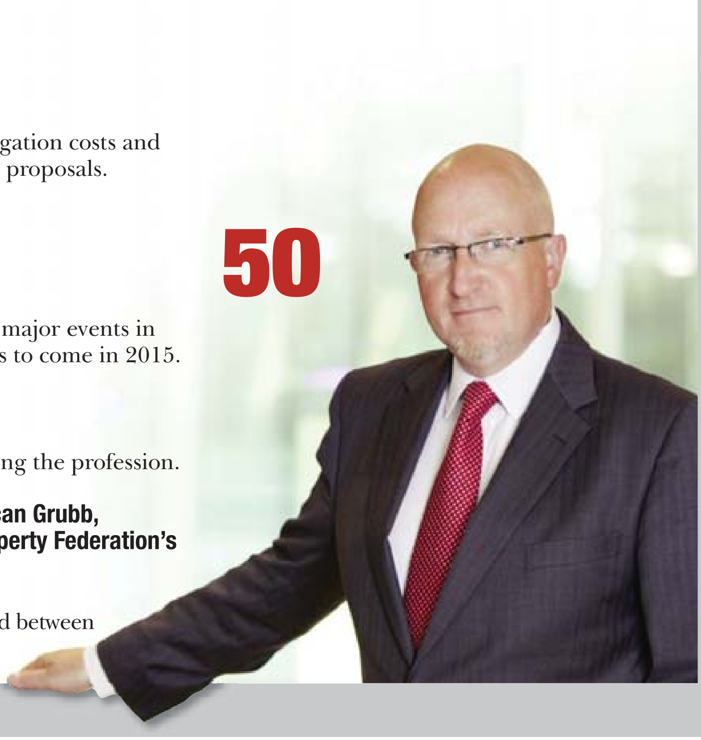
We also cover interest rate hedging product mis-selling in this issue, which many of you know I think is an important subject for IPs to address properly. Robin Henry discusses on page 36 that there are some difficult points to deal with, including conflicts of interest, set-off and whether a bank's floating charge extends to a redress claim against the bank. The assignment of IRHP mis-selling claims is discussed in the light of *Hockin* v. *Marsden* in our Legal Q&A on page 17.

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

Regulars

Regulars

50



Legal update

Features

The leisure industry

R3 Matters

Book reviews

Advertising

Themes of *RECOVERY* 2015

SPRING Directors
SUMMER Offshore – near and far
AUTUMN The perception of the insolvency profession and IPs
WINTER Financial services

Features

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Publishing manager Sandra Kessell
Tel: 01491 828939, sandra.kessell@groupgti.com

Publishing assistant Naomi Osinnowo
naomi.osinnowo@groupgti.com

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

Advertising executive Kym Freedman
Tel: 01491 828920
kym.freedman@groupgti.com

Art director Thomas Gray

Administration Eva Greenford, Paul Hinnell

Printed by Stephens & George

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

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Caterham and Marussia teams could re-enter F1 in 2015

Two F1 teams in administration have been re-entered for the 2015 season under new names. Caterham would be known as 1 Malaysia Racing Sdn Bhd, while Marussia would be known as Manor F1 Team.

But both need to find enough funds to keep going through the off-season and backers in the season ahead to secure their future and a place on the starting grid.

At the time of going to press Caterham and Marussia faced financial uncertainty, with crowdfunding keeping Caterham's hopes alive. A team is a more viable proposition if its name appears on the 2015 start sheet, but any prospective buyers will need deep pockets. Around £20m is needed to keep a team going through the winter months, according to one interested party.

Phones 4U administrators expect to pay only 0.4 per cent of unsecured debt

PwC has hired Quinn Emanuel Urquhart & Sullivan LLP to assist in further investigations into the conduct of former directors at Phones 4U, the administrators' report shows.

The report also indicates that the British taxpayer could lose up to £78m in VAT and corporation tax when the fallout from the collapse of high street retailer Phones 4U is totted up. Phones 4U customers are owed £4.8m, employees are owed nearly £26m and suppliers £42m. A sum of £17.2m in outstanding bills brings the total of unsecured debts to £168m. A further £450m is owed to bondholders and banks. The administrators expect to repay around £670,000 of the unsecured debt.

Ahead of filing the confidential 'D' report on its investigations into directors' conduct with the Department of Business, Innovation and Skills, PwC states: 'It is too early to form any assessment on what action may be possible or necessary, or the likely outcome. We will provide an update in our next report.'

Phones 4U collapsed in September with the loss of 3,500 jobs, despite posting pre-tax profits in 2013 of £43.8m, after leading mobile phone operators refused to renew contracts with the company.

Read more at **http://www.pwc.co.uk/assets/pdf/P4Uproposals1.pdf** and at **http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11234357/Collapse-of-Phones-4U-to-cost-taxpayer-78m.html**

IP appears in court

Insolvency practitioner David Whitehouse has appeared at Glasgow Sheriff Court charged with fraudulent activity associated with the sale of Rangers Football Club plc in 2011. Mr Whitehouse, who worked for Duff & Phelps, appeared with colleagues David Grier and Paul Clark and a fourth man, Gary Withey, who worked for legal firm Collyer Bristow. None made a plea and all were granted bail.

Mr Whitehouse, Mr Clark and Mr Grier, who were employees of MCR Partners before it was acquired by Duff & Phelps in 2011, also face charges of attempting to pervert the course of justice. Mr Withey faces a further charge under the Companies Act 2003. Duff & Phelps were appointed Rangers' administrators in 2012.

Read more at **http://www.bbc.co.uk/ news/uk-scotland-glasgow-west-30084830**

Rogue directors caused £50m VAT losses

Two men whose business when into voluntary liquidation owing more than £52m have been disqualified as directors for a combined 20 years.

The Insolvency Service has revealed that Jody Firth, aged 33, and Albert Goddard, 57, of JKL (Wakefield) Ltd allowed a disqualified director and undischarged bankrupt to act as a director of their business. The company was known for sponsoring Super League rugby team Wakefield Trinity Wildcats and Dewsbury Rams under the name of Eric France Metal Recycling.

Mr Firth and Mr Goddard deprived taxpayers huge sums of revenue, Official Receiver Ken Beasley revealed. The Insolvency Service investigation found that between 2008 and 2013 JKL (Wakefield) Ltd evaded tax liabilities to HM Revenue & Customs resulting in VAT losses of at least £50m and losses of £4,888,661 in respect of unpaid PAYE tax and National Insurance.

Judges turn down appeal

Three senior judges have rejected a sentence challenge from Michael Worrall, the former accountant at Bridge Business Recovery in Kent, who helped his colleague James Bradney defraud struggling companies. Mr Worrall was given a 32-month prison term earlier this year after admitting that he had transferred sums from five of the companies the firm was administering. More than £825,000 was transferred from the businesses, of which Mr Bradney spent £280,000 on himself. Mr Worrall did not benefit at all from the fraudulent enterprise, but manipulated the management accounts to ensure the transactions remained hidden.

Mr Worrall's lawyers argued that he had acted out of a misguided sense of loyalty, but Sir Richard Henriques, sitting with Lady Justice Rafferty and Mrs Justice Simler, dismissed his appeal saying that there had been no error of judgment in the sentence and the crime was a severe breach of trust.

Sycamore Aviation bought out of administration

Six jobs may have been saved at Sycamore Aviation after buyers from Glyn Wall Ltd stepped in to rescue it out of administration. The aircraft dismantling company, based at Durham Tees Valley Airport, had called in administrators Steven Ross and Ian Kings of Baker Tilly. A lack of orders throughout 2014 was blamed for the company's impaired financial performance.

David James memorabilia sold

Signed footballs, shirts, shorts, Raleigh Chopper bicycles and even a customised Vauxhall Astra van have been sold on behalf of bankrupt former England goalkeeper David James' estate. One England shirt, worn during the side's 1-0 World Cup win over Argentina in 2002 when Mr James was a substitute, brought in £672. Mr James' trustee in bankruptcy Mick Sanders of MHA MacIntyre Hudson instructed Hilco Industrial to sell the memorabilia. More than 1,000 people registered for the sale. The largest creditor in the estate is HM Revenue and Customs.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

President's column

Giles Frampton on the major events in recent years and what is to come in 2015.

Insolvency is a necessary part of an entrepreneurial economy. Even the most cunning financial plan can fail, and provision needs to be made for such failure. Yet this is frequently either forgotten or, at best, is an afterthought. Insolvency, as a subject, is seen by some as 'technical', or is regarded as being of little or no importance. It can therefore be a challenge to open people's eyes to just how interconnected insolvency is with the world in which we live.

It has been particularly gratifying then, that R3's recent campaign for a permanent exemption from the Jackson legal reforms has won so much support from others. This is not about more work for the profession; it is about protecting small businesses and public funds both by deterring rogue directors and by facilitating redress. Alongside the RPBs, the Bar Council and the Law Society, creditor groups including the Institute of Credit Management and the British Property Federation have also lent their support to our calls for government to change its course. The Labour party's shadow business and justice team is also supportive.

As I have written in these pages previously, engagement with other stakeholders is a very important part of helping us get across the value of our profession to policymakers and the wider public. By reaching out to others and establishing common causes – whether it is opposition to the government's plans for insolvency litigation funding or opposition to the government's Small Business Bill proposals to remove insolvency practitioners' powers to call physical creditor meetings – we can make a powerful case that the issues that we talk about are not issues that only we care about.

R3 has done a lot of work this past year to bring together different stakeholders to discuss the latest developments in the insolvency world. I think it has been enormously instructive for both us and The Insolvency Service to have had the opportunity to hear in detail what matters most to creditors. In turn, I think some creditor groups have appreciated hearing the insolvency profession's side of the story. In this edition of *RECOVERY* you will be able to find the British Printing Industries Federation's and the British Property Federation's views of the UK's insolvency regime – both are well worth a read. The more the profession talks with creditors and other stakeholders – whether on a one-to-one basis in our own practices or at a policymaking level – the fewer misunderstandings there will be, and the more we can get done.

Although 2014 has been an exceptionally busy time in terms of new insolvency policy and regulatory developments, 2015 will be every bit as active. The first half of the year should see the implementation of some of the recent bigger policy announcements: the Graham 'pre-pack pool' is expected to be up and running by the spring; the government's insolvency fees proposals may have been introduced (we anticipate a revised proposal around the end of this year); the Debt Relief Order thresholds and the creditor bankruptcy petition level may also be changed following this summer's call for evidence; and April 2015, as things stand, will herald the end of insolvency litigation's exemption from the Jackson reforms. 2015 may also see the introduction of partial licences and the new European Insolvency Regulation. And, of course, the big unknown next year is the outcome of the general election in May.

> "The more the profession talks with creditors and other stakeholders, the fewer misunderstandings there will be."

Whatever the result, there will be plenty of new faces in Parliament to meet and speak to, and there may be some changes in policy direction too. R3 has been making the case to all the political parties for the kind of changes to the insolvency landscape that would do most to help creditors and consumers after 2015. Included within our manifesto for change – published in October and available on R3's website – are calls for a permanent exemption for insolvency litigation from the Jackson reforms, action on football insolvencies to see more money returned to small creditors, greater involvement from government creditors in insolvencies, and a comprehensive review of the personal insolvency regime.

In 2010, our call for action on termination clauses and changes to terms of supply during business rescue procedures (our 'Rescue to Ransom' campaign) became a Liberal Democrat manifesto commitment, later government policy, and is now to be enshrined in legislation. The fact is, while over the past year the insolvency profession has been the subject of some major government reviews, such as those on fees and regulation, there still remains plenty of scope for the profession to make our own case for change and achieve it. Whatever the outcome in May, let us hope that future government policy will ensure the UK insolvency regime continues to be transparent, fair, trusted – and world leading.

GILES FRAMPTON is the president of R3 and a partner at Richard J Smith & Co.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

Current challenges facing the profession

The audit profession was in the spotlight a few years ago. That light is now shining on the insolvency profession.

The Small Business, Enterprise and Employment Bill was published just before the summer recess and contains a number of clauses that the ICAEW will be challenging before it becomes law in October 2015.

What bothers us?

We understand that the government is keen to reduce the emphasis on physical meetings as the default decision-making process. Nevertheless, we believe IPs should have discretion to convene physical meetings if they believe it appropriate to do so. Removal of this option smacks of micro-management of the insolvency process and is a step in the opposite direction in the drive to improve creditor engagement.

Although we support the introduction of regulatory objectives, we question why the regulatory objectives focus solely on the regulatory regime for IPs. The Insolvency Service has policy responsibility for insolvency matters beyond the regulation of the insolvency profession and this is an opportunity to develop regulatory objectives for the insolvency regime as a whole. And, as always, the devil is in the detail. What's meant by 'fair' in an insolvency context, for example?

We have serious concerns about the clauses that give The Insolvency Service the power to investigate IPs in public interest cases. There needs to be a lot more thought about how this will work from the fundamentals of what is meant by the public interest, to the mechanics of how cases will be investigated and how the investigations are funded.

We don't see the need for the bill to have a reserve power, albeit with a sunset clause, to establish a single regulator. Outside mainstream financial services, few professions have a single regulator. There are multiple regulators in audit, legal services and non-mainstream financial services. Multiple regulators should not lead to inconsistency; the key is effective oversight of the RPBs.

Progress on pre-packs

Teresa Graham concluded in her report published on 16 June that pre-packs should not be banned. Her evidence demonstrated that they serve a useful purpose and save jobs.

The Insolvency Service has started to bring interested parties together with a view to getting the proposed pre-pack pool off the ground, and work on revising SIP 16 is progressing well.

> "We have serious concerns about the clauses that give The Insolvency Service the power to investigate IPs in public interest cases."

There's also a reserve power in the bill to ban pre-packs if the voluntary measures don't work. Hopefully this power won't be needed if the profession embraces the voluntary measures.

Partial licences: more regulation?

The Deregulation Bill proposes moving from one licence to three. This will lead to further regulation around each licence. The ICAEW, along with most of the profession, opposes the introduction of partial licences.

Those in favour should be careful what they wish for. In April, the FCA assumed responsibility for the regulation of consumer credit. We know the FCA is looking at how debtors finish up with which product. Their current thematic review is also looking at the IVA market.

Could we see volume consumer IVA IPs having to take their licence from the FCA? The introduction of partial licences may make this an easy transition.

Jackson reforms are anti-business

Along with R3 and other bodies, the ICAEW continues to lobby hard for a permanent carve-out of insolvency litigation from the Legal Aid, Sentencing and Punishment of Offenders Act 2012. We believe the policy is anti-business, will increase tax avoidance and evasion, and benefits directors of insolvent companies who have committed fraud or behaved recklessly in relation to creditors.

Collective redundancies: something has to give

Protective awards are common and widespread due to inherent conflicts between employment legislation and insolvency law. Although current legislation on collective redundancies may be clear, in some insolvencies it's often difficult — if not impossible — to implement. The government appears to have no appetite for amending the law but this is a problem it has the power to solve.

Fees: what really pushes them up?

There seems to be an overriding presumption that costs are too high, but around 90% of those costs are caused by compliance with the law. An ill-thought-out focus on cost reduction could risk innovation. We don't believe the proposals issued earlier this year will achieve an increase in net returns to creditors. Perhaps upfront fee estimates will be the solution?

IPs and their teams must adapt

Economic conditions and legislative changes are prompting a number of fundamental changes to the insolvency market. The new regulatory framework will create a revolution in working practices. IPs are likely to need to offer more creative services that fall outside the legislation and provide those services earlier in the business cycle, possibly before formal insolvency is required. IPs who continue to provide formal services will probably need to provide them more efficiently.

The role of the regulator is to increase confidence in the profession and the ICAEW is keen to take a leadership role here. Equally the profession must continue to work hard to demonstrate that it deserves people's trust.

BOB PINDER is a director at the ICAEW.

Stepping into the light

A new perspective on the recent debates around insolvency and asset based finance is required.

It was in my second full week in the job of chief executive that the Asset Based Finance Association (ABFA) was scheduled to give evidence before the Treasury Select Committee (TSC) as part of their inquiry into SME lending. Our chairman, Martin Morrin, had the honour of representing the industry and did a first-rate job in getting across the excellent work that is the rule in our industry.

Nonetheless, we all recognise that these days it is rare to be asked before a parliamentary committee to be told what a wonderful job one is doing. Frances Coulson gave evidence alongside Martin and as she noted in her article in the last issue of *RECOVERY*, there are indeed challenges and opportunities ahead for both the asset based finance and insolvency sectors.

> "Critical focus invariably falls on the exceptions that prove the rule."

At the sharp end

The overwhelming majority of asset based finance clients are the healthy, growing businesses that we all want to be talking about. But the critical focus invariably falls on the exceptions that prove the rule. Clearly IPs and, on occasion, asset based finance providers find themselves at the pointy-end of the rescue culture. By providing working capital where other types of funding are more difficult, and by facilitating rescue, our members are playing essential roles within our economy and of this we should be proud.

There are some great stories to be told about businesses surviving and then thriving – and I would be the first to admit that our industry, in particular, needs to get better at telling them – but sometimes the outcomes are 'least bad' rather than 'best'. There is no magic bullet to address this. Greater transparency should help and in this respect we all look forward to the implementation of the proposals set out by Teresa Graham in her pre-pack review, for instance. In her article Ms Coulson also makes some interesting suggestions for technical changes, which I am sure will be considered going forwards. As far as the asset based finance industry is concerned we are focused on ensuring that our professional standards framework is effective and is seen to be so.

ABFA standards framework

Readers of *RECOVERY* may be aware that some allegations of poor practice have been made about the asset based finance industry over the last couple of years. Small in number, these have mainly been related to that intersection between asset based finance and the world of insolvency. The ABFA and the industry have taken the allegations extremely seriously; the association was working on a new standards framework before these allegations were made but it would be disingenuous to suggest that they did not bring renewed focus on, and an urgency to, its development.

We have repeatedly requested evidence to substantiate these allegations – if they raise genuine concerns then we would want the standards framework to be able to address them – but nothing of substance has been provided. Unaddressed (even if unsubstantiated) rumours of poor practice do nothing for the reputation of the industry.

> "Our members are playing essential roles within our economy."

It still surprises and frustrates me that allegations of such seriousness can be flung around so freely on both traditional and social media without there being a requirement to back them up. For the record, I must state that I have been in the industry for over 30 years and although the industry, like any in which human beings are involved, is not perfect, I do not recognise the image that the individuals making these allegations seek to portray. The most important thing is to have transparent and accessible mechanisms through which allegations can be properly investigated and either robustly addressed if they have substance, or dismissed if they have none. I believe the reputation of our industry has suffered because we have not had this until now.

At any one time the asset based finance industry will be providing in the region of £18bn to client businesses and we are an essential part of the commercial finance landscape in the UK. With that importance comes the obligation to provide a clear statement to clients and prospective clients about what they can expect from our industry. This is part of our industry stepping into the light and fulfilling its potential and we should be proud and proactive in doing this.

> "The system will continue to evolve."

With a new ABFA code and guidance, an independent complaints process delivered by the specialists at Ombudsman Services and an independent Professional Standards Council I believe we have put in place a system that can do this. We are not complacent, however, and the system will continue to evolve to ensure that it continues to meet the expectations of our industry's current and prospective clients, and our wider stakeholders.

Treasury select committee

So, it was in that context that we provided our evidence to the select committee. We were extremely keen to do so as we are immensely proud of the work that has been done to establish the standards framework; it has been a positive step forward for the industry and one that we believe will allow us to support even more client businesses in the future. We want to get the good news about our industry out there. But, we were not so naïve as to be expecting a pat on the back.

A couple of things particularly struck me about the experience. Firstly as is the case in a lot of industries, in asset based finance we do have a tendency to think the world does, or should, revolve around us. The harsh reality that it does not can be a bit of a blow to the collective ego. The TSC was looking at a wide range of issues through its inquiry of which our industry was just one small part. Indeed, less than half of the committee was in attendance during our session, but those that were there were well informed and posed some insightful questions. The chair, Andrew Tyrie MP, in particular set out some clear challenges that our system will need to meet if it can be considered to be a success. Allegations of poor practice were repeated by one of the members of the committee, Brooks Newmark MP, and we asked again at the committee and outside it for evidence or any substantive detail to support what was being alleged and on which action could be taken.

As an aside, it is notable that in the session Mr Newmark tempered his more critical sound-bites about the industry (as quoted by Ms Coulson) with recognition that 'Ninety-nine per cent of what is going on [in the industry] is good stuff…' We are certainly not complacent, however – we want to ensure that as near to 100 per cent as possible of what is going on in our industry is recognised as good stuff, which is why we have introduced the standards framework. But for that to truly succeed we need allegations to be backed up with substance so that genuine issues can be addressed, otherwise they can be lost in the hyperbole of rumour and the echo chamber of social media.

If MPs do receive a large number of complaints, as Ms Coulson believes, then clearly we need to do more to encourage them, and the complainants, to pass them on to the system we have established for properly considering them. The complaints process is accessible, free of charge for complainants and is provided by Ombudsman Services independently of the industry. The Professional Standards Council's door is always open as well.

The second main thing that struck me was that out-dated stereotypes about the asset based finance industry persist and the risk is that current white noise serves to reinforce them. If I may say so, in this respect we find ourselves in a similar position to the insolvency industry. We need to address that by telling our story better – the biggest advocates are those who use the products and the asset based finance industry has customer satisfaction levels that most industries, let alone financial services, would give their eye teeth for. But as well as telling it better, we need to prove it better. We need to continually work to raise, demonstrate and enforce the standards that ABFA members will meet. That is where the standards framework comes in again.

Regulation, regulation, regulation

For the avoidance of doubt, we want regulation of the asset based finance industry. We want a clear statement of the standards the industry will operate to and accessible processes available if those standards may not have been met. The ABFA designed and implemented the standards framework to do this. It could be described as a self-regulatory system but with significant independence hard-wired into it. This system will evolve and develop. We believe it is appropriate and is working effectively but we recognise that the onus is on us to demonstrate this.

The question is whether statutory regulation will be more effective in delivering positive outcomes for clients. It is fair to say that there are a range of views across our industry on this question and they do not neatly split between 'banks' and 'non-banks'. I personally think the jury is still out. One of the key lessons of recent years is that 'regulation' does not always ensure good practice. For an industry that prides itself on its ability to be flexible and move quickly to support the client a prescriptive statutory regime that focuses on process over outcome would be a concern. But on the other hand, an appropriate scheme that would have the ultimate effect of opening up access to the industry could be a good thing for the UK economy.

In her piece, Ms Coulson suggested that smaller businesses should be granted protection akin to that under consumer regimes. Clearly that is a significant question with implications far beyond our industry but it was one that we considered when the framework was being designed. We are cognisant that the majority of clients of the industry are towards the 'S' side of SME and this is why the independent complaints process is particularly designed for smaller businesses (those with turnovers of £6.5m or below).

I strongly agree with Ms Coulson's suggestion that a reputable badge of good lending is required; I believe that the standards framework provides that and will demonstrate this over time. But as the select committee pointed out, the inherent problem with any voluntary system is that it is just that, voluntary. The ABFA is not a licensing body and membership is not compulsory; we would hope and expect that all those involved in the industry would look to meet the standards set out in the ABFA code but we cannot compel them to do so unless they are members. We are reviewing our membership criteria to ensure it does not put unnecessary barriers in the way of good businesses joining the ABFA so that they can be covered by the framework. But we will not dilute the core standards that need to be met – membership has to mean something. I would also emphasise that the ABFA's members are funders, not brokers and we do not intend to change that – there are already effective organisations to represent and regulate the broker community.

> "We will not dilute the core standards that need to be met."

So, to summarise, a lot of areas of vigorous and robust agreement and also some challenges for all of us. We look forward to working on them with colleagues from the IP community and beyond.

JEFF LONGHURST is the Asset Based Finance Association's chief executive officer.

Beyond the brown envelope

Nigel Barnett talks about bribes and other proprietary rights in insolvencies.

Introduction

For over 150 years, it has been a principle of English law that if an agent takes a bribe or a secret commission, he is liable to account to his principal for the amount received. However, there has been conflicting authority and academic debate as to whether the principal merely has a personal claim against the agent or whether he can assert a proprietary claim to the monies received and any profits made therefrom.

In an insolvency context, the point may be very significant. Can an administrator be wholly comfortable that what appear to be company assets are not vulnerable to a claim by a third party? Will a secured lender's security be trumped by a proprietary claim?

> "A bribe or secret commission received by an agent is held on constructive trust for his principal."

In *FHR European Ventures LLP and others* v. *Cedar Capital Partners LLC* [2014] UKSC 45, the Supreme Court has clarified – and arguably extended – the law as to the ownership of assets derived from a bribe or secret commission. It held that a bribe or secret commission received by an agent is held on constructive trust for his principal, and as such the principal has a proprietary claim to the bribe itself (and therefore to any assets acquired with the proceeds of the bribe). In doing so the Supreme Court overruled its own decision (in its previous guise as the House of Lords) in *Tyrell* v. *Bank of London* (1862) 10 HL Cas 26 and the subsequent cases that had followed it. Few of those cases were decided in an insolvency context, but the most recent before FHR, the case of *Sinclair Investments Ltd* v. *Versailles Trade Ltd* [2012] Ch 453, had been. The outcome in *Sinclair* provided important guidance to insolvency practitioners and banks in determining whether or not they have been put 'on notice' of proprietary claims.

The *FHR* decision

In December 2004, FHR purchased a company that owned the long lease of the Monte Carlo Grand Hotel for €211.5m. Cedar had acted as FHR's purchase agent, and in this capacity owed fiduciary duties to FHR. Cedar had also entered into an exclusive brokerage agreement with the seller, which had paid Cedar a €10m brokerage fee on completion of the sale in January 2005.

FHR alleged that Cedar had not disclosed the exclusive brokerage agreement to it, and brought proceedings against Cedar for recovery of the fee. The primary issue was whether such disclosure had been given, and the judge at first instance concluded that it had not been. After a further hearing, the judge declared that Cedar's non-disclosure was a breach of its fiduciary duty as FHR's agent, and ordered Cedar to compensate FHR for the €10m it had received. However, the judge refused to grant FHR a proprietary remedy in respect of that sum. On FHR's appeal, the Court of Appeal declared that Cedar had received the fee on constructive trust, holding it for FHR absolutely. Therefore, FHR had a proprietary right to the €10m.

On Cedar's further appeal, the sole point in issue before the Supreme Court was whether FHR was entitled to a proprietary right or merely a personal right against Cedar.

There is a well-established equitable rule that, where a fiduciary acquires a benefit or takes advantage of an opportunity that came to his attention as a result of his fiduciary position, he is to be treated as having acquired that benefit on behalf of his principal. In such cases, equity treats the benefit as belonging to the principal, who is entitled to a proprietary remedy against the fiduciary accordingly. However, that line of authority is

> "The judge refused to grant a proprietary remedy in respect of that sum."

traditionally premised on the principle that the property or opportunity is something that 'belonged to' or was otherwise available to the principal. As such, it is an easy leap to say that the asset in question should be held on trust for the principal.

However, it has been said that this analysis does not lend itself so easily to a bribe or secret commission paid to an agent, because that cannot be said to have been intended to be, or otherwise derived from, the property of the principal. This was the crux of the decision of the House of Lords in *Tyrell* back in the 1800s. Relying on *Tyrell*, Cedar argued that there was no basis for finding a proprietary claim with regard to a secret commission.

FHR argued in favour of a broader application, contending that, in any case where an agent receives a benefit amounting to, or resulting from, a breach of fiduciary duty, the agent holds the benefit on trust for the principal.

In delivering the leading judgment of the Supreme Court, Lord Neuberger acknowledged that previous legal authorities did not provide a plainly right or wrong answer to determine the scope of the equitable rule. He acknowledged that a bribe or secret commission could be looked at as different in quality to, for example, a secret profit made on a transaction on which the agent is acting for his principal where it might properly be said to have been a benefit the agent should have obtained for his principal. How could the same be said of a bribe that the agent receives from a third party? If that benefit never belonged to the principal, then, it might be said, he could have no proprietary right in respect of it.

> "Bribes and secret commissions have the potential to undermine trust in the commercial world..."

In the absence of an obviously correct answer, Lord Neuberger thought it was right to approach the issue as a matter of clarity and simplicity. That approach would be the application of the equitable rule in all cases, to avoid uncertainty as to its scope. He held that the argument put forward by Cedar that a principal has no proprietary right to his agent's bribe or secret commission was unattractive for four primary reasons:

(i) as a matter of policy an agent should not accept a bribe as it puts him in conflict with the duty to his principal;
(ii) albeit that it would be too simplistic to say that the purchase price would have been €10m cheaper were it not for payment of the secret commission, it is common sense that there must be a strong possibility that in taking the bribe the agent has disadvantaged the principal in some way – e.g. by not obtaining the best price available;
(iii) it would be a curious scenario where a principal could be effectively worse off than his agent who obtains a benefit under questionable circumstances; and
(iv) bribes and secret commissions have the potential to undermine trust in the commercial world, and as such the law would be expected to be particularly stringent in relation to a claim against an agent who has received such a benefit.

In reaching his conclusion Lord Neuberger acknowledged that the application of the rule in all circumstances would provide a principal with a proprietary right, with priority over unsecured creditors in the event of his agent's insolvency. However, his Lordship felt that the unsecured creditors would suffer no real prejudice for two reasons. First, because the proceeds of a bribe or secret commission comprise property that should never have been in the agent's estate at all. Secondly, because (as mentioned above) the bribe or commission may have reduced the benefit received by the principal from the underlying transaction.

The *Sinclair* decision

Although Lord Neuberger eschewed the concept of a remedial constructive trust as a principle of English Law, one might be forgiven for thinking that *FHR* comes close to the line. It is instructive to revisit the *Sinclair* decision in the light of *FHR*.

The case emerged from the administrative receivership of the Versailles Trade Finance group. The group had been financed by bank debt together with additional funding from a pool of individual investors through an offshore company Trading Partners Ltd (TPL). TPL was a conduit controlled by the Versailles management. Its agreements with individual investors provided that monies would be held as agent for the investor and would be applied solely for the purpose of making the contemplated investments in Versailles. However, monies raised through TPL were mixed with the bank lending and ultimately misapplied. Following the collapse, the investors lost most of their investment and TPL was placed into liquidation.

The founder and CEO of the group had made a substantial profit in selling his shares in the listed parent shortly before the collapse. Some of that profit had been applied in repaying bank lending and entering into a settlement with the receivers who were pursuing claims against him.

The TPL liquidator assigned various claims to one of the investors, Sinclair, which then brought claims asserting a proprietary right to the profit made by the CEO, which, it claimed, could be traced and followed into the hands of the banks and the receivers.

By virtue of the common control of Versailles and TPL, and the nature of the agreements by which the investors' money was injected into Versailles, it was unarguable that the CEO had breached his fiduciary duties to TPL and made a profit through the share sale. The key question was whether that gave rise to a personal claim against the CEO alone or whether there existed a tracing right to the proceeds in the hands of the banks and the receivers.

The Court of Appeal dismissed TPL's proprietary claim. It followed *Tyrell* and held that because the benefit could not properly be said to be the property of the principal beneficiary (ie TPL), no proprietary claim existed. As such, there was no possibility of following the profit made into the hands of third parties.

Post *FHR*, the position might very well be different. If we are moving closer to the position where the receipt and misapplication of monies by a fiduciary will always give rise to a proprietary claim, that is a slippery slope. Albeit Lord Neuberger was attracted to the simplicity of the concept, one can see fertile ground for litigation around the scope of the tracing remedy and when an innocent recipient of trust monies is deemed to have had notice of the trust claim.

What amounts to notice?

A recipient of property that is subject to a proprietary claim will nonetheless take the property free of that claim if:

(i) it is acquired for value;
(ii) the recipient is acting as a *bona fide* purchaser; and
(iii) the recipient has no notice of the proprietary claim at the time of acquisition.

This is the formula to create the archetypal '*bona fide* purchaser for value without notice'. In Sinclair, there was no suggestion that the receivers and the banks were not acting *bona fide*, and clearly they gave value for the property received from the CEO in terms of the discharge of loans and the settlement of claims. However, notice was a live issue. A key question was whether their investigations did, or should have, given notice of the competing trust claim. A further wrinkle was that, one year into the receivership process, the liquidators of TPL had purported to give notice (albeit without particulars) of a possible trust claim.

> "The founder and CEO of the group had made a substantial profit in selling his shares in the listed parent shortly before the collapse."

Such issues are fact specific and not easily resolvable. In *Sinclair* the court concluded that neither the receivers nor the banks had notice of a proprietary claim. Rejecting the efforts of the TPL liquidator to fix the receivers and the banks with notice, the court held that, to constitute proper notice, two key elements were required:

(i) notice of a right rather than a mere assertion of a claim; and
(ii) notice of the facts and the law applicable to those facts, upon which the right is based.

Those elements of 'notice' include both actual and constructive notice, ie not only what the recipients did know but also what would have been discovered if proper steps had been taken. The 'proper steps' required depend on the context – for a » bank with the benefit of highly experienced IPs, the steps might have included making further enquiries or seeking specific advice to determine whether a proprietary right existed.

Practical issues and headaches

While the fairly unique and extreme circumstances of *Sinclair* are unlikely to be repeated, in the light of *FHR* there is undoubtedly greater scope for proprietary rights to disturb the normal course of asset realisation and distribution. It may be

> "The court concluded that neither the receivers nor the banks had notice of a proprietary claim."

tempting for an insolvency practitioner to rely on the high threshold to be put 'on notice' as set out in *Sinclair*, and not to go looking for the facts and seeking legal advice that might support a claim. However, sticking one's head into the sand would be a dangerous option for an insolvency practitioner to take, particularly as Lord Neuberger openly embraced the supremacy of a simple and coherent rule in all such cases over and above the interests of creditors generally.

Short of direct evidence that a bribe or secret commission has found its way into an insolvent estate, some 'red flags' to look out for include:

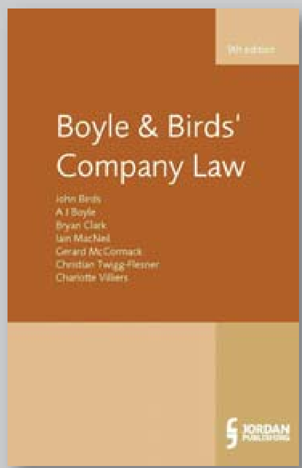
(i) agreements that establish an agency relationship, or explicitly refer to a party acting in a 'fiduciary' capacity;
(ii) groups of companies that may involve entities not under the control of the IP, but were (or still are) under the control of former common management;
(iii) specific assertions of proprietary rights by a third party – do not ignore if the alleged equitable owner of the property (ie the claimant), the nature of the right claimed and the exact property in question are all clearly identified; and
(iv) more generalised assertions of claims by a third party – although even if they do not meet the requirements to put an IP on notice, consider carefully whether further investigations should be made and advice sought.

Beware of unintended consequences remains a good watchword. Lord Neuberger's aim of achieving 'simplicity' may lead to greater complexity in resolving the conflict between trust creditors and estate creditors! ◻

With thanks to Ian Fox of Dentons for his assistance in preparing this article.

> "Sticking one's head into the sand would be a dangerous option for an insolvency practitioner to take."

NIGEL BARNETT is the head of the London restructuring practice of Dentons.



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- **Publisher** Jordans 2014
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Boyle & Birds' Company Law

A rarely found balance between theory and practice is struck by the editors of this book to produce a work that is of value and interest to both academics and practitioners.

Possibly the most up-to-date book to cover the breadth of company law, this edition has been updated throughout to include recent case law and changes to legislation. The chapter on *Legal Personality: Its Consequences and Limitations* in particular provides a careful analysis of the shifting nature of incorporated bodies through the recent case law on piercing the

> "A work that is of value and interest to both academics and practitioners."

corporate veil, while the changes to the public offering of securities and admission to trading on regulated markets brought about by the reform of Part VI of the Financial Services Markets Act 2000 and the impact of the Financial Services Act 2012 are also helpfully summarised.

The chapter on *Corporate Reconstruction and Insolvency* will be of particular interest to insolvency practitioners. It provides a helpful guide to the law and procedure that operates in this area, running to over 100 pages of thorough explanation and analysis, flagging key issues for consideration along the way and carefully examining the ambit of insolvency practitioners' powers and duties. This edition has also been updated to provide a review of the ongoing development of the administration procedure and the rise of pre-packaged administrations.

The excellent chapter on *Shareholders' Remedies* also deserves a mention as a very valuable starting point for legal practitioners advising on breaches of directors' and shareholders' duties, a topic dealt with less comprehensively in rival texts.

Boyle & Birds' Company Law therefore remains, with this new edition, one of the leading texts on company law, covering the topic in greater breadth and depth than many similar works and doing so in an exemplarily readable manner. ◻

VICTORIA PRINCE is a paralegal at Memery Crystal LLP.

Guidance on IPs' duties to identify ROT stock

Richard Clark takes a more in-depth look at the recent decision of the Bristol District Registry of the High Court in the case of Blue Monkey Gaming Ltd.

Blue Monkey Gaming Limited v. *Hudson & Others* [2014] All ER (D) 222 provides useful guidance for insolvency practitioners on the extent of their duties in respect of identification and preservation of retention of title (ROT) stock.

What was the case about?

This case concerned an action for conversion brought by MDM Machines Limited against the administrators of a company called Frankice Limited in respect of gaming machines supplied under alleged retention of title terms. There was no dispute that the ROT terms had actually been incorporated into the contract.

Frankice's group (Agora) was placed into administration in 2009, the proposals being to trade the business until a buyer was found, to produce both rental income from Agora's series of amusement arcades and to realise capital sums from the sale. MDM wrote to the administrators in June 2010 (five months before the eventual sale took place) regarding the return of machines supplied (some £1.8m being owed), and sought a declaration of ownership while – all the while – continuing to supply Frankice with new machines. The expectation was that a purchaser would ultimately pay for the machines supplied. The administrators confirmed that they would not have permitted Frankice to purchase machines for its own account, as the trading of the administration was being conducted at a loss, and it was only due to the potential purchaser's demand for newer, more attractive machines to improve the group's position that drove those orders.

In June 2011 (after the sale) MDM brought an action for conversion against the administrators personally, alleging that the administrators had caused Frankice to use the machines to the benefit of the administration, and that the machines had not been delivered up when requested. Prior to the hearing, MDM itself went into liquidation, and its claims were assigned to Blue Monkey Gaming.

The court was asked to decide the issue of conversion, Blue Monkey alleging that circa £4m owed.

What did the court decide?

The court found against Blue Monkey. The key findings of fact included that:

> "The machines had been permitted to be used through the administration at no cost."

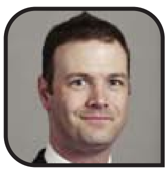
i) the administrators were never personally in possession of the machines;
ii) Frankice had been in lawful possession of the machines until December 2010 when the business was sold;
iii) it was not the administrators' job to identify the claimant's assets, and they were able to reject ROT claims on the basis of incomplete evidence. Although administrators should offer supervised access to identify the goods, it is up to the claimant to be clear and specific about the goods to which it is claiming title.
iv) MDM had not clearly identified its assets, and had not unequivocally demanded the return of the machines. The letter evidencing that request had not identified the specific goods, and that letter (combined with MDM's subsequent conduct in continuing to supply goods) made clear that the request was merely posturing on MDM's part rather than a genuine attempt to reclaim its goods. The court observed that MDM had in fact allowed the goods to remain on site precisely because they expected a better return by allowing the goods to be sold to a third party than through their return.
v) MDM could have made an application under para 43 of Sch B1, to the effect that future use of machines would be subject to their being treated as an administration expense, but had not done so. On the contrary, the machines had been permitted to be used through the administration at no cost.

What does this mean for practitioners?

This case does not create anything in the way of new law, but is a useful reiteration of some core principles. It is easy to lose sight of the wider issues when considering ROT, by focusing simply on the question of incorporation of the relevant terms into the contract for supply of goods. Four major hurdles still remain, namely:

i) identification of goods (especially with 'simple' rather than 'all monies' ROT clauses, where goods have to be identified by reference to particular purchase orders or invoices);
ii) separation of the goods in question (a facet of identification, but more of an issue where generic goods – capable of being confused with other goods of the same type – have been supplied);
iii) the goods have not been onward-supplied/sold or incorporated into other goods (ie cannot be removed, or at least not without damaging the goods into which they have been incorporated) and
iv) a clear revocation of the express or implied permission to on-sell combined with an unequivocal demand for the return of the goods. Many suppliers know about incorporation of contract terms and identification/separation of goods issues; however, on the last point, there is often a margin for doubt, especially where supply continues in the hope that a purchaser of the business will 'see the supplier right'.

In any event, the decision will provide comfort to IPs that there are boundaries as to their responsibilities, and that there is more to ROT than simple incorporation of the contract term.



RICHARD CLARK is a senior associate at Burges Salmon LLP.

Technical update

The Cape Town Convention and the financing of 'aircraft objects'.

An interesting recent consultation that may not have come to everyone's attention concerns the Cape Town Convention on International Interests in Mobile Equipment (the Cape Town Convention).

The Cape Town Convention, together with its Protocol on Matters Specific to Aircraft Equipment, aims to reduce the cost of raising aircraft finance by reducing the risk to creditors of lending to airlines and leasing companies. The treaty establishes a harmonised international legal framework for the creation and registration of international interests (such as mortgages and leases) in helicopters, airframes and aircraft engines over a certain size and engine capacity ('aircraft objects' in the language of the Protocol). The Convention and Protocol provide a framework to deal with any disputes arising under the treaty such as the ability of creditors to recover their aircraft object should there be a default on repayments and the remedies available to creditors while a court considers a creditor's claim. In addition, the treaty enables interests to be registered against aircraft engines separately in an international register, something that is not possible on the UK's National Register of Aircraft Mortgages where interests against aircraft engines must be included as part of an aircraft mortgage.

Article XI of the Protocol deals with remedies on insolvency, and is optional – a contracting state may declare that it will apply the provisions of the Article when it ratifies the Protocol. The Article contains two alternative sets of provisions (Alternative A and Alternative B), either one of which must be applied in its entirety if a contracting state declares that it intends to adopt Article XI.

> "The treaty enables interests to be registered against aircraft engines separately in an international register."

Following a call for evidence in July 2010, the UK government announced that it was committed to ratifying the Convention. In May 2014 The Insolvency Service held a round table discussion on the merits, or otherwise, of adopting Article XI, and this was followed in June by a Department of Business, Innovation and Skills (BIS) consultation document on options for implementation of the Convention as a whole.

Alternative A

Under the provisions of Alternative A of Article XI, on the occurrence of an insolvency-related event, an insolvency practitioner or debtor must either give up possession of the aircraft object to the creditor or cure all defaults and agree to perform all future obligations under the relevant transaction documents by the end of the specified waiting period. If under national insolvency law a creditor is entitled to possession prior to the end of the waiting period, that right is retained by Alternative A. Alternative A also requires the insolvency practitioner or the debtor to preserve the aircraft object and maintain it and its value in accordance with the transaction documents until possession of the aircraft object is given to the creditor.

Alternative A does not require a creditor to obtain permission from the court before taking possession of the aircraft object at the end of the waiting period. Under Alternative A, until the creditor has been given the opportunity to take possession of the aircraft object, the creditor can apply for any other forms of interim relief available under national law.

If an insolvency practitioner or debtor cures all defaults and agrees to perform all future obligations and fails to do so, a second waiting period does not apply and the creditor is entitled to immediate possession of the aircraft object.

Where a creditor takes possession of an aircraft object, the remedies of deregistration and export of the aircraft object are available and the registry authority must make these remedies available within five working days of notification from the creditor that they have a right to these remedies.

At the end of the waiting period, a court in a contracting state cannot suspend, prevent or delay any of the remedies for enforcement of an interest over an aircraft object permitted by the treaty. Furthermore, the national court cannot vary any of the terms of the agreement between the debtor and the creditor without the consent of the creditor. Thus, a national court is precluded from exercising some of the powers that it has under national law and any automatic stay under national law that is inconsistent with Alternative A will not apply.

> "If the IP or debtor failed to give notice of their intention the court could permit the creditor to take possession of the aircraft object upon such terms as the court ordered."

Under Alternative A, no interest or right has priority over registered interests, except any non-consensual rights of a category declared by the contracting state under a different part of the Convention. In the UK this would include a possessory lien in respect of work done on the aircraft, any right to detain an aircraft pursuant to an Act of Parliament.

Alternative B

Alternative B would require the insolvency practitioner or the debtor to give notice to the creditor, upon the creditor's request, whether they will cure the defaults and perform all future obligations or give possession of the aircraft object to the creditor within the time period specified in the declaration. This is subject to any additional steps or guarantee that a court may order. If the insolvency practitioner or debtor failed to give notice of their intention, the court could permit the creditor to take possession of the aircraft object upon such terms as the court ordered. The aircraft object could not be sold pending a decision by the court.

The main differences between Alternative A and Alternative B are that under Alternative B the recovery of the aircraft object has to be initiated by the creditor and recovery of an aircraft object requires a court order, which may include conditions imposed at the court's discretion. Alternative B does not make available the remedies of de-registration and export of the aircraft object on an expedited basis. Furthermore, under Alternative B, the creditor has to provide evidence of its claim and proof that an international interest has been registered.

The majority of respondents to the 2010 call for evidence cited the adoption of Alternative A as, economically, the most important provision in the treaty and argued that adopting Alternative A with a waiting period of 60 days would provide greater certainty that creditors could recover their aircraft objects. The majority of respondents to the call for evidence thought that this would lower the cost of raising aircraft finance, particularly in the capital markets. According to BIS, the majority of contracting states that have ratified the treaty have adopted Alternative A with a waiting period of 60 days.

Other respondents to the call for evidence stated the adoption of either alternative is not necessary in the UK since UK insolvency law is robust and well established and would not be improved by adopting either alternative. In addition, the majority of creditors are able to recover their aircraft object within 60 days through the courts.

No respondents to the call for evidence were in favour of Alternative B, so there is no intention to adopt it. The question therefore boils down to whether the UK should adopt Alternative A, or simply retain existing insolvency law.

Both at the round table meeting, and in its response to the consultation, R3 argued against the adoption of Alternative A.

R3 argued that the adoption of Alternative A would in effect create a separate insolvency regime for airlines, since the use of aircraft equipment is integral to the operation of airline businesses and the changes in the manner in which the security over aircraft equipment can be enforced would fundamentally change the shape of the regime for airline insolvency. There was no strong argument for treating airlines as a special case for the purposes of insolvency law, as, unlike the businesses for which special regimes have been introduced, such as financial institutions and utilities, there is no lack of alternative suppliers and no systemic risk presented by an airline insolvency.

Financing

The argument that insolvency law should favour one group of financiers because it would make it easier to obtain financing has also been made before: on behalf of banks when resisting the abolition of administrative receivership. There appears to be no reason why the policy decision to reject that argument in the case of banks should not apply to aircraft equipment financiers.

The suggested justification for adoption is that it would make access to aircraft financing easier for UK airlines. At the round table meeting, it was suggested that this would be the case because most aircraft financing is carried out in US dollar transactions by US based financiers and the parties taking the credit decisions are familiar with the US treatment of security over aircraft equipment, which mirrors the provisions of Alternative A. Under the US system the trustee has a breathing space of 60 days to decide whether to cure any defaults, during which period s362, the famous automatic stay provision, applies, and will continue to apply if the defaults are cured within that period (see s1110 of the US Bankruptcy Code). However, it emerged from those discussions that in commercial terms, the treatment of the secured party under US law is arguably worse than is the case under English law. It was stated that under US law there is no requirement for an insolvent airline to pay for the use of aircraft equipment during the standstill period before the airline has to decide whether to confirm the finance contract and make the contractual payments. Under English law, any aircraft equipment used by an airline during its insolvency would have to be paid for as an expense of the insolvency process (either an administration expense or a liquidation expense). Accordingly, although under English law secured creditors do not have a fixed period of moratorium before which their security can be enforced, they do have a high level of assurance that the costs associated with the use of aircraft equipment during the administration will have to be met.

> "R3 argued that the adoption of Alternative A would in effect create a separate insolvency regime for airlines, since the use of aircraft equipment is integral to the operation of airline businesses…"

Another reason put forward in favour of the adoption of Alternative A is that the level of understanding by finance providers of the regime relating to aircraft equipment where Alternative A or a similar system applies (as in the US) means that airlines with weaker balance sheets are nonetheless able to acquire financing. This raises the policy question of whether the UK government wishes to adopt a regime that arguably has the effect of downgrading the need for airlines to have strong » financial fundamentals. This would seem to run counter to the current culture of airline regulation. In the USA, where s1110 has been in place for some time, there have been a significant number of Chapter 11 filings by airlines. In contrast UK airlines have thus far stood up well even during the recent severe financial downturn.

UK airlines

Any analysis of the insolvency position relating to security over aircraft equipment operated by UK airlines would also have to take account of the fact that most of this equipment is internationally mobile and the UK is subject to the EC Regulation on Insolvency Proceedings. It is not open to the UK unilaterally to modify the EC

> "Under US law there is no requirement for an insolvent airline to pay for the use of aircraft equipment during the standstill period."

Regulation. It is not clear whether the UK adoption of Alternative A would extend to provide a moratorium against enforcement against aircraft equipment in other jurisdictions particularly in EC member states (other than Denmark).

It is also doubtful whether the 60 day moratorium period under Alternative A would be sufficient to allow the implementation of a rescue or reorganisation in administration. If that is the case, the inadequacy of the period would be likely to increase the bargaining power of aircraft finances in a restructuring enabling them to achieve a better outcome as against other creditors than is currently the case. It is also possible that the knowledge that they will be able to recover the financed equipment in a relatively short period, if the moratorium is likely to be too short to achieve a rescue, may encourage financiers to hold out against an informal restructuring.

Furthermore, there is a danger that that the obligation to cure existing defaults after the 60 day period (which it appears would extend to pre-administration defaults) would further distort the UK regime in favour of aircraft equipment financiers to the detriment of other creditors. The costs involved can often be substantial if they include accumulated maintenance costs, and this would both elevates the lessor's claim to super-priority and deprive unsecured creditors of further funds.

For all these reasons R3 is not in favour of the adoption of Alternative A. If nonetheless the UK government is minded to adopt Article XI, consideration might be given to appropriate changes in domestic insolvency law to ensure that UK airlines that enter insolvency are not disadvantaged. In particular, this could be a statutory modification of the provisions relating to administration and liquidation expenses, which would deprive parties financing aircraft equipment of the right to payment for the use of that equipment during the standstill provided by the protocol.

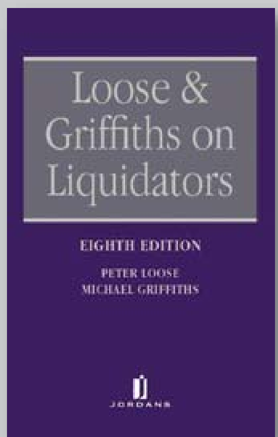
It is also important to note that even if Alternative A is adopted, the parties to a transaction can agree that the insolvency provisions will not apply. This raises the unhelpful prospect that in an airline insolvency some aircraft equipment may be subject to Alternative A and some may not; different regimes could apply to the same aircraft. If domestic insolvency law were modified to take account of cases where Alternative A applied as suggested above, it is likely that the existing regime would

> "It is doubtful whether the 60 day moratorium period under Alternative A would be sufficient to allow the implementation of a rescue or reorganisation in administration."

need to be retained for cases when Alternative A was contracted out of. If in fact the existing UK regime does provide a better commercial outcome for financiers than Alternative A (with the suggested removal of liability to pay for the equipment during the moratorium) financiers may be incentivised to opt out of Alternative A in any event.

At the time of writing, the government's decision on Article XI is still awaited. □

MIKE WOOLLARD is a partner at King & Wood Mallesons LLP.



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Loose & Griffiths on Liquidators

An invaluable source of guidance and information for everyone undertaking liquidations and, in my view, essential reading for anyone considering JIEB. Presented in an easily accessible

> "Essential reading for anyone considering JIEB."

and understandable format, the content provides both practical and up-to-date advice on all areas of liquidation law, which is clearly referenced to source material such as case law and regulatory updates. Even for those of us who have dealt with numerous liquidations over the years this book will prove a valuable point of reference and provide useful insight on many issues. The book also includes copies of statutory forms (useful to have in one place) as well as more practical documents such as templates for letters to employees and third parties; draft minutes of meetings and checklists. In a time of ever-increasing compliance and focus on best practice, easy access to practical assistance and guidance for all the team is essential. □

CAROLINE STARK is a restructuring and insolvency manager at Mercer & Hole.

Legal Q&A

Dominic Offord and Emma Taylor answer your insolvency queries.

Q I am an administrator of a company. The director shareholders believe the company's collapse was connected with interest swap agreements that had allegedly been mis-sold to the company by a bank. I do not want to bring the claim against the bank in the company's name and the directors want me to assign the claim to them for a very modest amount of money. Can I be compelled to assign the claim to them?

It is not uncommon for administrators to assign claims that belong to the company in administration. A claim is an asset of the company that can be realised for the benefit of its creditors. The power to assign can be found in paragraph 1 of Schedule 1 of the Insolvency Act 1986 (the act).

The circumstances in which an administrator may be ordered by the court to assign a claim were recently considered in *Hockin* v. *Marsden* [2014] EWCH 76. In that case, the directors and ultimate shareholders of the company in administration applied to the court under

> "It found that it was unnecessary to prove that the administrator has acted perversely or in bad faith."

paragraph 74 of Schedule B1 of the act for an order directing the administrator to assign an interest swap claim to them. The consideration offered was £5,000 together with 10 per cent of any compensation received. The application was made on the grounds that the administrator had been acting unfairly so as to harm the interests as members/creditors of the company.

The court ordered an assignment on the terms offered. It found that it was unnecessary to prove that the administrator has acted perversely or in bad faith (the test for challenging a liquidator's conduct under s168 of the act). Instead the applicants had to show that (as members or creditors) they had been harmed by the decision. The claim was not vexatious and although the sum being offered was small it was not derisory. The judge held that the claim should be assigned as otherwise the opportunity to realise one of the company's assets would be lost.

You should therefore consider the merits of the claim with your lawyers. If the

claim is vexatious then, as a matter of public policy, it should not be assigned. If the claim is not vexatious you should consider the terms offered and whether better terms can be achieved by offering to assign the cause of action elsewhere. If the director shareholders' offer is the best offer available, and no higher price can be negotiated with them, then you would be expected to assign the claim to them if otherwise it would be lost. However, you should first demand a personal indemnity to protect you against any adverse costs order.

Q I am a proposed liquidator of a company entering into CVL. My appointment depends on the vote of one particular creditor. That creditor has returned its proof of debt and a proxy form but these were not received until after the midday deadline stipulated in the notice convening the section 98 meeting. What should I do?

Generally, proofs and proxies that are not lodged within the prescribed time limits cannot be admitted for voting at a meeting of creditors.

However, where a creditor's vote is considered significant, the chairman has a discretion to adjourn a creditors' meeting to another date (rule 4.65 of the Insolvency Rules 1986). This will allow creditors who have not returned their proofs and proxies on time a further period of up to 14 days within which to do so. Any proofs and proxies already lodged for the original meeting can be retained for use at the adjourned meeting.

Alternatively, the chairman of a creditors' meeting has a discretion to accept a late proof if he thinks fit (*Painter* v. *Hutchinson* [2007] EWHC 758 (Ch)) or to allow a creditor to vote without lodging a proof if he is satisfied that this failure was due to circumstances beyond its control. Even if a creditor's claim can be accepted in this way that creditor would still need to attend the creditors' meeting in person or arrange for another party to attend in its stead in order to effectively cast its vote.

If a proxy has already been submitted (albeit out of time) a creditor would first need to withdraw that proxy in order to attend the meeting and cast its vote. In *Re Cardona* [1997] BCC 697 it was held that a creditor who is entitled to appoint a proxy is also entitled to revoke that proxy at any time prior to the relevant creditors' meeting.

> "That creditor would still need to attend the creditors' meeting in person or arrange for another party to attend."

If the creditor in question is a company it may, by resolution of its directors, authorise a person to act as its representative at any such meeting. That person would then be able to exercise the same powers on behalf of the company as if it were an individual creditor. In this scenario, a separate proxy is not required; however, a certified copy of the relevant resolution should be produced to the chairman of the meeting.

While changes were proposed to simplify these rules, disappointingly, those measures have not been incorporated in the eagerly awaited draft Insolvency Rules 2015. Until further steps are taken to modernise these procedures, the old rules will continue to govern and dictate the steps necessary for a creditor to be entitled to vote. ◻

DOMINIC OFFORD is head of insolvency & corporate recovery at Browne Jacobson LLP.

EMMA TAYLOR is a solicitor in the insolvency & corporate recovery team at Browne Jacobson LLP.

Recent case summaries

Two corporate insolvency updates from **Daniel Lewis**.

Corporate insolvency 1

***Re Brilliant Media Specialists Limited*, unreported 23 September 2014**

The application concerned an attempt by a motivated creditors' committee to limit the administrators' remuneration. The administrators' proposals were for a short administration of no more than six months; the creditors' committee were eager for the administrators to complete the administration as quickly as possible and thereby to limit the investigatory work of the administrators. The registrar made a number of comments about the extent to which creditors can dictate terms to administrators by limiting their remuneration.

Facts: There was a pre-pack sale of the company's business upon the appointment of administrators. Proposals first presented to creditors after two months envisaged the company remaining in administration for such period as the administrators thought necessary and appropriate and that the company would then move into creditors voluntary liquidation (CVL) (with the administrators as liquidators). Those proposals were not accepted by the creditors, who wanted the administration to be completed speedily and for liquidation to commence as soon as possible with different office-holders. Revised proposals were then approved two weeks later, which provided for a six-month time limit to the administration, following which the company would be placed into CVL with different office-holders. Despite some problems along the way (including an application to remove the administrators that was not proceeded with), ultimately the company was placed into liquidation on 12 August 2012.

> "It is for the office-holder to decide how the administration should be conducted."

The view of the creditors' committee was that the trading of the company and the pre-pack sale should be investigated by independent office-holders. The six-month period was intended to ensure that the minimum practical and administrative steps were taken to ensure a speedy exit from administration and the commencement of those investigations by an independent liquidator. They therefore

contended that a large amount of the work carried out by the administrators had not been intended to be performed as part of the administration, and refused to agree remuneration aside from that necessary to bring the appointment to an end.

Held: On the application of the administrators under r2.106 to fix their remuneration, Mr Registrar Jones held that, while the views of a creditors' committee should be taken into account, it is for the office-holder to decide how the administration should be conducted. It followed that the administrators were entitled to remuneration for work carried out regardless of the stated intention that the company should be placed into CVL as quickly as possible. Further, the court had jurisdiction to approve remuneration, notwithstanding that the work in question fell outside the scope of the proposals although it should not normally do so. The court did not address post-appointment remuneration, for work performed at the request of the subsequent liquidators, which it did not have jurisdiction to fix under r2.106 and which was exclusively a matter between the former administrators and the liquidators.

Corporate insolvency 2

***Re Business Environment Fleet Street Limited* [2014] EWHC 3540 (Ch)**

This case concerned an application by administrators for leave under paragraph 68 and 72 of Schedule B1 to dispose of assets. The question was whether administrators could override third parties' claims to assets, the sale of which would achieve considerable 'marriage value' with the company's assets.

Facts: The company owned two properties through which serviced office accommodation was provided to customers under subleases. There was a services agreement between the company and the respondent companies (which were part of the same group), by which the respondents were to provide services including the operation of the serviced offices within the properties. The company's lenders subsequently appointed administrators to sell the properties subject to the subleases under which the serviced office accommodation was let.

The company itself had no employees: the respondents provided the equipment and staff necessary for the servicing of the office accommodation. The administrators sought leave to dispose of goods said to be subject to a chattel leasing arrangement under paragraph 72. Alternatively, they sought relief under paragraphs 67 and 68 of Schedule B1, by which (i) they were required to take possession of property to which they thought the company was entitled and (ii) they were required to administer the 'affairs, business and property' of the company and comply with any directions given by the court.

Held: In construing the agreement between the company and the respondents, Mr David Halpern QC (sitting as a Deputy Judge of the Chancery Division), held that the respondents retained possession of the assets and that they were therefore not available to be sold by the administrators under paragraph 72.

> "Such a conclusion would also confer an exorbitant jurisdiction on administrators…"

The arguments under paragraphs 67 and 68 were also rejected. It was accepted that paragraph 67 contained no requirement that the administrator should have a reasonable ground for believing that the company was entitled to the property in question. Nevertheless, paragraph 68 did not extend the power of disposal of property to that which the company is not entitled even if there was a reasonable ground for believing that it was. Such a conclusion would also confer an exorbitant jurisdiction on administrators to convert property belonging to third parties. Although s234 protects an administrator from third party claims arising from third-party claims, it does not go so far as to provide the administrator with licence to convert third-party property, still less so where the administrator merely thinks subjectively that the property belongs to the company. □

DANIEL LEWIS is a barrister at 3 Hare Court.

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Email: samantha.taylor@willis.com

Sadie Clarke
Client Service Director – North/Scotland/N.I
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Email: sadie.clarke@willis.com

Andrew McIntosh
Client Service Director – Midlands/South
Mobile: +44 (0)7944 918542
Email: andrew.mcintosh@willis.com

Alan Stockdale
Client Service Manager – North/Scotland/N.I
Mobile: +44 (0)7908 995891
Email: alan.stockdale@willis.com

Nick Christie-Rundle
Client Service Manager – Midlands/South
Mobile: +44 (0)7956 306416
Email: nick.christie@willis.com

The practicalities of dealing with intellectual property rights

Brett Israel and **Pippa Hill** detail some key points for IPs.

An incontrovertible truth these days is that more companies than ever, across a greater range of sectors, own or depend on one or more forms of intellectual property right (IPR) for their business. When a company gets into financial difficulties, professionals asked to assist them, including insolvency practitioners (IPs), will inevitably have to get to grips with understanding not just what IPRs the company owns or depends on, but also the terms and conditions governing their use and/or exploitation.

> "Seek to understand what you have."

Other articles in this edition of *RECOVERY* examine some of the more technical, legal issues that concern IPs, but this article considers various practical issues that can generate both unexpected and far-reaching ramifications for IPs. We will consider these with some examples that amply demonstrate the potential risks of underestimating (or under-investigating) the rights and assets you think you might have.

Understanding what you have

The starting point on appointment (or, ideally, if feasible, beforehand) is due diligence – seek to understand what you have. In some businesses, particularly those with a strong brand in their own right, identifying the key IPRs and assessing their value should be relatively easy. However, even if IPR is not apparently a major asset class, an evaluation of the balance sheet and asset registers should identify any material IPRs. The 'post-appointment IPR checklist' [opposite] sets out various possible enquiries to be considered. Do not overlook that, particularly where there is an international dimension, it may also be necessary to instruct a trade mark attorney to carry out overseas registry checks.

Of course, as well as unearthing valuable IPRs owned by the company of which the IP would not otherwise have been aware, this exercise should help to identify whether there are IPRs that the company does not own but which are nonetheless mission critical for its business, especially for any proposed period of trading.

Self-evidently, such rights may be licensed to the company. The issues that arise from this are examined later. A related point from the other end of the telescope is that the company may also have licensed out rights to third parties. This presents the potential benefit of a (perhaps unexpected) royalty stream, though this in turn may need to be assessed against any ongoing maintenance or development-type obligations that the company may have contractually undertaken pre-insolvency (and that might render the licence disclaimable in a liquidation).

The crucial due diligence investigation process should also contemplate two other classes of potential interested party here: directors and employees and IP 'trolls' and cybersquatters.

- Particularly where employees or directors have been involved with the company since its early 'start-up' stage, and perhaps before employment contracts were put in place, IPRs like patents and registered designs may well be found to be registered in the name of their inventor rather than the company itself. The central question here will be whether the IPR was developed in the ordinary course of the director's/employee's employment in which case it should, legally, belong to the company. It should be possible to negotiate the transfer/assignment of such rights to the company, but there is clearly scope for such person adopting a potentially expensive leverage position;

> "The crucial due diligence investigation process should also contemplate other classes of potential interested party…"

- Trolls and cybersquatters are entities that seek out the gaps left by big brands in registering their IPRs. They often register patents, marks or domain names for themselves and then seek ransom payments from companies (with whom the underlying products or brands are closely associated) that subsequently wish to use (or reserve) them for their own benefit.

It is not unknown for trolls and cybersquatters to take a particular interest when a company enters an insolvency process, taking advantage of the situation to swoop on any 'loose' domain names or IPR registrations that have lapsed, expired or been overlooked. If a buyer acquiring the IPRs of the insolvent company negotiates a retention for any IPRs that are not successfully transferred to it, this kind of situation could ultimately affect the amount realised from the sale. Ultimately, however, provided the troll or cybersquatter has only 'squatted', and not infringed the insolvent company's rights by registering any interest or domain name, there is likely to be little the IP can do other than to seek a commercial deal to buy the relevant rights.

> "Are there significant royalty or other payments due?"

Maintaining licence arrangements and registrations

Having (hopefully) identified the company's IPRs, the IP will next need to review carefully, ideally with specialist legal advice, the terms of all licence arrangements. The starting point will always be the extent to which the licences terminate automatically on the company's insolvency (or on unrelated, but applicable grounds) or have become terminable at the counterparty's discretion. The analysis should extend both to rights on which the company is reliant (granted by third-party owners or immediate licensors) and whether the company has the benefit of any licences that it has granted to others.

The purpose of the former category is to understand what the cost/liability position is: for instance, are there significant royalty or other payments due; has the company undertaken costly maintenance or development obligations; is there a significant portfolio of ongoing registration/renewal fees payable? In the latter case, the company might actually have a potentially unexpected windfall asset in the form of royalties receivable the receipt of which the IP would want to preserve and, if necessary, enforce.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

The IP will carry out a cost/benefit analysis to assess the merits to creditors of maintaining licence rights in place against the costs (financial and otherwise) of doing so. Ongoing costs related to preserving IPRs in place, such as registration fees or royalty payments, are likely to qualify as expenses of the insolvency, ranking ahead of the IP's own remuneration. Underlying this analysis will be whether any period of trading is planned and, if so, whether such licence rights are critical for that or will be

> "It may be important to maintain registrations and licences to retain or maximise the value of core assets"

a core component of the attractiveness of the business to any prospective purchasers. Even in a company where IPRs are a secondary asset, it may be important to maintain registrations and licences to retain or maximise the value of core assets.

The authors recently experienced a case in point. Acting for the buyer of assets and IPRs from a collapsed alcoholic drinks distributor that had entered administration, it quickly became clear that, while the core asset being acquired were significant stocks of wine, it would also be necessary to acquire (or license) certain brands alongside for, without doing this, the buyer would not have been lawfully able to on-sell the wine stock under those labels. The alternative would have been to remove all of the labels – which would have had a significantly detrimental effect on the values that could have been realised!

Post-appointment IPR checklist:

- Carry out searches of the registers held by the UK Intellectual Property Office, the European Office for Harmonization of the Internal Market, the World Intellectual Property Organization, and the national intellectual property registers for any jurisdiction in which the company has traded.
- Carry out a search of Nominet UK (whois.net) and any relevant national domain name registries to find out who owns any domain names from which the company trades.
- Consider whether the company might have any – potentially valuable – unregistered IPRs or quasi IPRs (such as copyright, database rights, unregistered design rights, company and/or trading names, confidential information and/or knowhow).
- Carefully check the company's asset registers and files for licence documentation and any correspondence that might relate thereto.
- Review the mortgage index at Companies House and any national company registries to determine whether security has been granted over any of the IPRs.
- Take control of any social media accounts that the company might have. Controlling these accounts may be a key way of communicating with the company's customers, enabling the IP to limit damage to the brand insofar as he can. Social media accounts may also provide a valuable list of customer contacts. IPs should familiarise themselves with the company's social media policy.

IPRs – the international dimension

With business being carried out on an increasingly global platform, in many insolvencies IPs will need to consider not just IPRs registered or used in the UK, but also throughout Europe (where registration may have been effected at the European Office for Harmonization of the Internal Market or at individual national registries) and beyond (where registration may have been effected at the World Intellectual Property Office, or indeed at multiple, individual national registries in specific jurisdictions). In the case of an insolvent company with an international reach, the IP will need to consider whether he has the ability to use any brands or other IPRs he might need in one or more jurisdictions. This may entail both assessing what registrations have been made (and their current status) as well as a review of all applicable licence terms.

Returning to the drinks distributor, and having acquired certain brands, our client wished to start a sales and distribution process in the Nordic region but was surprised to learn that a third party already owned the domain name it planned to use in Norway. It was forced to enter into negotiations with that party for the purchase of the name, but this did not prove to be a straightforward, speedy or cheap process.

Quasi IPRs

Besides the established registrable IPRs (trademarks, design rights and patents) and non-registrable rights (copyright, database rights and unregistered design rights), there are also various 'quasi' IPRs, most notably confidential information, knowhow and trade secrets. Goodwill is sometimes thought of as a 'quasi' IPR too (though that is a more contentious classification).

What is clear, however, is that such rights are potentially more elusive than others – not only are they not registrable, but they are less clear cut legally and intrinsically mobile! Regardless of the legal niceties that can be debated, these types of rights often raise fiendishly difficult issues in practice. The key concern will always be that much of such rights may reside within the minds of one or more of the company's employees – and they are free to walk away taking what might be absolutely crucial technical data and operational knowhow with them. In many cases, the comparison may be made with a piece of hardware that may be rendered all but useless without the software and/or the technical operational skillset needed to operate it. In such cases, the IP may well be forced over a (ransom) barrel by circumstances that dictate that he has to keep such employees on board no matter what (or how much it costs) for at least a period of time.

Peering over the edge...

It is no coincidence that some of the biggest ticket litigation cases in recent years both in the UK and elsewhere have involved IPRs, particularly in the technology and pharmaceuticals space (the multiple *Apple* v. *Samsung* trials around the world spring to mind). These encapsulate the lengths that IPR holders and owners will go to preserve their rights and the inherent commercial values involved.

> "Distressed stocks of branded clothing acquired from bust retailers have to have their labels removed manually before resale"

IPs will do well to avoid the threats of litigation and other grave sanctions if they cross the biggest, most assertive rights owners. They have legal teams that issue ultra-robust 'cease and desist' letters at the drop of a hat. Mention was previously made of the threat of labels having to be removed from wine bottles. Distressed stocks of branded clothing acquired from bust retailers are routinely sold cheaply on eBay, but have to have their labels removed manually before resale if the wrath of the rights owners (and severe sanctions) are to be avoided. If material is produced or distributed in breach of licence or ownership rights, it is not unusual not only to be told to cease such infringing action, but also to provide demonstrable evidence that the relevant production line equipment and tooling has been destroyed (so it cannot be used again)!

BRETT ISRAEL is a partner at Wragge Lawrence Graham & Co LLP.

PIPPA HILL is a senior associate at Wragge Lawrence Graham & Co LLP.

Licensed brand rights in insolvency

Bree Taylor considers both sides of the licensing coin.

The legal position in relation to brand rights in an insolvency will depend upon two key factors:

- Is the insolvent company the licensor or the licensee?
- Is the process an administration or a liquidation?

Licensee

A licensee of brand rights going into an insolvency process usually has two options:

(a) Continue to pay licence fees and use the licensed brand rights; or

(b) Fail to pay licence fees and stop using the licensed brand rights.

Because most licences provide a right to terminate by the licensor on the insolvency of the licensee, option (a) is usually dependent on the agreement of the licensor. The administration moratorium will not prevent the licensor from exercising contractual rights of termination, although it might prevent the licensor from taking repossession of any property that has been leased to the licensee under a hire purchase agreement as part of the arrangement, for example computer equipment or machinery (see the principles in *Re Atlantic Computer Systems plc* [1992] Ch 505).

> Many brand licences contain restrictions on assignment and sub-licence by the licensee.

The licensee might opt for option (b) if the licence is not critical to its business. This will leave the licensor with an unsecured claim for damages for breach of the licence. The damages would usually include a sum equal to all of the licence fees to the end of the licence period (subject to the licensor's duty to mitigate). Many brand licences contain restrictions on assignment and sub-licence by the licensee and so licensed rights are usually only capable of realising value for the creditors of the licensee if licence fees are all paid up to date *and* if the licensor specifically agrees to an assignment or sub-licence by the insolvent licensee.

Licensor

Where a licensor goes into an insolvency process, this may have no practical effect on either party. It is not usual for a brand licence to be determinable on the insolvency of the licensor and so the licensee will generally be obliged to continue performing and paying licensees as usual provided that the licensor continues to perform any contractual obligations it might have under the terms of the licence. If the licence is determinable by the licensee on the insolvency of the licensor, the administration moratorium will not prevent the licensee from exercising this contractual right.

Some brand licences provide for termination by the licensee on a change of ownership or control of the licensor or of the licensed intellectual property rights. This means that a sale of the underlying intellectual property rights by the insolvency practitioner appointed over the licensor might not be achievable without a loss of the licence and the income stream generated by it.

If the licence contains onerous provisions for the licensor, for example, an obligation as to marketing or promotional activities at its own cost, a liquidator of the licensor does have the right to disclaim the licence as onerous property under s178 of the Insolvency Act 1986. This does not bring the licence to an end and the licensee may continue to use the licence brand rights subject to it performing its own obligations. The disclaimer operates so as to release the licensor from its obligations but it does crystallise a claim by the licensee for any damages suffered as a result of the licensor's failure to perform. Such claim will be an unsecured claim against the insolvent licensor.

An administrator does not have the power of disclaimer. An administrator of a licensor may opt, however, to cease to observe the terms of the licence leaving the aggrieved licensee with a right to terminate and/or an unsecured claim for damages.

> Some brand licences provide for termination by the licensee on a change of ownership.

Sometimes licences contain provisions entitling one party or the other to acquire intellectual property rights on the insolvency of the other party or vesting such rights in one party. If the effect would be to upset the *pari passu* distribution of the estate, they are likely to fall foul of the anti-deprivation principle and will thus be unenforceable.

BREE TAYLOR is a partner at Memery Crystal LLP.

The real story of a business

Paul Hemming on metrics in the leisure sector.

Valuing a business is, at least in theory, a fairly straightforward process of calculating the present value of all future cash flows. But how simple is this to derive in practice, given the diverse nature of company operations? What are the metrics that tell the real story of a business?

The reality is that every valuation requires an understanding of how the target company matches up to its peers in the market. By understanding the sector in which the company operates, the valuer can focus on the specific key metrics for that market and the impact they will have on the quality of future earnings and likely future cash flows. Without this knowledge, critical factors may be missed or incorrectly assessed.

The leisure sector has its own specific key valuation metrics that depend on a deep understanding of the market to provide a real-world valuation. Areas for particular caution include financial forecasts, estate issues and operational metrics.

Outlook and projections

Informed buyers look at more than just sales, gross margin and headline earnings before interest, taxes, depreciation and amortisation (EBITDA) when evaluating a pub, bar or restaurant business. One of the first challenges is to examine the integrity of management's financial forecasts in order to separate the hopeful from the realistic.

> "Areas for particular caution include financial forecasts, estate issues and operational metrics."

Management forecasts, particularly in turnaround scenarios for leisure businesses, are usually predicated on an improvement in sales following a period of capital investment. To evaluate the turnaround plan the obvious focus is on historic return on capital, but in restructurings there has often been little recent investment to evaluate. You are therefore left with understanding market level return on capital for similar businesses, which requires real sector knowledge. The trading assumptions around the performance of the uninvested section of the estate can be benchmarked against the competition or against market trackers such as the Peach Tracker.

Even top performing sites should be evaluated in the light of the level of current

and potential competition in that location. The speed of development in many towns means previously successful trading areas can find themselves off pitch when new developments open. Competition is a key factor, especially in the casual dining space. Here, although consumer spend is relatively static, the number of new sites opening means competition has never been more intense and this threat needs to be factored into the assessment of future performance.

Estate/portfolio considerations

The larger pub companies operate predominately freehold estates, but the majority of other leisure businesses operate from leasehold premises. In most leisure restructurings, the problem stems from the fact that a 'tail' of underperforming sites has grown up within the business as a result of a lack of investment.

A leisure business in particular needs to continually invest across its estate in both maintenance and refurbishment capital expenditure. If not, performance and staff morale quickly deteriorate. Such 'tail sites' reach a tipping point when performance falls significantly as a result of prolonged underinvestment. These sites then take up a disproportionate amount of management time compared with the earnings that they generate. When considering the value of a leasehold estate the calculation of site EBITDA should take into account maintenance capital expenditure to reflect the fact that this expenditure is not optional, but a mandatory part of the future success of the business.

If the business being valued is in distress, we always consider the break-up value alongside a full company value. If the site portfolio includes a tail of underperforming venues then we reflect the cost of exiting these sites, whether solvently or insolvently, and the separate value of the rest of the business.

Operational metrics

Although there is a consistent set of metrics to consider for every sector, each sub-sector will have its own characteristics. For instance, when considering a casual dining business, typical metrics will include gross margin, staff costs and spend per head. Concerns would be raised by a gross margin of less than 70 per cent, and staff costs in excess of 35 per cent would also be an issue. Spend per head varies with the type of operation but a low or reducing spend per head with high staff costs is indicative of a poorly run operation or possibly significant discounting.

Many restaurants use discounting to increase visitor numbers but examining discounting in restaurant businesses is not immediately straightforward. Accounting for discounts is not consistent across the industry, with some companies including it in the gross margin calculation and others including the costs in marketing/operating expenses. This affects comparison of gross margin and operating costs.

Site-specific metrics also play an important role. For leasehold sites these include rent cover, where EBITDA below two times rent is a potential problem and rent as a percentage of sales typically

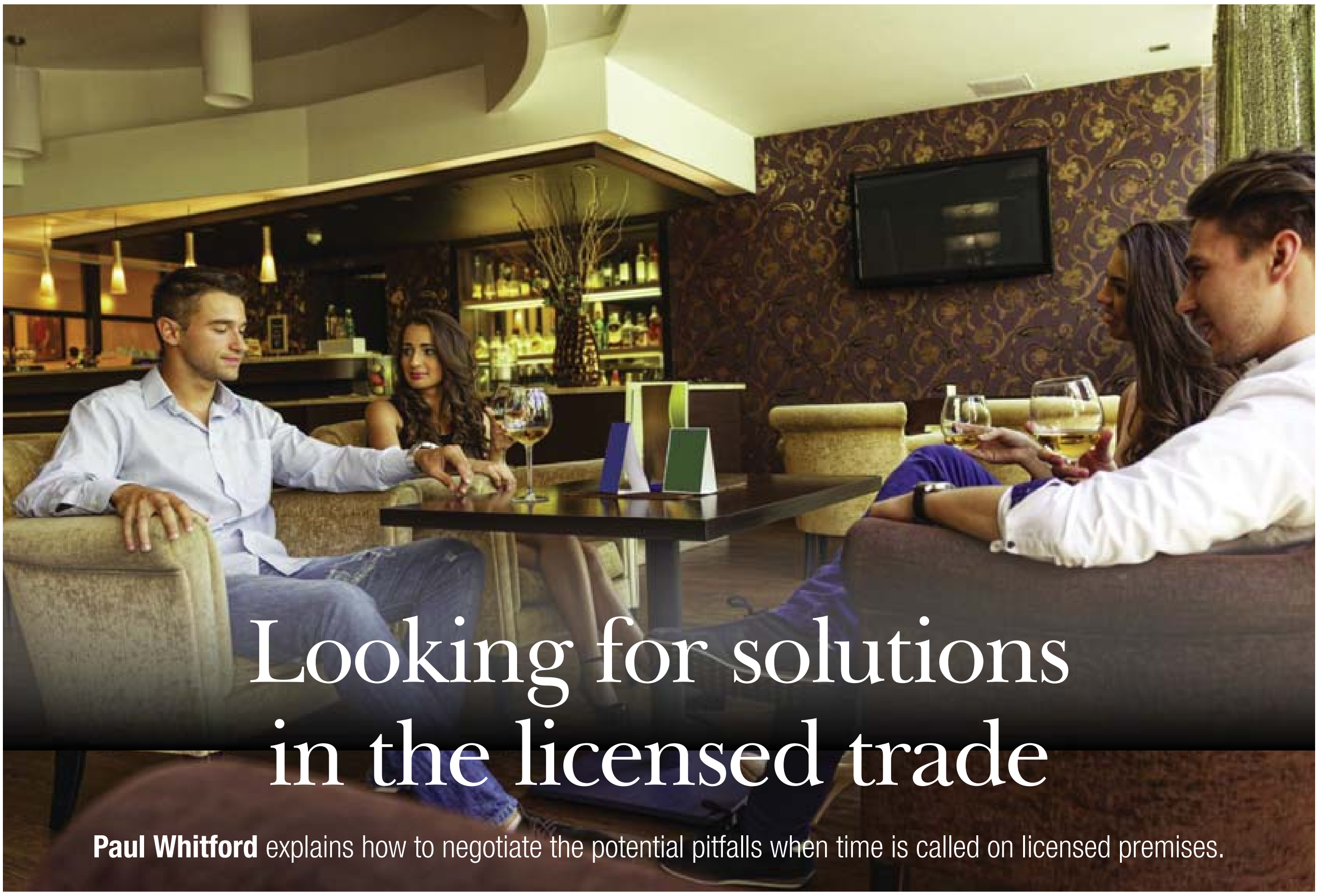
> "A low or reducing spend per head with high staff costs is indicative of a poorly run operation or possibly significant discounting."

becomes a concern when it rises above 15 per cent. Clearly these are general metrics and specific situations may justify an anomaly but this shows the complexity of the valuation process.

Acquirers will also have a target level of head office costs, typically five to seven per cent of turnover for a steady-state estate, meaning some head office cost reductions may also need to be taken into account.

These are just some of the many factors that need to be considered when determining the potential value of a business in the leisure sector. By combining sector expertise with sound financial analysis principles, the valuation will provide an independent view that takes into account the real story of a business as seen through the eyes of a knowledgeable buyer. ◻

PAUL HEMMING is a partner and head of corporate finance and the leisure sector at Zolfo Cooper.



Looking for solutions in the licensed trade

Paul Whitford explains how to negotiate the potential pitfalls when time is called on licensed premises.

When the global recession first manifested itself in 2008, one of the sectors in which it immediately became very visible was the licensed trade. Initially it was leasehold pubs and chains that suffered with many entering court appointed processes and others simply being closed. The sad sight of shuttered premises in high streets and villages became increasingly commonplace over the following period. With little appetite among potential purchasers, very few chains survived intact with the very best being cherry picked out and the remainder being either sold on to operators at much reduced prices or to developers with plans for change of use.

> "The sad sight of shuttered premises in high streets and villages became increasingly commonplace."

With this initial flurry running its course for two or three years, the next segment to hurt was that of hotels. In the first instance, it was high-profile, high-end names that suffered with a good number of prestige establishments entering administration and, following often significant periods of operation, being sold on for well below initial estimates. The high end quickly gave way to the mid-market sector with a large stock of two and three star hotels being similarly afflicted. Again, there was limited appetite among purchasers, many of whom were naturally keen to avoid leveraging themselves further when their own core properties were finding trading conditions particularly challenging.

Slow recovery

Five or six years on, the volume of licensed trade businesses entering administration has reduced as the economy slowly recovers. However, it is evident that, although financial institutions may have taken care of the most serious cases within their loan books, there are still many pubs, hotels, restaurants and other related licensed trade entities that are weighed down by large pre-recession loans.

There is a strong feeling among commentators that many licensed trade businesses are part of a so-called 'zombie' cadre. Struggling to make interest payments, owners are operating right at the limit of their borrowing facilities, often having to manage cash flow on a daily basis simply to ensure the continuing flow of supplies. Not only does this mean that there is little or no prospect of them making capital repayments (particularly if interest rates rise in due course), it also suggests that little or no cash is available for capital expenditure, the life blood of business development in the hospitality sector.

At first sight, the licensed trade appears to be very accessible in terms of gaining an insight to how it functions. Whether on business or pleasure, we all visit pubs, restaurants, hotels and other licensed operations on a very regular basis and are, as a consequence, relatively familiar with both the environment and the way in which business is carried out. However, while the retail nature of trading in the sector is relatively straightforward, it perhaps goes without saying that the operational imperatives, financial constraints and key performance indicators are certainly more complex.

As such, operators require significant experience, manpower and access to a wide range of complementary expertise to ensure that their product continues to attract and satisfy today's increasingly fickle and demanding customers. In terms of trading within a court ordered process,

> "There is a strong feeling among commentators that many licensed trade businesses are part of a so-called zombie cadre."

this places significant pressure upon insolvency practitioners (IPs) and their teams both in terms of resource allocation, industry knowledge and, as ever, liability.

In addition to employment and health and safety, particular areas of concern to appointment holders include online revenue generation and management, consistent management information (imperative for both control and the sales process), supply chain management, recruitment (in what can be a high labour turnover environment), licensing and merchant services.

There is clearly, therefore, an argument that says that specialist industry expertise is required both to safeguard the appointees and the interests of the lender. Experience has shown that the latter often insists upon the appointment of such specialists to protect and develop these kinds of assets. In addition, given the management-intensive nature of the sector, the modern-day complexity of revenue generation and the economies of scale required to drive down supplier prices and the like, it is almost always more cost effective for an IP to outsource licensed trade projects.

Experience and expertise

Licensed trade operators used to consume paper by the rainforest; however, the advance in technology over the last ten years has seen the operations of businesses evolve at considerable pace. Hoteliers, in particular, have never had it so good with a huge range of information now available at their fingertips via highly sophisticated property management systems. An experienced hotel operator should have the expertise to extract the information (past, present and future) that IPs require to obtain a holistic picture of the business they are operating.

> "If the licence is allowed to lapse or is revoked, a brand new application is required, which will take a minimum of 28 days to be processed."

The engagement of a specialist operating team should not only ensure that such expertise is available but, critically, also facilitate negotiations with systems/software providers in the event of administration. It is clearly imperative that the business maintains service to site and (in many cases) to third parties via channel management (online distribution), so preventing an impact on trading potential. With many systems being cloud rather than local server based, disconnection often results in zero visibility of reservations – with no paper back up!

Following the insolvency of a hotel, it has become customary for online travel agents or third-party providers (eg Laterooms, Booking.com and so on) to immediately suspend service until commission arrears are settled. In many cases the provider will insist on personal guarantees from IPs in order to continue service. However, having a third-party operator to adopt and manage contracts on their behalf is almost always a quick and effective way to circumvent this issue.

Of all the administrative tasks within the licensed trade sector, the most time and resource-consuming task for IPs is the generation of accurate management information (MI) to share with both lenders and prospective purchasers. Experienced third-party operators with first-hand industry knowledge will offer bookkeeping, accountancy and payroll services and, in many cases, be capable of generating trading and cash flow forecasts. With lenders requiring regular updates and the ultimate goal being the sale of the asset, it goes without saying that the provision of robust MI to prospective, knowledgeable purchasers is of paramount importance.

The same applies to the supply chain for pubs, clubs, restaurants, hotels and other licensed trade venues; having the operator directly contract supply is clearly a turnkey solution, particularly as most will have existing agreements in place with suppliers and service providers that take advantage of national, bulk-purchasing discounts. Not only can this improve margins across the board, it also eradicates ransom payments to incumbent suppliers.

Leadership and staff

The removal of directors from office on appointment will often leave sites heavily exposed, particularly smaller properties where a director may double as the landlord/general manager. Leadership, control and focus are obviously at risk and the supply of an experienced replacement at short notice is often a priority. Operating companies will normally have a network of temporary landlords, general managers and chefs (to suit different styles of operation) available at short notice to solve these kinds of problems.

Unless some kind of Opco/Propco arrangement is in place, operators will not generally contract directly with hotel employees – such contracts would usually be with the insolvent company although appointee exposure is generally mitigated by the operator ensuring that contracts limit risk and that the employer's obligations are fulfilled. Alternatively, most operators have arrangements with employment agencies that allow staff to be taken on in a third-party capacity.

Similarly, while health and safety matters within the business remain the ultimate responsibility of the IP, a strong operator will provide support in this field to ensure the property remains compliant and to facilitate statutory requirements.

Licence holders

Responsibility for holding a premises licence, the core asset of any licensed trade business, has become increasingly onerous. Several other government agencies now use the premises licence holder as a reference point for ensuring compliance and revenue collection in other areas, including gaming machine permits/notifications, environmental health, machine games duty and marriage/civil ceremonies licences.

If the licence is allowed to lapse or is revoked, a brand new application is required, which will take a minimum of 28 days to be processed. Such a process can be both costly and time consuming and, in many cases, this can result in the imposition of conditions of trade, further restricting business operations. Even if a site is closed, it is vital that the premises licence is protected to maintain asset value.

Consequently, the premises licence holder is at risk from much greater exposure and faces the danger of incurring fines or prosecution for non-compliance. Having an operator hold the relevant licences is therefore, in all honesty, a very easy decision for appointees.

Payment and services

In a world where cash is disappearing as a means to pay for goods and services, the ability to accept debit and credit card payments, in person and online, is extremely important. Many IPs will have experienced the discomfort of finding that, on appointment to a business, its merchant account services have been withdrawn and that, even with long and patient negotiation, are only restored on the basis that six months of transactions are withheld.

There are thankfully a few licensed trade operating companies that have fully flexible arrangements with merchant account providers that enable them to provide card terminals to sites at 24 hours' notice. Not only does this ensure cash flow

> "A few licensed trade operating companies have fully flexible arrangements with merchant account providers that enable them to provide card terminals to sites at 24 hours' notice."

at a critical time, it also ensures that the appointees are not obliged to sign up to highly restrictive terms and conditions in order to be able to trade. Without this facility, some otherwise profitable businesses are obliged to close, simply because their cash flow is cut off on day one.

The licensed trade covers a very wide range of business segments and therefore demands skill sets that can almost certainly only be provided by specialist operators. Over the last six years, lenders have increasingly indicated that they prefer such assets to be operated by professionals with direct industry experience. IPs have similarly taken this view, not least due to the fact that their personal liability is significantly mitigated in a number of key areas, but also because it almost always provides a cost-effective solution. ◻

PAUL WHITFORD is a director of Licensed Solutions Ltd.

Outsourcing expertise and the risks involved

From duck farms to licensed premises, IPs have to deal with it all.

These days, if a business is not sold via a pre-pack – thus avoiding many of the costs and risks of trading – it is likely that some or all of the obligations connected with that business will be sub-contracted out to third parties specialising in licensing, retail sales or whatever it might be.

In this article, I briefly look at some of the areas of a leisure business that are regularly contracted out by insolvency practitioners (IPs), the legal issues that arise in those circumstances and how IPs can best protect against those issues.

Lack of expertise and personal liability

The great thing about what we do is variety. We all have the skills, knowledge and experience based around the insolvency legislation that we deal with every day. However, what keeps it interesting is how we apply that skill, knowledge and expertise to the businesses and sectors we come across.

One day we could be dealing with a football club and the next, a duck farm – or maybe I have been unlucky in my experiences! The point is that we are experts in restructuring/insolvency, not necessarily the industries and sectors we operate that expertise in.

> “In order to sell alcohol on premises, a party must be licensed by the local licensing authority.”

It is entirely understandable therefore that we should seek the advice and expertise of those who do specialise in those areas. However, the common theme to this article, and I am sure what is closest to all IPs’ hearts, is the question of personal liability and how to protect against it.

IPs are remunerated for what they do, but often that remuneration is only a fraction of the financial risk they take on in fulfilling their role, so clearly they don’t want to increase that risk by putting that role in the hands of third parties.

Licensing

In order to sell alcohol on premises, a party must be licensed by the local licensing authority. In the context of corporate insolvency, that licence will be held in the name of the company and will lapse pursuant to section 27(1) of the Licensing Act 2003 if the company goes into an insolvency process.

IPs must apply to the relevant licensing authority within 28 days of the insolvency process to transfer or dispose of the licence, failing which it will lapse. If the IPs want to transfer the licence, the application should be copied to the relevant police authority.

The party taking on the licence can be the IPs, although if it is, they will become responsible for observing the conditions of the licence and will potentially be liable for criminal offences should the terms of the licence be breached.

IPs often therefore apply to have the licence transferred to a professional agent who specialises in dealing with licensed premises so they can take over management of the premises and continue operating the licensed business. However, the IPs will need to understand clearly what liabilities the agent is prepared to take responsibility for as the licence holder and on what terms.

Health and safety

The Health and Safety at Work etc Act 1974 is the primary piece of legislation covering occupational health and safety at work. The act sets out the general duties employers have towards employees and members of the public, including obligations on companies to provide written policies, assess risks to employees and third parties, and various other provisions.

> "IPs will need to understand clearly what liabilities the agent is prepared to take responsibility for as the licence holder and on what terms."

Pursuant to section 37 of the act, directors and company officers can be charged where it is proved that an offence by the company under the act was committed with their consent, connivance or neglect. This wording suggests that IPs who continue to trade run the risk of prosecution if that company commits a health and safety offence, albeit that the act provides protection for those who have not had an historic involvement with the business.

This is an obvious area where IPs could benefit from sub-contracting these issues to a third party with expertise. However, that third party would still be acting as agent of the company and, if the IPs were aware that either the company or its agent were acting in breach of the provisions of the act, the IPs would remain at risk of prosecution. So the IPs need to satisfy themselves that the agent is keeping the company within the parameters of the act.

Retention of title (ROT)

As with any trading business, stock is likely to have been supplied under retention of title (ROT) provisions. Whether those provisions work and are valid will depend on the circumstances. However, if the business is being traded by an agent, that stock is going to be used in the course of trading.

IPs would usually have systems in place to deal with the attendance of ROT claimants for the purpose of them identifying stock, and to then assess the strength of the ROT clause and the ROT claimant's position.

The risk for IPs is that, if a ROT claimant has a valid ROT claim over stock and that stock is sold, the IPs can be personally liable for the tort of conversion in converting those goods, most probably into cash, which is then mingled with other funds in the company's trading account(s).

Such risk can be mitigated by undertakings in respect of the application of the invoice value of the stock, segregation of the proceeds, or potentially segregation of the stock. However, where an agent is instructed to trade a business in an insolvency process, the IPs are likely to have less visibility on the whereabouts and dealings with stock that may be subject to a potential ROT claim.

Employees

It is unlikely that an agent trading a business will want to take responsibility for a company's employees, but would rather want to ensure that that responsibility remained with the company and its IPs. From the IPs' perspective, as recent press coverage has shown, the treatment and consultation with employees can be an area fraught with difficulty and potential liability.

While employees remain employed by the company in an insolvency process, certain discriminatory claims can fall at the feet of IPs personally and therefore IPs have a vested interest in retaining control of interaction with a company's employees.

Arrangements between IPs and agents should therefore make it clear that the employees remain employed by the company and the responsibility of the IPs, and to the extent that it will indemnify the IPs accordingly if the agent breaches those provisions. And if the agent intends to employ its own agency employees, the arrangements should also make it clear that responsibility remains with the agent.

Practical considerations

I have identified above a selection of the various areas where the instructing of an agent can be of great benefit and cost saving to IPs. However, there are also a number of areas that can give rise to personal liability and risk on IPs and, as set out above, the sub-contracting of obligations to a third party will not remove the threat of personal liability for IPs.

The third party will usually be an agent of the company, as the IPs will be, but the difference is that the IPs will be officers of the court with executive functions in respect of the company. The agency arrangements entered into with third parties therefore need to be as clear as they can be as to the respective roles and obligations of the third party and the IPs, particularly around what the agent can bind the company to and what it can't.

This is particularly relevant in respect of any argument that the agent's activities give rise to them incurring expenses under the insolvency legislation. On the face of it, this should not be possible and it should be made clear that the agent is acting as agent of the company, not on behalf of the IPs. But, to the extent that such an argument is raised, the IPs will want to be comfortable that the exposure is budgeted for and can be repaid.

Where the IPs anticipate risk and personal liability arising as a result of the agent's actions, the IPs should look for indemnity protection from the agent, where possible, recognising that it is a commercial relationship, which will hopefully have cost benefits to the IPs and the estate.

The agreement should be clear on its duration and the ability of the IPs to terminate to avoid circumstances where the IPs are incurring personal liability and/or are in breach of their statutory duties and obligations due the agent's actions.

> "Thought needs to be given to the ability of the agent to abscond with the money..."

To the extent that the agent is using premises rented by the company, the IPs need to be alert to the obligation to pay rent as an administration expense in respect of premises occupied for the purpose of the administration and therefore be happy that the agent will give up occupation, if required, and are properly protected if it fails to do so.

If the agent is handling company money, the arrangement needs to make it clear the basis on which that money is being held with regular reporting. Additionally, thought needs to be given to the ability of the agent to abscond with the money and/or the agent going into an insolvency process. The IPs should also be comfortable the agent has satisfactory insurance in place to cover the risk arising from its activities.

Conclusion

Agents can be a valuable and cost-saving resource for IPs in the current market that we are in. However, IPs need to remember that agency arrangements do not remove risk or personal liability in certain circumstances and therefore those arrangements need to be drafted appropriately.

NEIL SMYTH is a partner at Taylor Wessing LLP.

The final whistle

What happens when the future of a community sports or social club is put into doubt?

Many of us in our leisure time, through our own or our children's activities, will get involved in a variety of sports or other social clubs. The constitution of such clubs will take a variety of forms, be they limited companies or unincorporated entities; in addition, some will be registered as charities with the Charity Commission. The one attribute that they are likely to have in common is that they are run by volunteers. Finding such volunteers is becoming an increasingly difficult exercise, with fewer people being prepared to take on the role due to a combination of a lack of time and the potentially onerous responsibilities. This reluctance often puts greater pressure on those who are prepared to get involved. At a time when finances have been squeezed due to the impact of the recession on personal budgets, which in turn has affected club funds, the combination of pressures can bring the very existence of some sports and social clubs into doubt.

"On the face of it, there was a sizeable pot of cash in a sinking fund."

Recently the trustees of a community sports club who were facing such problems approached me. In many respects, it was just a straightforward case of a limited company needing to be placed into creditors' voluntary liquidation. While the company was limited by guarantee, a review of the memorandum and articles of association revealed nothing that would cause complications and prevent us from putting the company into liquidation. Likewise, nothing in the trust's constitution threw up any particular problems.

Responsibilities

The committee of management was made up of volunteers, who were busy professional people with only a certain amount of time to commit to the organisation in question. While the trustees were all accepting of their responsibilities and the need to ensure that matters were dealt with in a professional and timely manner, it was difficult to get all the relevant people together at the same time to make important and necessary decisions about the trust continuing to trade. The situation was not helped by the fact that former members of staff, who were not available to provide the level of assistance required, retained much of the detailed knowledge of the operation of the company.

Over a number of months, issues had arisen about the club's location and about certain employees, which had had a significant impact on the club's finances. Resources were therefore in short supply and the ability of potential benefactors to provide additional funding was being rapidly exhausted. While fees for the new term were due, some already having been received, they alone would be insufficient to see the trust through the new term. Taking in the fees therefore was a risky option and limited the courses available to management. Consideration was given as to whether the club's activities could be resurrected within a new club; however, the lack of facilities and funding meant this was not a realistic alternative.

Taking legal advice

With a decision taken by the committee of management that the trust had no option other than to cease to trade, the next hurdle was whether there were sufficient funds to enable the company to be put into liquidation. On the face of it, there was a sizeable pot of cash in a sinking fund but the question was whether such funds could be used to pay for the costs of a liquidation. We were told that the trust had been required to keep such funds in a separate account in joint names of the trust and a third party, but this had not been done. It was clear that legal advice would have to be taken to determine whether the trust or the third party had entitlement to those funds, and that without a decision the liquidation process could not begin.

As with many insolvencies, closure of the business meant a number of unhappy former employees – the jobs lost ranging from the paid management of the trust to the coaching staff – at a time when alternative employment would not be easy to come by. However, the most voluble creditors were the parents of the children who had paid for the term's fees up front. Those who had paid fees by credit cards were able to try to recover fees from the card providers, but the majority had paid in cash with no prospect of recovery. While the amounts involved were small in real terms, the loss of such amounts to those involved and the impact on their children's activities led to an exercise in managing their concerns and expectations. The impact on the local community was such that it was also a matter of interest to the local press.

"The most voluble creditors were the parents of the children who had paid for the term's fees up front."

Fortunately, emotions were calmed, sense prevailed and we negotiated a compromise with the third party laying claim to the funds. It was agreed that a proportion of the funds could be used to cover the cost of the liquidation irrespective of any subsequent legal decision as to the true entitlement to the funds. As a result, the club's life was brought to an orderly end and the community turned to other providers in other locations for their sports facilities.

PETER GODFREY-EVANS is a partner at Mercer & Hole.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

Arms, IPs and the sea

Alan Taylor examines the issues when dealing with licensed weaponry during the liquidation of a failed private maritime security company.

The recent failure of the established private maritime security company (PMSC) Gulf of Aden Group Transits has highlighted the difficult state of this once-burgeoning market. Other companies in this sector have failed in recent months and more are set to, as downsizing and consolidation affects the industry. There are a number of unique problems facing a liquidator appointed to administer the failure of a PMSC, which by its very nature will be a case of international insolvency crossing many borders. The most obvious is that of the situation facing the human operatives that may have been deployed anywhere across a vast geographical area. However, for the liquidator this may not be the most difficult or complex problem to be faced. Such companies deploy kits of weapons and equipment that are strictly controlled, which cannot be disposed of as easily as other assets. This article explores the nature of the PMSC industry and focuses on the problem of dealing with licensed weaponry and controlled items of equipment facing a liquidator.

> “Behind this human story there is another headache for the liquidator.”

The private maritime security industry

On 29 July 2014 *The Independent* newspaper was one of many news sources to report that a prominent PMSC Gulf of Aden Group Transits (GoAGT) had ceased trading.[1] The article focused, as most others around the same time did, on the plight of the many operatives that GoAGT had deployed to deliver their security services – that of providing armed teams on board commercial vessels in the Gulf of Aden/Indian Ocean region to protect them from attacks by Somali pirates. With the collapse of GoAGT, around 100 operatives were left on various assignments at various stages of their voyages across a region that stretches from Egypt at the top of the Red Sea to Sri Lanka in the Indian Ocean, and from South Africa to the Persian Gulf. However, behind this human story there is another headache for the liquidator engaged to deal with GoAGT's affairs – one that will face any liquidator engaged to

> “Such companies deploy kits of weapons and equipment that are strictly controlled, which cannot be disposed of as easily as other assets.”

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

deal with the collapse of a PMSC in the future: what to do with, and how to deal with, the various items of weaponry and equipment owned and used by the PMSC, spread across a wide geographical area. As controlled items they cannot be simply sold on to another company on liquidation as other assets could, they cannot just be returned to the original supplier, and, they cannot easily be disposed of.

> In the same year 111 piracy incidents had led to 42 ships being seized by pirates.

Before considering the implications of such a company's failure it is important to understand the nature of the PMSC industry, its core business model, its rapid rise from 2008 onwards, and the current market collapse.

The rise of the private maritime security industry began in 2008 in response to the rise in Somali piracy. In the same year 111 piracy incidents had led to 42 ships being seized by pirates and by 2010 the annual cost of Somali piracy had been estimated to be as much as US$5bn.[2] In response, commercial vessels began to deploy teams of armed guards on board when operating in areas deemed to be at risk of pirate attack across the Gulf of Aden/Indian Ocean region.

PMSCs therefore provide equipped teams, of typically three or four ex-armed services personnel, plus firearms and additional equipment, on board a commercial vessel, such as a tanker or bulk carrier, while it undertakes a transit of the Gulf of Aden/Indian Ocean region. The team, weapons and equipment are taken on board at a suitable point at the beginning of a transit and then offloaded at another suitable point at the end of a transit. A vessel sailing from Europe to China, for example, would load the team and its equipment at Port Suez, Egypt and disembark them at Galle, Sri Lanka before continuing its voyage to China. Most transits were west–east/east–west or north–south/south–north focused but some could take a circular route, for example, from the Persian Gulf to the East Coast of Africa and back.

By 2012 the Security Association for the Maritime Industry (SAMI) reported that its membership alone was *…made up of over 100 maritime security providers…*[3] In the same year SAMI reported that PMSCs were charging in the region of US$5,000 per day for an armed team and that their use *…will only increase…*[4] Payment terms also favoured the PMSC with even the industry-standard *GUARDCON* contract including provision for advance payment of at least part of the fees and costs.[5]

Sadly, this growth proved to be unsustainable. The shipping industry has been under commercial pressure for a number of years with low income and reduced utilisation. A report by UNCTAD (the United Nations Conference on Trade and Development) in 2013 highlighted that *…the maritime sector continues to experience low and volatile freight rates in its various segments because of surplus capacity…*[6] Pressure to reduce costs filtered down to the use of armed guards and an article in *Shiptalk* in August 2014 noted that this had led to an *…unsustainable price war…* as PMSCs sought to secure continuity of business and to try to survive through the inevitable consolidation in the industry.[7]

The inevitable result will be the failure of other PMSCs in the future.

The licensing of firearms for use in private maritime security

The equipment provided consists primarily of firearms (semi-automatic rifles, sniper rifles, shotguns), ammunition, body armour and helmets, which are all controlled items. However, other items of equipment, such as, sights, range-finding equipment and night-vision goggles, can also be classed as controlled. Items of weaponry and so-called dual-use items are controlled under both EU and national law.

The European Union Council Directive 91/477/EEC recognises a requirement to control the possession and movement of certain items, and requires that such controls are enacted in member state laws.[8] These controls are enacted in the UK under the Firearms Act 1968, which is compatible with the requirements of the EU Directive.[9]

> PMSCs were charging in the region of US$5,000 per day for an armed team.

In order to hold, use and move firearms, a PMSC must hold a number of licences. To use semi-automatic rifles, the usual choice of weapon for a PMSC, as the working example: let's assume that the PMSC is licensed from the UK but may have weapons supplied from an arms dealer in the UK and/or another state such as Malta (arms dealers in Malta have provided many of the weapons used by PMSCs).

Semi-automatic rifles require an s5 licence under the Firearms Act 1968 to enable a person to carry such weapons on UK soil, which includes a commercial vessel sailing under the British flag.[10] Some PMSCs have provided protection to British-registered vessels and so may have gained such licensing.

However, no such licence is required if a UK PMSC is only providing armed security services to non-British-flagged vessels, which will apply to most PMSCs. In such cases, the weaponry used is held exclusively abroad and as such the PMSC must comply with the exporting rules of the supplying country. Most flag-states such as Panama, Singapore and the Bahamas have offered a pragmatic clearance to PMSCs to enable them to carry weapons on board their registered » vessels, often in violation of their national firearms laws, on the basis that they will always only ever be on board a vessel in a location remote from home soil.

Regardless of whether they hold an s5 licence, a UK PMSC will usually hold a registered firearms dealer licence (RFD) issued by their local police force under the provisions of the Firearms Act 1968.[11] Although not an s5 licence, this does allow a PMSC to carry out certain otherwise-prohibited tasks, such as the transportation of ammunition from the UK when necessary. One point to note is that the RFD is usually registered in the sole name of a nominated responsible person on behalf of the company and this is usually one of the directors.

In terms of the issuing of export licences for firearms to be used exclusively abroad, the rules vary between states such as the UK and Malta.

For weapons provided from the UK the firearms, and much of the accompanying equipment, fall under the trade controls defined and administered by the UK Department for Business, Innovation & Skills (BIS). The initial export is controlled under an export control order, as provided by the Export Control Act.[12] The PMSC is issued with a standard individual export licence (SIEL) to enable the export to a suitable receiving country, such as Oman (many weapons used by UK PMSCs were initially deployed through Muscat in Oman). The weapons would be deployed from the receiving country onto the initial vessel and would then be moved from vessel to vessel, being stored in state-controlled armouries when not in use, as and when required.

> "Items of weaponry and so-called dual-use items are controlled under both EU and national law."

The deployment of such weapons from the UK is also accompanied by an end user undertaking (EUU). This is an undertaking by the company (usually by one of the company's directors on its behalf) that the weapons are intended solely for use in maritime security operations. This documentation does not itemise the individual serial numbers of the weapons concerned, these must be held by the original supplying dealer.

If exporting weapons from Malta, the Maltese government implemented a system of licensing based on European Union Regulation 428/2009.[13] The Maltese government would issue an end user certificate (EUC), which details the use for maritime security and includes individual serial numbers of each weapon. This would allow the export of the weapons to the PMSC through a suitable point of deployment such as Oman.

The deployment of weapons into the field of operations is only the first part of the licensing requirements for UK-based PMSCs and any non-UK-based PMSC that is utilising British personnel. BIS continues to monitor and control the movement of such weapons around the Gulf of Aden/Indian Ocean region by virtue of its trade control licensing regime. Any weapon movement in/out of an armoury, on/off a vessel must be logged and can only be actioned if the PMSC holds a suitable trade control licence. Every PMSC is also audited by BIS annually to ensure that all the relevant paperwork/logs are being kept accurately and up to date.

In 2012 BIS started to issue an open general trade control licence (maritime security) (OGTCL) to PMSCs.[14] Referred to as the OGTCL Map, this licence details the many deployment/storage points that a PMSC is registered to use during its operations across the Gulf of Aden/Indian Ocean region. The Map will, therefore, document all of the armouries that the PMSC will use in places such as Port Suez, Galle, Muscat, Nairobi, and so on.

It is important to note that even weapons issued from Malta also fall under the BIS controls and so the requirements of the OGTCL Map.

At this point it would be useful to summarise the elements of licensing required to be held and maintained by a PMSC, and which would fall under the responsibility of the liquidator on the commercial failure of the PMSC:

- s5 firearms licence (if applicable)
- registered firearms dealer licence
- end user undertaking (UK weapons)
- end user certificates (Maltese weapons)
- open general trade control licence (maritime security).

As part of the liquidation process it is important that the appointed liquidator contacts BIS as soon as possible following the ceasing of trading of the PMSC to begin the process of administering the company's weaponry. The liquidator will assume all the responsibilities of the company's directors, including responsibility for the firearms, equipment and ammunition.

The location of every item of weaponry, equipment and ammunition should be ascertained and verified, whether deployed on-board ship or held in an armoury. All documentation should be up to date. If there are any gaps then the directors of the PMSC should be asked to provide an explanation and/or any supporting or missing documentation. On occasions floating armouries have been used outside the jurisdiction of a coastal state, but there should still be some form of record of such a transfer. Any use of ammunition should be logged whether used for weapons-testing or, as is possible, to fire warning shots in the case of an instance of attempted piracy.

The ownership of all firearms should also be verified. Some weaponry was deployed unpaid or part-paid and so commercial title to such assets could remain in whole or in part with the original providing dealer. However, it is important to ensure that all the necessary licensing and paperwork is processed before allowing the original dealer to regain possession of such weapons, individual items of which may be situated in different geographical locations.

> "The weapons would be deployed from the receiving country onto the initial vessel and would then be moved from vessel to vessel."

Weapons may be seized and/or destroyed by authorities that are holding them in lieu of unpaid storage charges. It is important that any seizure/destruction is accompanied by suitable certification that can be used to resolve the eventual fate of the weaponry post the use by the PMSC.

Finally, items can only be sold on to another company in conjunction with suitable approval and licensing with BIS and the jurisdiction of the receiving company's home state.

Complicated corporate structures

PMSCs are by their very nature multinational corporations; although they may be UK registered, the bulk of their operations may be undertaken abroad. There may also be a complicated corporate structure behind the main UK-based operational entity.

The *Southern Daily Echo*, for example, referred to GoAGT as Lymington based,[15] whereas, *Malta Today* considered the company Seychelles registered with at least one subsidiary company in Malta itself.[16] This highlights how complicated the corporate structure of a PMSC may be and the licensing may have been issued across one or more of the company's corporate entities.

EU-based international insolvencies are governed by the provisions of Regulation 1346/2000.[17] Non-EU international insolvencies are usually resolved under the UNCITRAL Model Laws.[18] Both employ the principle of the Centre Of Main Interest (COMI) to define where the main seat of the insolvency procedure should lie, and Establishments to identify other locations where a company in liquidation has a commercial presence.

> "The liquidator will assume all the responsibilities of the company's directors, including responsibility for the firearms, equipment and ammunition."

The COMI for a PMSC may be disputed on the basis of where the company's main point of control may lie, which could be argued to be where the weaponry that is key to the operation of the business is licensed/administered?

The complicated nature of a PMSC's operation across the vast Gulf of Aden/Indian Ocean region holds scope for many locations to be deemed as *Establishments* under the various rules for international/cross-border insolvencies. A further note on this is that many of the operatives were employed on a casual/contract basis and through locations abroad. Even if an operative was a UK citizen, they may have been registered offshore for tax and paid through an agent in a location such as Dubai, UAE. PMSCs will have also used agents/handlers in all of the ports that their teams visited and so there are likely to be many international creditors of the company.

Conclusions

There are many challenges facing the liquidator that is appointed to administer the affairs of a failed PMSC. Apart from the complication that the failure will, by its nature, be an international/cross-border insolvency, the liquidator will also be responsible for ensuring that the firearms, ammunition and equipment used by the

PMSC are dealt with and disposed of in line with the stringent requirements of its licensing.

Questions that a liquidator should immediately ask on taking over the affairs of a failed PMSC are:

- What licences are held?
- What items of firearms, ammunition and equipment are involved that are covered by the company's licensing regime?
- Where are these items?
- Is the necessary paperwork up to date? If not, what further information can the existing directors provide?
- Who owns what title to the items?
- What options are available for their disposal and what steps need to be taken to achieve them? ◽

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ALAN TAYLOR is a PhD researcher & associate lecturer at Lancashire Law School.

The Small Business, Enterprise and Employment Bill

What IPs need to know.

Of the 150 clauses in the Small Business, Enterprise and Employment Bill, 30 relate to the UK's insolvency regime. The government's aims for the insolvency clauses include:

- removing 'unnecessary' costs from the regime;
- increasing creditor engagement; and
- strengthening the regulatory framework of the regime.

R3 supports the aim of the bill, which includes measures that will increase confidence and transparency in the insolvency regime. There are also parts that will introduce changes that R3 has been demanding for some time.

However, there are sections of the bill that would contradict its aims. There are particular issues with the proposals on creditor engagement and financial redress for creditors, and there are instances where the bill could have unintended consequences or lacks clarity.

Creditor engagement

The need for greater opportunities for creditor engagement is something that's been highlighted by both the 2013 Kempson review of insolvency fees and creditor groups attending R3's 2014 policy round-table series. But, the Small Business Bill could undermine creditor power and influence.

There are five particularly troublesome clauses that the profession needs to be aware of:

- Clauses **110** and **111** would abolish the power of office-holders to hold a physical creditors' meeting without the backing of 10% of creditors;
- Clauses **112** and **113** would allow creditors to opt-in and out of receiving notices from IPs. Some tweaking is needed here to prevent administrative costs from ballooning for IPs; and
- Clause **121** would see the official receiver automatically appointed as the trustee in bankruptcies, which could make it trickier for creditors to have an IP appointed to handle a case.

While clauses 110 and 111 still allow IPs to hold virtual meetings (the clauses are designed to encourage the use of virtual meetings as a cost-cutting measure), the technology is not yet available for virtual meetings to be a satisfactory like-for-like replacement for physical meetings. According to the Federation of Small Businesses (FSB), 45,000 small businesses still rely on dial-up internet connections, which risks essentially precluding them from serious involvement in insolvencies if the bill were passed in its current form. Alongside R3, the FSB and the Institute for Credit Management have called for the creditors' meeting clauses to be amended.

Financial redress for creditors

As with creditor engagement, the bill's aims for financial redress are laudable: financial redress from directors to wronged creditors is a good thing. Unfortunately, the bill overlooks the fact that there are existing mechanisms for creditor redress and the bill's proposals could do much to disrupt the good work that is already done by the insolvency profession.

> "Alongside R3, the FSB and the Institute for Credit Management have called for the creditors' meeting clauses to be amended."

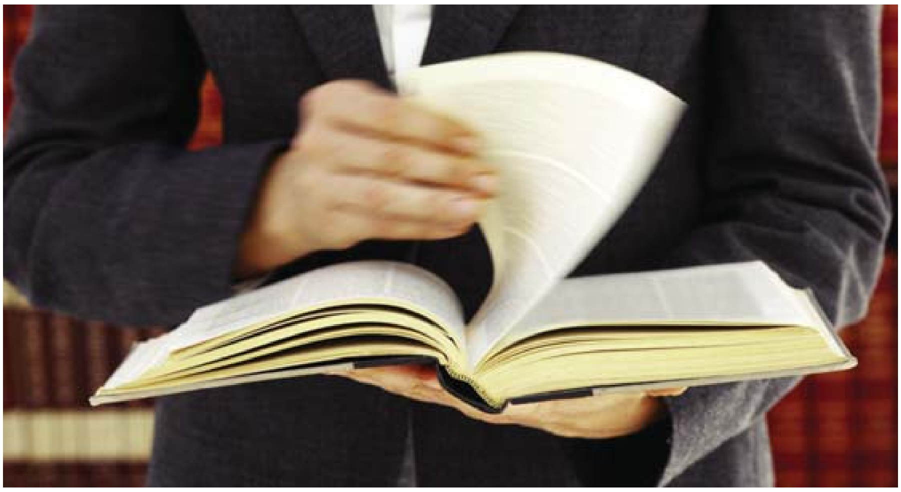
Clause 98 would introduce 'compensation awards' for creditors. The plan is that these would be awarded at the same time a director is disqualified – at the discretion of the secretary of state for the Department of Business, Innovation & Skills (BIS), and potentially to one particular creditor.

Each part of the proposal raises potential problems. The threat of compensation awards hanging over a director is likely to make them think twice about agreeing to a disqualification undertaking; these currently account for more than four in five disqualifications. More contested disqualifications would mean fewer successful disqualification proceedings and more harm to creditors in the long term. Meanwhile, asking the secretary of state to decide the level of compensation risks the process becoming inconsistent and would add to The Insolvency Service's workload.

Furthermore, making the awards payable to selected creditors would undermine the principle of equal treatment for all creditors that has underpinned UK insolvency law since the 16th century. Favouring select creditors could see those who 'shout the loudest' receive redress while others would lose out – again. If the redress proposals remain in the bill, R3 has called for the compensation to be placed back into the estate for the benefit of all creditors.

Then there are the problems with how the proposals would interact with the existing regime. Separate actions by the secretary of state and an insolvency practitioner could prejudice the other, while tweaks to the existing regime would be much simpler to pull off than the introduction of whole new redress mechanism.

The current system of IP-led actions returns several hundred million pounds a year to wronged creditors from directors, although roughly half of this is under threat by the Jackson legal reforms. A permanent exemption for insolvency



litigation from these reforms, rather than new financial redress powers for the government, would return much more to creditors every year.

The bill also includes powers for administrators to bring wrongful trading actions (clause 105) and the power for office-holders to assign claims against directors to third parties (clause 106). Although, given the wording of the two clauses, it's not clear how much of a practical impact either will have.

Lack of clarity

There are two topics on which the bill could be much clearer: the reserve powers relating to pre-packs and IP regulation (clauses 117 and 132 respectively).

The pre-pack proposals are potentially more problematic. Firstly, the clause would give the government the power to ban connected party pre-packs, which was explicitly not recommended by this year's Graham review. Secondly, it's not yet clear under what circumstances the reserve power would be used. And, lastly, the clause does not just propose to ban connected party pre-packs, but any kind of connected party administration.

Concerns over pre-packs aside, banning *any* connected party administration would be an unnecessarily extreme option for the government to pursue and would have a seriously negative impact on the UK's business rescue culture. R3 has called for the government to narrow down the scope of this clause considerably.

IP regulation

The bill gives the government the reserve power to introduce a single regulator for the profession. The implications are slightly similar to the pre-pack clause: it's not clear what the circumstances are in which this power would be introduced. Additionally, some of the wording in the clause, such as references to an undefined 'public interest', could be tightened up.

> "The bill gives the government the reserve power to introduce a single regulator for the profession."

Problems with particular clauses aside, there are plenty of positives in the bill. The Insolvency Service is getting beefed-up oversight powers to monitor the regulators, which should help improve confidence in the insolvency regime. There are also improvements to the director disqualification regime, with electronic reporting – a long-standing feature on the R3 wish-list – and recognition of overseas bans being brought in.

Backing a better bill

The government is keen to pass the bill before Parliament dissolves on 30 March 2015 and ahead of the general election, so time for parliamentary scrutiny is limited. But there's still a long way for the bill to go before it's finalised, so much could still change. R3 will be working closely with MPs, The Insolvency Service and the shadow BIS team to make sure the bill is changed for the better. R3 vice-president Phillip Sykes gave evidence to a committee of MPs examining the bill on 16 October. The bill is being debated by the House of Commons again in November and then by the Lords in December. Regardless of how much change there is, though, the bill will have a big impact on the profession's work. ◻

VICTORIA JONSON is director of communications and public affairs at R3.

R3's new microsite

R3 to launch a new microsite to assist unsecured creditors through the insolvency process.

R3's new microsite will feature a step-by-step guide that aims to help unsecured creditors better understand and engage in an insolvency procedure by providing information on key areas, such as how to file claims and how to get involved in a creditor meeting.

The 2013 Kempson Review on insolvency fees found that insolvency can often be a difficult and complicated situation for creditors. Those needing advice have limited sources, most of which are either overly technical, only explain certain parts of the process, or are not written from the creditors' perspective.

Working with creditor representative groups, including the Institute of Credit Management, R3 has developed the microsite to help address those issues and improve understanding, transparency and communication for unsecured creditors during an insolvency procedure.

The microsite will feature a range of tools including sections on frequently asked questions, a checklist for creditors and a glossary of common terms. Users will find links to useful contacts and sources of information from relevant government departments and regulatory bodies. The microsite also explains frequently misunderstood parts of the insolvency process, such as the IP's role and the position of unsecured creditors in the order of priority.

The site will be launched in the coming months. Please look out for the official launch in R3's monthly e-bulletin, and direct unsecured creditors to the site. The site can be accessed through R3's website at **www.r3.org.uk**. ◻

Getting to grips with IRHP mis-selling

Robin Henry gives an update on interest rate hedging products and how to deal with them in insolvency cases.

Judging by the number of insolvency practitioners who attended a recent R3 breakfast briefing on the thorny subject of how to deal with interest rate hedging product (IRHP) mis-selling claims held by insolvent companies, IPs are at last trying to get to grips with this issue. The FCA estimates that of 19,082 swap claimants in the FCA review, around 2,000 companies were insolvent or dissolved.

> "Act fast since in many cases the statutory limitation period for bringing claims may shortly be expiring."

That does not include other potential claimants who do not fall within the terms of the review and could still make claims in court. However, IPs may need to act fast since in many cases the statutory limitation period for bringing claims may shortly be expiring.

It became common practice in recent years for banks to offer IRHPs to companies and individuals taking out loans. The idea, sensible at face value, was to offer hedging protection against rises in interest rates. Various products were available, ranging from:

- caps, which provided a maximum limit on the interest rate payable;
- swaps, which would, for example, replace a variable interest rate with a fixed one;
- simple collars which provided both a ceiling and a floor to interest rates; and
- structured collars, which were similar to simple collars but under which the borrower may have been subject to increased interest rates where base rates fell below the floor.

In many cases, companies were required to enter into such products as a condition of the loan and the duration of the IRHPs often far exceeded that of the loan itself.

While interest rates remained relatively stable, the detailed provision of IRHPs did not give rise for concern. However, with the dramatic fall in interest rates in 2008/9 from five per cent to 0.5 per cent, thousands of borrowers found themselves required to pay interest rates that might be ten times the market rate. They then may have discovered that they were over-hedged or required to pay very substantial break costs in order to terminate the IRHPs.

Attention quickly turned to the question of whether the banks had adequately explained the risks and costs inherent in such products and the matter was taken up by the FCA, which subsequently found that over 90 per cent of IRHPs had been mis-sold. Following this finding, the banks concerned agreed to set up a review supervised by the FCA to determine whether compensation should be available to customers.

> "The duration of the IRHPs often far exceeded that of the loan itself."

The scope of the review has been criticised in some quarters as unduly restrictive since it has excluded claimants whom the banks categorised as 'sophisticated'. The definition of sophistication for these purposes means either:

- the customer's actual experience and knowledge indicated that they were sophisticated;
- the company was not a small company as defined under section 383 of the Companies Act 2006; or

- claimants with an IRHP notional value of more than £10m.

For those excluded from the review, they still had the option of bringing legal proceedings against the banks.

The issue of whether IPs can bring litigation claims in respect of IRHPs has now reached an urgent phase. As mentioned before, most of the loss-making IRHPs were sold in the period around 2008, when the financial crisis was at its height. That means that many claims are reaching the normal six-year statutory period beyond which legal claims cannot normally be brought. Many IPs recognise that, if they have not done so already, they need to investigate whether a protective claim should be issued in the courts to prevent the limitation expiry date being missed. Having said that, it is possible that the limitation period may be extended in some cases. The start of the limitation period may be delayed by up to three years, if it can be shown that the claimant was not put on enquiry as to the facts which would allow it to bring a legal claim until some time after it entered into the contract.[1] The case of *Re Kays Hotel Limited*[2] is an example of that possibility. In that case, the borrower had agreed a collar with Barclays Bank in 2005 but did not issue proceedings until 2012. The bank applied to strike out the claim as time-barred but the court refused to do so on the grounds that it was open to the borrower to argue at trial that it was not alerted to a possible claim against the bank, until the full financial consequences of the collar became apparent.

> "Over 90 per cent of IRHPs had been mis-sold."

Resolving potential conflicts of interest

The whole issue of IRHPs obviously puts IPs into a position of potential conflict of interest against the bank, which may have appointed them. This concern that there is a perceived or actual conflict has led many IPs to appoint a separate independent IP to deal solely with the IRHP claim.

In addition, IPs have the usual issues to consider when investigating potential legal claims, such as whether funding is available and whether they have sufficient evidence to mount a legal challenge. Even if those obstacles may be overcome, for example, through ATE insurance or litigation funding, there is also the question of to whom the proceeds of such a claim would belong.

In most cases, there will be a shortfall in the insolvency in the amount owed to the bank. The question therefore arises as to why the bank should not receive those proceeds where it has a floating charge. Alternatively, there are arguments that the bank could simply set off the amount of such claim against the amount due to the bank or that it would be subject to automatic insolvency set off. Some have even argued that proceeds of such a legal claim are not floating charge assets and would fall outside the scope of the bank's security. However, these are issues that have remained largely untested.

In other situations, however, the proceeds might benefit parties other than the bank. For example, where:

- the amount of the IRHP claim exceeded the shortfall to the bank and created a surplus in the insolvency, which would be repayable to the shareholders;
- proceeds could be made available to unsecured creditors under the ring-fenced fund out of floating charge assets; or
- they could benefit a personal guarantor by reducing his or her personal liability.

For these reasons, other parties may be putting pressure on IPs to consider bringing IRHP claims. For example, in the case of *Hocking* v. *Marsden*,[3] an IP had decided not to bring an IRHP claim but had refused to assign it to one of the directors who was also a creditor. The director applied to the court, claiming that the administrator's actions had caused the creditor unfair harm.[4] The court agreed that the claim should be assigned, subject to the creditor providing the administrator with a personal indemnity against any adverse costs order.

IPs who are in a position to bring IRHP claims will still need to overcome a number of legal hurdles in order to succeed.

The first issue to consider is whether the claimant can claim damages for breach of FCA regulations, which protect investors dealing with regulated financial firms. Under the Conduct of Business rules (COBs), regulated firms are under an obligation to ensure that they provide adequate advice in relation to financial products and to ensure that those products are suitable for the customer.

However, damages for breach of the COBs rules are only available if claims are brought by a 'private person'. The definition of a private person is either an individual or a company not acting in the course of its business. As a result, almost all companies find themselves without this damages remedy. They have to try to establish liability of the banks through general principles of contract and tort. A number of cases have established the following principles over the last few years:

- as a general principle, a bank does not owe its customer a duty to advise as to the merits of any proposed transaction;
- if, however, the bank 'crosses the line' and provides advice, then it owes the customer a duty to exercise reasonable skill and care in providing that advice;
- the banks may state in their terms of business that they are not providing advice. The courts have so far upheld such 'basis' clauses; and
- where a clause is held to be an exclusion clause rather than a basis clause, it is open to the test of reasonableness under the Unfair Contract Terms Act 1977.

Crestsign v. *RBS*

These principles have been most recently considered by the High Court in the case of *Crestsign* v. *RBS*.[5] The conclusions of the court were:

- the bank had given the customer advice and that advice had been negligent;
- however, the bank's terms of business had disclaimed any liability for providing advice and, as a result the court accepted that the bank was not liable for the advice that had been given;
- the court did not accept that the 'basis' clause was an attempt to rewrite history after the event;
- although the customer could not rely directly on the COBs rules for damages, as it was a company, there was no reason why the common law rules should not overlap with COBs; and

> "The director applied to the court, claiming that the administrator's actions had caused the creditor unfair harm."

- the bank was not under a duty to ensure that the customer had understood all other available options in order to take an informed decision, but the bank was nevertheless subject to a duty to provide full information in relation to the products it was selling. However, the court considered that the bank had satisfied its duty to provide that information to the customer and so was not liable.

As a consequence, the customer in this case failed to achieve any compensation from the bank (subject to any appeal). However, the result is not a conclusive win for banks and the door has still been left open for other cases where different facts and different terms and conditions might result in banks being found liable. ◻

1 Section 14A Limitation Act 1980

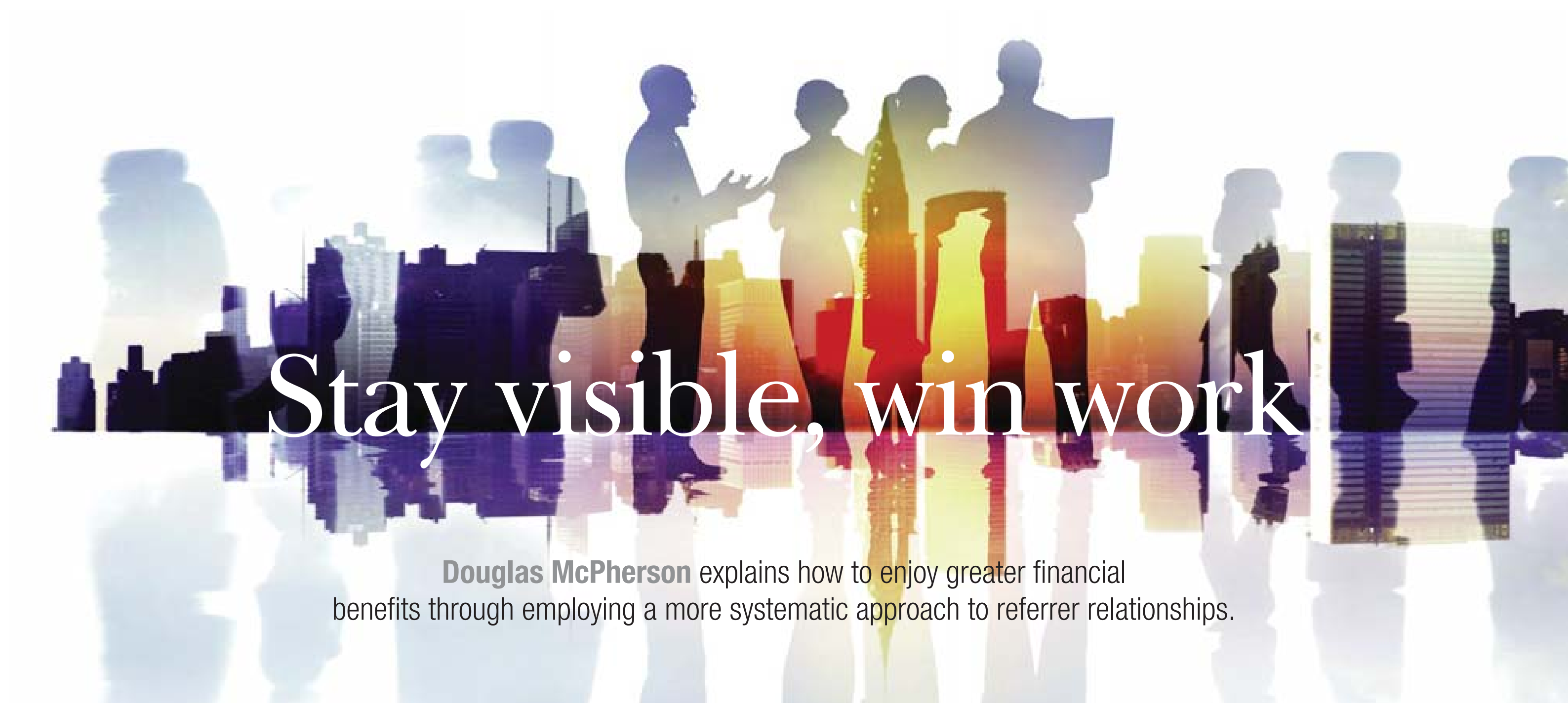
2 *Re Kays Hotel Limited (Trading As Claydon Country House Hotel)* v. *Barclays Bank Plc* [2014] EWHC 1927

3 *Hocking and others* v. *Marsden and another* [2014] EWHC 763 (Ch)

4 Paragraph 74 of Schedule B(1) to the Insolvency Act

5 *Crestsign Limited* v. *(1) National Westminster Bank PLC* and *(2) The Royal Bank of Scotland PLC* [2014] EWHC 3043 (Ch)

ROBIN HENRY is a partner in the financial disputes team at Collyer Bristow LLP.



Stay visible, win work

Douglas McPherson explains how to enjoy greater financial benefits through employing a more systematic approach to referrer relationships.

While I don't want to annoy anyone with my first sentence, I think it's fair to say that if business owners were to list out the subjects they want to talk about, insolvency and recovery would not be at the top of that list.

I would be willing to add that if the same business owners were to find themselves in serious financial trouble, the likelihood they would go out of their way to admit their situation and make contact with IPs and/or insolvency lawyers would be, at best, slim. So if the market doesn't want to talk to you (or even recognise their need for your services) what are you supposed to do when it comes to marketing? Well, there are a number of options.

You could just sit and wait for work to arrive. You do a good job after all and, as such, surely work will find you.

> “You could just sit and wait for work to arrive.”

Or you could look enviously at your colleagues in the other areas of your business or the other professionals you see out and about who actively farm your local market. They are probably embracing client relationship management (CRM) and using the principles of – not to mention software behind – CRM to further their cause and win work across those practice areas more widely considered to be aligned to growth rather than demise.

Or you could look to build on the fact that, just like your colleagues or the other serial networkers you see, you actually do have a firmly established 'client' network of your own. Moreover, if you were to commit to managing this client base a little more systematically, it would not only continue to deliver a consistent flow of profitable work, the volume of work it delivers may even grow.

Relationships, not software

One of the common misconceptions about CRM is that it's all about software. What CRM is really about is relationships and good old-fashioned human interaction. Relationships have always been pivotal to the insolvency market, although your relationships will usually consist of trusted external partners – let's call them referrers – rather than traditional paying clients.

The only trouble is, however important to your insolvency practice your referrers are, can you honestly say you have put in place the infrastructure you need to manage these relationships effectively? And despite the fact these relationships represent your single most productive source of new business, are you using anything more robust than what is in your head to ensure consistent and continual contact with your network?

If the answer to both questions is 'no', it may be time to take the principles of CRM but skew the focus slightly so they meet your requirements. You could even call this new version RRM, referrer relationship management.

For you the primary objective of more rigorous RRM is the same as it would be for traditional 'new business' marketing; it's about staying visible. Terms such as marketing, business development or sales mean different things to different people. I firmly believe all three terms could drop out of the English language tomorrow and be replaced with the word 'visibility' without the context of any sentence being altered in the slightest.

The only difference for you is that when it comes to traditional 'new business', marketing is pretty straightforward; you identify a target, you make sure you get visible to them, you stay visible and – eventually – you will win work. Everyone can see the process from start to finish and you can monitor what works and what doesn't and tweak your visibility strategies accordingly.

However, when it comes to businesses such as insolvency, that are heavily reliant upon referral channels rather than an awareness–interest–desire–action model, it works the opposite way. You often won't notice your referrers have jumped ship (most likely to one of your competitors) until the flow of work you have come to take for granted declines, slows or even stops entirely.

> “Cultivate trusted adviser status.”

While within the more mainstream professional services (eg tax, audit, employment, company/commercial or commercial property) the effect would be detrimental, in the insolvency sector it would be disastrous. You can't compensate for the loss of key referrers by targeting likely prospects or switch your focus to social media, click-through ads or hardcore networking.

You would need to cultivate trusted adviser status with a brand new set of potential partners and that requirement is hampered by two arguably insurmountable obstacles:

1. Establishing the requisite levels of trust is not a quick process and the drop in work your practice would experience during the courtship is likely to affect your bottom line
2. Given the number of players in your geographic market, there aren't likely to be too many replacements anyway.

In addition, I frequently hear the insolvency sector described as 'capricious' or even 'gossipy'. This, added to the limited size of your local market, means your competitors not only covet your key contacts but are also well placed to work on them if they spot a potential crack.

A more systematic approach to RRM will keep you in front of the right people and involved in active conversations about clients and opportunities. This more consistent contact will help you avoid having to lose and, subsequently, replace any of your key relationships.

> Asking a football man to a rugby match could end up causing more harm than good.

I trust that this argument sets out the benefits of implementing a more rigorous RRM strategy; if you are convinced of 'why?' I'm guessing your next question will be 'how?'

Contact planning

The good news is all we're talking about is a 'little and often' strategy; having a coffee or a beer here or making a phone call or sending an email there.

I do not doubt for a minute that these are all things you do as standard. However, and I'm not sure about you, but in both mine and my clients' working lives it is often the case that when you think about seeing someone you tend to think 'it's OK, I saw them a few weeks ago' only to find out it's actually been more than a year since you saw them. Having your contact planned out will make sure:

1. Contact with everyone in your network is consistent
2. Reminders are put in place in case someone slips between the cracks
3. There is a variety of events covering the social and the formal
4. You have a note that covers the last things you discussed you can look up quickly and easily as an aide mémoire
5. The visibility you create face-to-face is supported in between meetings with emails, e-marketing, social media.

With regard to number one, you need to be ruthless. Make sure the frequency (and cost) of contact is in line with the commercial importance of the person. You should spend the most time with those who give you the most work so your receipts are in line with the results they produce.

To maintain the 'personal touch', the type of contact should be designed to meet your contacts' preferences not yours. Forcing someone who likes a quick coffee into a lengthy lunch or asking a football man to a rugby match could end up causing more harm than good.

Likewise your contact should, as mentioned above, cover the social and the formal. As well as drinks, lunches, coffees and miscellaneous sporting events, you should also include office visits and wider team-based events like round-table discussions and updates/training on your side of the process. This will help you keep the relationship on a business footing and allow you to underline the fact your relationship is about producing work without actually having to say it.

Potential rewards

I recognise that, whatever the frequency of contact you decide upon, these are all activities that have to be fitted in around billable work but, as they are also all activities proven to pay back in spades, you need to work out how best to make sure they are fitted in.

In order to balance the potential rewards with the potential investment of time, many of the savvier IPs and solicitors we work with have developed a number of shortcuts. These shortcuts help them make sure their visibility remains high but involve less marketing time.

For example they may agree to meet a contact at a local event rather than one-on-one so they can see some of their other contacts at the same time. They may automate email contact so that, despite it looking as though it has come from their personal account, has actually been sent as an informal reminder to their entire database.

So how do you get started?

The first bit requires a little analysis, not an attractive proposition but if it is done properly and updated as you move forward, it will only need to be done once. Your analysis should tell you who you give work to most frequently and who gives you work most frequently. Because of the way human beings are wired up it's often the case that you associate the highest levels of success with those you like most but it's not always the case.

Having the numbers in front of you will show your priority relationships, those with whom you need to spend most time and most effort. It will also highlight any disconnects between the levels of work being exchanged so you can have a grown-up conversation. It'll also show up any dead horses bearing the painful marks of continual flogging so you can move your time and budget onto developing alternative sources.

I know that type of direct approach isn't something that sits comfortably within the UK market but economically these aren't comfortable times so now more than ever your focus must be on the contacts that deliver.

The next step is segmentation. If this is starting to look like the advice you'd associate with mainstream marketing that is because when it comes to the insolvency sector this must be considered mainstream marketing.

Time and return

As discussed, RRM will only generate the required returns if you balance the time you have available according to the likely return and are ruthless enough to promote and relegate between your tier one and tier two contacts based on productivity and the opportunity.

You should also consider the size of your group. While there is some credence to the old adage that the more people you know, the more opportunities will come your way, you also need to bear in mind that you only have a certain amount of work to give out. The last thing you want is to be on the end of a difficult conversation with one of your most valued contacts, explaining why they haven't received anything from you in a while. Keeping a manageable group happy is much easier than having to re-enact that infamous trick with the loaves and fishes.

> Keeping a manageable group happy is much easier than having to re-enact that infamous trick with the loaves and fishes.

In conclusion why should you really invest in RRM? I always illustrate the tangible benefit of any marketing activity in three ways – it'll save you time, it'll save you money and it'll save you hassle. RRM is no different.

- RRM will ring-fence and protect your current relationships and save you the time you'd have to invest in developing new referral relationships
- RRM will save you from a financial shortfall as you work on developing these relationships to the point they regularly produce good, profitable work
- RRM will save you the time and cost of developing these relationships to the point they regularly produce good, profitable work
- RRM will save you the time, money and hassle of having to invent new marketing messages and methods to get your name in front of potentially troubled businesses

And lastly, taking a more common sense approach to RRM will save you from having to buy in fancy, expensive software. All of this can be managed by Excel, Outlook and an off-the-shelf mail platform such as Mailchimp, which will save you even more time, money and hassle, and allow you to concentrate on making your key referrer relationships more productive. □

DOUGLAS MCPHERSON is a director of Size 10½ Boots.

Legal risks in the digital world

Stephen Mason details insolvency pitfalls in the age of the cloud.

Insolvency practitioners have checklists of topics that must be covered when entering a business for the first time. Some of the items included in this article may well be usefully added to the internal list maintained by each practitioner or firm. It will not be necessary to follow up every item for every business. Proportionality is important, taking into account the risks associated with the subject business. It may be necessary to hire a digital evidence specialist to help with some or all of the issues noted below. The scale and risks will determine how many of these points need to be considered.

Physical

It might be necessary to prevent certain directors or employees from entering the office. Where the business rents offices, alert the management of the building to any concerns, because they might control access. This includes cancelling physical passes and passwords.

Bring your own device (BYOD)

There is a move, intentionally and unintentionally, for people in business to permit or suffer the use of a device by a director or employee that is not owned and controlled by the organisation. First, check for the existence of a relevant policy, if any. A competent policy should provide for the authority to search devices, and provide for control and ownership of data. People use devices to connect to the network. Undertake an audit to establish how many devices can join the network (eg smartphones; laptops; tablets; USB sticks); who owns the devices; the rights of access each device has; how the device connects to the network; what data is stored on the device; and how to disconnect devices from the network. The next step is to gather all relevant passwords and user identity of those that can join the network. This will enable you to prevent unauthorised devices from joining the network.

Assess whether personal devices are capable of obtaining personal data (eg employees; customers; suppliers). The data controller must remain in control of the personal data for which she is responsible, regardless of the ownership of the device, for which see *Bring your own device (BYOD)* (Information Commissioner, 2013).

Data

The IP becomes responsible for the personal and business data owned and stored digitally, including in the cloud. It is necessary to establish who controls the data and where the data is stored – that is, in-

> "Undertake an audit to establish how many devices can join the network."

house or off site (maybe in somebody's garage, or stored on hard drives; CDs in drawers; USB sticks), and whether it is mirrored in the form of a back-up and if so, whether in the cloud.

Establish whether encryption is being used, and if so, where the keys are stored; if there is a back-up of the keys, and if so, where; whether the keys are stored on cards or a server; how the keys are protected, and the person responsible for safeguarding the keys.

Obtain and secure all passwords relevant to business data and personal data. In addition, ascertain whether there is a record of passwords; where they are stored (on devices; on the server; not stored at all), and who controls the passwords.

'The cloud'

Many people, knowingly or unknowingly, work from and store data in what is called 'the cloud'. This might mean that the business does not have any data stored on physical devices or computers. Some of the issues to consider include: establishing the nature of the use of cloud computing; ascertain whether an agreement exists; check the terms and conditions, in particular to determine the rights of the business over the data; the rights of any third parties in the event of insolvency; where the title to the data is held and what, if any lien applies. Whether a lien applies will depend on the meaning of 'ownership' of data in digital format. In *The Environment Agency* v. *Churngold Recycling Ltd* [2014] EWCA Civ 909, the Court of Appeal indicated that data in digital format could not be possessed. The geographical location of the data might be crucial if legal action is required to repatriate data. In such a case, the issue of jurisdiction will be central.

The network

To take over a business effectively, it is necessary to understand how the network communications system works, where data is stored, and who owns or runs the network. It might be that the network is run by a company within the group of companies (even overseas), and those in charge of the network may take action to prevent the actions of the subject business from affecting its own business. This may include terminating all rights of the subject business to the detriment of finding data. Take time to establish the number of networks that exist; if there is a wi-fi network, and if so, find out how it is controlled and secured and take steps to take full control and, if necessary, close it down. Ascertain digital security generally and whether it is adequate.

Domain names

Domain names will have some value, and it will probably be necessary to keep any domain names and website active. A number of domain names will be registered, and it will be helpful to establish which organisation (or individual in a room of their home) hosts the website; the name of the person to whom the website is registered; ascertain registration details of all other domain names, together with domain names of a similar name that might be registered. Take control of all domain names by having them transferred.

The domain name of the website used by the business might be different to the name of the business. Find out all the trading names used by the business, together with any related websites that might be used for the purpose of trading and marketing. It will be essential to find out who the administrator is and to instruct them accordingly.

Regarding correspondence, change the disclaimer on all emails leaving the business.

STEPHEN MASON is a barrister, author and speaker.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

Printers, pre-packs and practitioners' fees

Andrew Brown of the British Printing Industries Federation on what concerns printers when a company fails.

Pre-pack sales have long been a thorn in the side of printing companies. They suffer as creditors when they lose money owed to them by customers who pre-pack. But they also suffer when a fellow printing firm pre-packs, thereby improving its ability to compete against them by dumping previous debts.

The impact of pre-packs on competitor companies is often overlooked. It's argued that pre-packs preserve jobs. Or that the attendant secrecy prevents their customers being poached, enabling the value of assets to be preserved and realisations to be maximised for the benefit of creditors. But pre-packing also means that other companies then face a competitor who has acquired a distinct trading advantage, with any jobs preserved by pre-packing outweighed by those lost elsewhere in the sector concerned. This is accentuated if – as is often the case – the new company goes on to fail again.

Connected parties

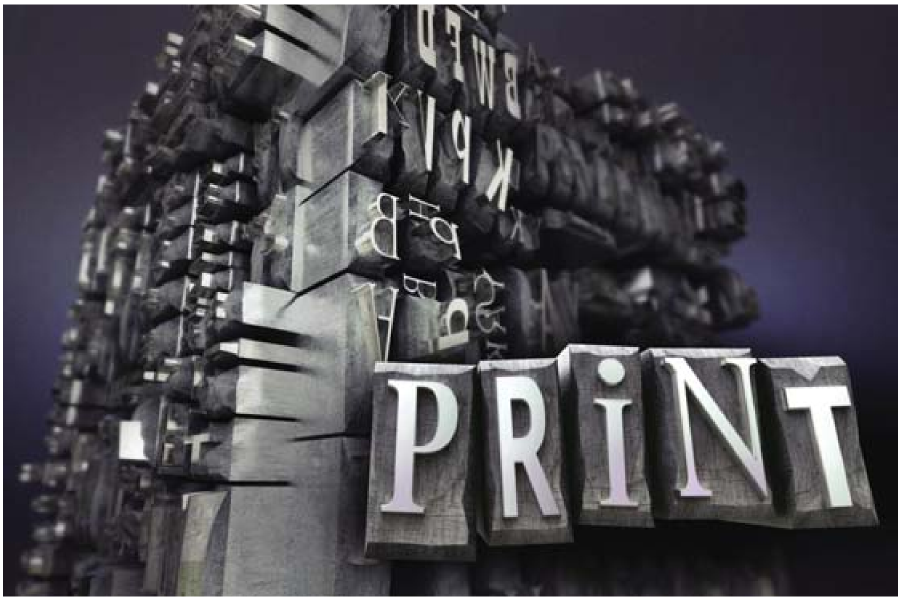
Pre-packs sales to connected parties are a particular concern. These businesses can fail because they are not well managed. Some will have run themselves into the ground by undercutting rivals with kamikaze pricing policies, while failing to pay for raw materials obtained on credit. Pre-packing such businesses can militate against necessary industry consolidation that might otherwise improve the trading position and future prospects of other companies.

Of course not all pre-packs arise from mismanagement. Some result from sheer bad luck – such as a natural disaster or a bad debt. These companies might be worth rescuing, but their future prospects might still be better served by an injection of fresh management. Unfortunately the 'closed-door' nature of pre-pack sales usually leaves potential rival bidders in the dark until after a deal has been done with the incumbent management team.

So it's not surprising, therefore, that announcement of yet another pre-pack deal is usually greeted with little enthusiasm in our industry. Not only is the dead man walking again, but he has a fresh spring in his step.

Ups and downs

After a series of false starts by government over the past four years, including the publication of draft regulations that never came to fruition, the recommendations set out in the Graham report should help curb abuse of pre-packs involving connected parties. On the plus side, her proposal for a pool of business experts to review and opine on proposed deals, and for a viability review, are helpful. But the recommendation that could potentially deliver most benefit is that relating to wider marketing, particularly if this is built into a new SIP16. Wider marketing should ensure greater transparency and increase the prospect of bids from other parties.



> "Some will have run themselves into the ground by undercutting rivals with kamikaze pricing policies."

On the downside, we were disappointed that the regulatory reforms for which we repeatedly called were not on the agenda. But it's clear from her report that Graham, a self-confessed 'de-regulator by heart', has no appetite for new regulations.

Printing companies serve customers in every business sector. Many are significant in size, and their relative bargaining power means that printing companies have to extend significant levels of credit to secure or retain business. Should these customers become insolvent then invariably their print supplier becomes an unsecured creditor. For this reason, we commented in some detail on The Insolvency Service's recent proposals to strengthen the regulatory regime and fee structure for IPs.

Fees and fostering trust

In respect to IP remuneration our view is that the use of time and rate should be restricted to cases where there is tight control over the work being done (ie by a creditors' committee or by secured creditors), enabling unsecured creditors to be confident that fees charged will be based on the value of the work done. We consider that percentage of realisations should be the presumed method for remuneration, with other methods of charging adopted only for specific aspects of casework such as statutory duties and investigations. We firmly believe this would enhance the credibility and reputation of the insolvency profession by aligning the interests of IPs and unsecured creditors more closely. As such, this change should be welcomed by the insolvency profession as a positive step. Not only would this offer better value for money to unsecured creditors but it would also foster a new spirit of partnership and trust between IPs and their clients.

ANDREW BROWN is a public affairs advisor at the British Printing Industries Federation (BPIF).

Time is of the essence

Helen Beckinsale offers some background information and advice to ensure successful engagement with the PPF.

The Pension Protection Fund (PPF) was established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation. It is not funded by the government or taxpayers, but through a compulsory levy, much like an insurance premium, collected from eligible schemes. Its objective is to minimise the call on those levy payers by operating cost effectively.

Insolvency practitioners (IPs) are key to this initiative and the PPF is actively seeking to engage with all IPs to improve the assessment period.

Our specialists

Following the receipt of the section 120 notice from the IP, eligible schemes enter an assessment period. During this time it is determined whether the assets of the scheme are sufficient to pay out a pension over the PPF compensation levels. If they are, the scheme will not enter the PPF.

One of our strategies for achieving our objectives, when a scheme does go into assessment, is to work with an optimum group of core specialists who are expert in our processes. They exhibit the behaviours we value, such as proactivity, pragmatism and being solution focused. To facilitate this we have created five specialist panels:

- an actuarial panel comprising of five companies who are now expert in undertaking PPF 143 valuations
- a panel of eight pension scheme administrators who undertake critical assessment period tasks
- a panel of six trustee firms offering trustee-style services
- six audit organisations
- five legal firms.

We have started to see some real successes in this area, with assessment periods and costs falling significantly. Without doubt, a key contributory factor is working alongside professional partners that are expert in PPF processes, particularly those that have kept pace with and actively embrace our new ways of working.

The pension scheme trustee is one such critical partner and experience has shown that if there are trustees in place that are not completely up to date with our processes and ethos, we encounter difficulties during the assessment process. Ultimately, these difficulties result in a negative experience for members and impact on our ability to deliver value for money for PPF levy payers.

> "It is not funded by the government or taxpayers, but through a compulsory levy."

Panel of experts

The trustee panel launched on 2 September 2013. Prior to this launch we piloted a project whereby we encouraged incumbent trustees that have limited or no experience of PPF, to appoint a PPF expert trustee to work alongside them as either a co-trustee or a specialist project manager acting under delegated authority. This has proved very successful with incumbent trustees happy to defer to the specialists. From our perspective it is key that we get PPF expert trustees in place as soon as it is known that a scheme is likely to enter an assessment period. Early involvement means that we can expedite key work items. In fact, our new processes dictate that we try and get all major issues identified, within the first 100 days, following the submission of the s120 notice. This would be difficult without an expert PPF trustee in place from the start of the assessment period.

Support from IPs

One of the other ways that a trustee can be put in place early is by the IP using the pension scheme's power of appointment, where it is available to them. Rather than waiting for the pensions regulator (tPR) to appoint, which can be a lengthy process because of the statutory notice periods (and which do not fit with PPF's 100 days initiative), IPs would assist both the members and the PPF by making an appointment from our trustee panel. We would like the IP to contact the PPF as soon as the s120 is likely to be submitted so we can then allocate a trustee to the scheme. The trustee would be chosen on the basis of capacity and experience of circumstances surrounding the scheme. tPR is happy with this approach. We would also welcome a discussion around

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

whether it would be beneficial for the IP to remove an incumbent trustee, in addition to appointing.

Benefits for IPs

The key benefit for IPs is that they do not have to concern themselves with the PPF/pension scheme aspects as they know they have an expert in place to handle any issues that arise. Instead, they can focus on employer matters with employees' concerns around pensions being managed by the trustee and PPF working together. Further efficiencies should also flow to the IP from such an appointment, for example a trustee from PPF's panel will understand what PPF requires in terms of recovery of unpaid contributions and s75 debt claims. The benefit to the PPF is that we get an appropriate expert trustee on board quickly, so work can immediately commence within PPF's 100 days framework. Members will benefit from the ability to reach a decision more quickly providing them with certainty at a very worrying time.

We want to get as much preparatory work done, before the s120 notice arrives. Again, we would be very keen that one of our panel trustees was appointed on cases where a restructure or deal may be underway through a regulated apportionment arrangement (RAA) or CVA, which will eventually lead to the scheme entering an assessment period. We accept that some deals may be very sensitive and it may not be appropriate to bring in a PPF expert trustee at a very early stage but we would hope these will be few and far between. From the perspective of delivering clarity and certainty of outcome to scheme members, certain key tasks can

> “It is important in these scenarios that there is a trustee in place who can act robustly and knowledgeably.”

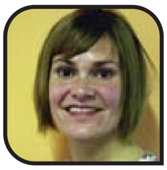
be undertaken prior to the actual assessment date to significantly reduce the time taken to transfer to PPF. These key tasks include analysis of historic participating employer issues and associated s75 debt settlement.

In addition, the PPF, which is often the economic stakeholder in such situations, and tPR recognise that it is important in these scenarios that there is a trustee in place who can act robustly and knowledgeably in developing outcomes. PPF's panel trustees will have a close understanding of being involved in such negotiations and of working closely with PPF and other stakeholders. Where possible, the PPF would encourage those advising employers, or existing trustee boards in such situations, to consider the appointment of a specialist trustee from PPF's panel promptly. Clearly, in these circumstances, the choice of which PPF panel trustee would remain with the employer or existing trustees (depending on who has this power). The key point for the PPF is to get the trustee panel experience involved at the earliest possible opportunity.

Work with us

The PPF is in active discussions with IPs on this approach and the feedback and support to date is very positive. We encourage all IPs to consider adopting the approach, which has significant benefits for all stakeholders and ultimately ensures we pay the right people, the right amount, at the right time. ◻

For further information please contact Helen Beckinsale, Panel Manager at Helen.beckinsale@ppf.gsi.gov.uk



HELEN BECKINSALE is the panel manager at the PPF.

The Insolvency Service: communication and collaboration

Communication is at the heart of any effective relationship and is key to ensuring that parties can work together efficiently and successfully.

Having listened to feedback from members of the profession and recognised professional bodies (RPBs), members of the investigations and enforcement services division of The Insolvency Service recognise that we could do a lot more in this area and so we are increasingly taking proactive steps to engage in regular dialogue with insolvency practitioners.

We currently run a programme of outreach visits, attending IPs' offices to explain our processes and to invite feedback. We encourage you to contact us, if you would like us to visit you, with details of the topics that you would like to discuss. We are also ensuring that we show our recognition of the very important role that is played by the profession in the corporate investigation and enforcement arena.

Dear IP

We hope many of you will have seen the recent addition of a new chapter to *Dear IP*, 'Working together'. The purpose of the new chapter is to open another communication channel between The Insolvency Service and members of the profession so that important information on collaborative investigation and enforcement topics can be communicated on a more regular basis.

Firstly, this involves providing up-to-date disqualification statistics, so that you can be updated regularly throughout the year instead of waiting for published year-end reports or intermittent informal communications. To date, the figures have been fairly high level with little granular analysis but we would welcome any feedback on the content of this section so that we can tailor the communication to your needs.

Secondly, we are using the chapter as an opportunity to highlight, with their permission, instances where individual IPs, or members of their staff, have particularly stood out through the quality of the information they provide on investigation cases and their efforts in working together with our investigators to ensure that the right directors can be targeted and disqualified where appropriate.

D return targeting process

We are continuing to address frustrations that have been expressed around the perceived lack of transparency in our targeting processes when we receive D returns from IPs.

"We welcome feedback so that we can tailor the communication to your needs."

We have amended our letters that advise IPs of a decision not to investigate, including a more detailed explanation of why a case has not been pursued. We will also call office-holders where discussion will aid our targeting decision and we invite IPs to call us to discuss cases where they believe that we haven't got it right. Sometimes a simple phone call can be extremely useful!

We are keen to work with you to ensure that directors who ought to be disqualified do not escape enforcement action. It is extremely important, therefore, that where there is evidence we have not fully understood or considered, this is brought to our attention. We do listen and we will revise targeting decisions where it is appropriate to do so.

Investigation decision

As of 1 October 2014, we amended our processes to ensure that IPs are also informed when a case has been targeted for investigation. All targeted cases are placed in a pool pending allocation and prioritised taking into account a number of factors including the level of harm caused and the need to protect the public and the marketplace. The most serious cases in the pool take precedence and not all targeted cases necessarily result in an investigation. The pool is constantly reviewed so, should further information become available while the case is in the pool, this should be notified to the insolvent targeting team so that we can re-assess the priority of the case.

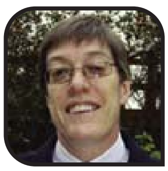
We also have to consider whether sufficient time remains before the two-year limitation date to be able to properly investigate the matter and undertake all of the pre-action protocols required prior to filing proceedings in court. So if the case has not been allocated to an investigator by the time it is around 13 months old then it will be reviewed and either allocated to an insolvent investigation team or a decision made that there will not be an investigation. Should that occur, the insolvent investigations team will communicate this to the office-holder.

IPs tell us that it can sometimes seem like cases disappear into a black hole once they reach our insolvent targeting team but, by improving the transparency and frequency of our communications, we hope to encourage further engagement with the profession with a view to enhancing our investigation and enforcement activity.

Moving forward

The collaborative approach we take to working on disqualification cases is extremely important and, going forward, will become even more so.

The introduction of the new conduct reporting process, together with other changes to be introduced by the Small Business, Enterprise and Employment Bill, will mean that continued dialogue between ourselves and office-holders will be fundamental in ensuring that we continue to take the most appropriate action against those individuals who are unfit to act as directors of companies and whose actions are so damaging to the UK economy. ◻



VICKY BAGNALL is the director of investigation and enforcement services at The Insolvency Service.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

SPG Forum

Andrew Tate reviews October's SPG Forum.

This year's SPG Forum was held at the Hilton Metropole (NEC) Birmingham and was arguably the best one yet. A big thank you to those who attended and, for those of you who couldn't make it this year, here's what you missed!

Day one

The forum kicked off with a lively mock creditors' meeting, with stellar performances by all involved. The performance as a whole was met with laughter and good-natured heckling, and it was a great start to the event.

This was followed with an update from Frances Coulson (Moon Beever) on fraud and how to tackle it. In particular, Frances focused on the use of CFAs to fund fraud investigations and the potential impact of Jackson and the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LAPSO). In this regard, R3 continues to lobby in favour of a permanent exemption to LAPSO for insolvency cases (the current exemption is due to expire in April 2015). Frances also informed the attendees of a recent development in mesothelioma case law where the possibility that fee uplifts will be a breach of the European Convention on Human Rights was raised. According to Frances, this is unlikely: it would require the government to compensate all those who have paid CFA uplifts in the past. The failure of the court to rule uplifts as a breach of the ECHR could open the door for the argument to keep the CFA and uplift carve-out for certain cases (such as insolvency). So there is still hope!

Later on in the day, Douglas McWilliams presented a witty, fresh talk on the global and UK economic outlook – this was extremely interesting and well received by all who attended. The audience was very responsive and Douglas provided a very useful insight into the expected economic performance over the next few years. Where corporate insolvency is concerned, he predicted a drop in numbers but not a dramatic one – 'nowhere near pre-2000 levels'. This is because business is now inherently riskier than before, so there is a naturally higher level of corporate failures. Insolvencies are also likely to be trickier in nature – many businesses' main asset is their staff, so once they leave there won't be many assets left to realise.

'The Mysteries of Google' (a talk on rankings, search engine optimisation (SEO) and dealing with bad reviews) given by Harry Dance (Reeves & Co) and Hannah Stephen (HeadRed) was also very well received – there was a substantial amount of interest in the audience about how to get the most out of SEO and how to deal with bad reviews. If this is an area you're interested in, R3 will be producing a more detailed guidance note on this area later in the year, so stay tuned.

The final slot of day one fell to yours truly, joined by Emma Hobson from R3 and Professor Peter Walton of Wolverhampton University in discussing the results of the recent 'Benchmarking Survey'. Perhaps the most exciting (and useful) bit of information to come out of this survey related to chargeable time recorded versus costs actually recovered. The survey showed that, on average, only 59 per cent of time costs are recovered. Administrations had the highest time recorded and a recovery rate of around 53.4 per cent. CVAs had the best recovery rate (71.3 per cent), MVLs were second best at 67.8 per cent, but IVAs had the lowest recovery rate at 44.6 per cent. These stats could be very useful in rebutting some of the adverse perceptions about IP fees. R3 expects to publish the full results of the survey before the end of the year.

Day two

Highlights on day two included a regulatory and policy update from Dean Beale at The Insolvency Service. The underpinning message in his presentation was that the service is aiming for better creditor engagement and lower costs in the most recent reforms. Questions from the audience at the end of this session were lively. In particular, one attendee highlighted that every IP he had spoken to thinks that single licences are a terrible idea, and potentially dangerous. Dean commented that it was not necessary to study areas that one is never going to practice, and perhaps the best people to ask for opinions on this topic were not qualified IPs but rather people working in the profession who were aspiring to be IPs. The audience member interpreted this as the IS 'dumbing down exams for those who currently can't pass' – clearly this was a very heated area with some strong views involved.

Finally, Teresa Graham gave a great presentation on pre-packs, stating that any legitimate way of saving a business is welcome and her natural stance is a de-regulatory one wherever possible – she doesn't believe in automatically relying on the state to fix problems. With this in mind, Teresa reviewed her findings on pre-packs and her recommendations going forward. She found that although there were relatively small numbers of pre-packs, there was a negative pre-conception of them based on mistrust by creditors and a lack of transparency largely caused by insufficient marketing. Although pre-packs are positive in that they preserve jobs (lowering number of creditor claims from employees), they are cheaper than other regimes, and deferred consideration is usually paid. Teresa's report recommended voluntary regulation of pre-packs to connected parties with a back stop power to regulate if the voluntary changes aren't effective (although she strongly hopes this won't be the case). The audience engaged with Teresa during question time, and overall her presentation was received positively.

Summary and looking forward to 2015

Aside from the great schedule of speakers, the social side of the event was also a success – with the new addition of private drinks the night before the forum began and a suitably lively reception and dinner after the first day. All in all, it was a great event and we hope to see you all again next year at the new venue in Manchester.

ANDREW TATE is R3 SPG chairman and a partner at Reeves & Co.

SAVE THE DATE

18 March 2015
R3 Annual Dinner
Lancaster, London

20–22 May 2015
R3 Annual Conference
Grand Hyatt, Berlin

R3 events, courses and conferences

December

Date	Event	Venue
2	South West & Wales AGM & Christmas Dinner	Be in Bristol, Bristol
3	North West Women's Group Gin Tasting Event	The Botanist, Manchester
4	Advanced Restructuring	Holiday Inn Bloomsbury, London
9	Introductory Series – Liquidations 2 and Liquidations 3	Prospero House, London
10	Introductory Series – Liquidations 2 and Liquidations 3	Irwin Mitchell Solicitors, Leeds
11	Personal Insolvency	Cheltenham Chase, Cheltenham
11	Southern Regional AGM & Social	Southampton

February

Date	Event	Venue
3	Core Tax for Insolvency Practitioners	Copthorne Tara Kensington, London
3	Advanced Tax for Insolvency Practitioners	Copthorne Tara Kensington, London
12	Advising Directors in the Twilight Zone	Thistle Bristol
12	A Guide to Dealing with Regulatory Regimes	Thistle Bristol
24	A Beginner's Guide to Restructuring Issues	Novotel London City South

Regional events

R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2014/15 programme. Alternatively, call the Courses team on 020 7566 4234 to request further details.

R3 contacts

President
Giles Frampton
giles.frampton@richardjsmith.com

Vice-president
Phillip Sykes
phillip.sykes@moorestephens.com

Deputy Vice-president
Andrew Tate
andrew.tate@reeves.co

Administration

Chief Executive Officer
Graham Rumney
grumney@r3.org.uk

Assistant Office Manager
Tasneem Choudhury
tchoudhury@r3.org.uk

Smaller Practices Group; Personal Insolvency; Fraud Group; Regional Communications Committee

Director
Emma Hobson
ehobson@r3.org.uk

Policy and Committee Support
Fay Robinson
frobinson@r3.org.uk

Finance

Finance Manager
Ryan Porter
rporter@r3.org.uk

Assistant Finance Manager
Alex Coles
acoles@r3.org.uk

Membership & Marketing

Head of Marketing & Member Services
Cynthia Matthews
cmatthews@r3.org.uk

Marketing Executive
Fareeha Afghan
fafghan@r3.org.uk

Membership Officer
Shemin Karim
skarim@r3.org.uk

Database & IT Administrator
Samit Vadgama
svadgama@r3.org.uk

Membership & Marketing
membership@r3.org.uk
T: 020 7566 4238

Communications, Public Affairs and Policy

Director of Communications & Public Affairs
Victoria Jonson
vjonson@r3.org.uk

Communications Manager
Nick Cosgrove
ncosgrove@r3.org.uk

Communications Officer
Orla Hennessy
ohennessy@r3.org.uk

Public Affairs & Policy Manager
Georgina Dowling
gdowling@R3.org.uk

Public Affairs & Policy Officer
Alex Green-Wilkes
agreen-wilkes@r3.org.uk

Education, Courses & Conferences

Head of Courses & Conferences
Angela Stannard
astannard@r3.org.uk

Courses and Conferences Organiser
Natalia Lada
nlada@r3.org.uk

Catherine O'Mara
comara@r3.org.uk

Courses and Conferences Marketing Executive
Kirsten Scully
kscully@r3.org.uk

Courses Administrator
Maggie Dean
mdean@r3.org.uk

Regional Events Co-ordinator
Sara Calvert
scalvert@r3.org.uk

Course Bookings
courses@r3.org.uk
T: 020 7566 4234 F: 020 7566 4225

Technical

Technical Director
John Francis
jfrancis@r3.org.uk

Technical Officer
Jonathan Ausena
jausena@r3.org.uk

Committee Chairs

Constitutional Adviser
Deborah Gregory, 020 7296 2000

Education, Courses & Conferences
David Chubb, 020 7583 5000

General Technical Committee
Mike Pink, 0207 311 1000

Membership & Member Services
Matt Dunham, 0161 953 6495

Policy Group
Steven Law, 01284 763311

Regional Communications Committee
Laurence Weeks, 01223 326600

Scottish Technical Committee
Eileen Blackburn, 0131 225 6366

Smaller Practices Group
Andrew Tate, 01634 899800

R3 in Scotland

Chair
Tim Cooper, 0131 222 9817

Representative on the R3 Council
John Hall, 0131 222 2460

Regional Chairs

Eastern
Frank Brumby, 01603 611370

London & South East
James Money, 020 7486 5888

Midlands
Richard Philpott, 0121 232 3000

North East
Allan Kelly, 0191 511 5026

North West
Richard Wolff, 0161 828 1990

Northern Ireland
Brian Murphy, 028 9043 9009

South
Andrew Watling, 023 8033 6464

South West & Wales
Ross Connock, 0117 923 4274

Yorkshire
William Ballmann, 0845 437 4660

Regional Representatives on the R3 Council

Eastern
Laurence Weeks, 07836 252136

London & South East
Alison Goldthorp, 020 7606 8855

Midlands
James Martin, 0121 265 2522

North East
Linda Farish, 0191 256 9500

North West
Richard Wolff, 0161 828 1990

Northern Ireland
Joan Houston, 02890 918200

Southern
Julia Branson, 0118 959 0261

South West & Wales
Richard Clark, 0117 939 2000

Yorkshire
William Ballmann, 0845 437 4660

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

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Duncan Grubb

Duncan Grubb is chair of the British Property Federation Insolvency Committee and head of credit control at Hammerson. In his role with the BPF, Duncan heads a group of insolvency experts – from major landlords, leading law firms to insolvency practitioners – responding directly to government consultation papers on insolvency issues and meeting with The Insolvency Service. He has overall responsibility for the credit control teams at Hammerson, operating on the company's portfolio of shopping centres and retail parks. He is responsible for all aspects of credit strategy, including covenant approval for much of Hammerson's business and has been directly involved in many of the high profile retail insolvencies including CVAs, where he has promoted landlords' interests and in some cases helped shape the proposals in direct consultation with the CVA supervisors.

Interview with…

Duncan Grubb

Sandra Kessell talks to **Duncan Grubb**, chair of the British Property Federation's Insolvency Committee.

Why is the current perception of IPs negative?

An IP's involvement represents an interruption to an established business model. Our business is to cater for our investors; most of the big landlord companies are investment companies that deal in property and most of the investors are global pension funds. Any interruption to that investment flow is seen as negative. It also impacts other areas, such as valuation. If you have a unit that stops trading due to an insolvency regime, or is traded as a concession in order to keep the lights on, that can affect the valuation. The valuation is paramount because independent valuers assess a centre – which is the reported asset of the company or the value of the company's assets – and that directly affects the share price. Obviously, a reduction in a significant number of the assets due to a spate of insolvencies negatively affects the share price. It's probably more critical for smaller landlords – for those who have two or three shops in a local high street. Not only could an administration result in a unit closing and the landlord not receiving rent or service charge, but if it goes into liquidation he may get a disclaimer and no rates protection either. So the secondary and tertiary landlords are suffering far more than the prime at the moment. We may be talking about a recovery, but it's only at the top of the scale.

Has that perception changed in recent years?

Over the last four or five years, largely down to R3, it has changed. The BPF was invited to contribute to an R3 conference years ago, and Brian Green from KPMG and I gave a joint presentation because at that point there had been some very prejudicial CVAs that had been voted down by the landlord community due to the potential to negatively affect the business plan in an unacceptable way. I presented a case for the landlord community during which I outlined their dilemmas and where the touch-points and no-go areas were for us. We felt the level of understanding among IPs at that conference was shockingly low, yet the level of willingness to engage was terrific.

Since then, there has been a coming together of the two sides. IPs realise we are a major creditor group and that we can only help them in certain areas for reasons that aren't under our control; investor protection and asset protection, and the level of engagement is very good. I'll discuss CVAs in particular in the later question. I see the potential for improvement to continue because it makes all our lives easier. The lines of communication are better and the old confrontational idea of the IP, as a court-appointed officer who can do what he likes while the landlord has no say in the matter, is long gone, thankfully.

Would you like to see young and trainee IPs having more information about what you do at an early stage so that their level of understanding starts early?

Yes – the same way as I would like to see more business studies courses include modules on credit management and insolvency. They are taught to micro-manage every other aspect of running a business but these two areas are often skipped over. It may also be useful to offer trainee IPs an internship with a landlord for a couple of weeks.

How engaged are landlords in the insolvency process?

It does vary. The big majors have more attachment to proper credit management and don't confuse credit management with debt recovery. But risk protection, proper evaluation of tenants, making sure you're adequately protected if something goes wrong despite everybody's best intentions, that's given a lot more credence than in the past. The bigger landlords employ full-time credit managers and relationships have improved as a result, because we tend to keep an eye on everything and deal with the IPs on a regular basis – an important point in the engagement process. We're going to deal with them again, unfortunately.

> "All these things sound very nice, but you're trying to get investors to put money into these businesses."

Smaller landlords with a smaller portfolios deal with insolvencies rarely – perhaps once in their lifetime – and come to the BPF only when needed. There are links on the BPF website, there's a PwC link and a LinkedIn discussion group specifically aimed at small landlords who don't have the expertise or money to pay for insolvency lawyers when they do come up against an insolvency problem. They don't get a great deal of use, unfortunately.

What are the BPF's views on the recent pre-pack report?

The report was very well prepared. Teresa Graham took on board everything that we had said and included a landlord section. The intent was good but we are concerned that the proposal for the pre-pack pool is voluntary and the amount of take-up on it will be anybody's guess. There's a lot of work to be done setting it up and meetings are ongoing. It may work as it is, but there is primary legislation in the background if it doesn't.

Tell me about the work the BPF is doing around CVAs.

To go back to our points on engagement; the landlord community started discussions during the Powerhouse case, back in 2007, which we felt was a prejudicial CVA because it permitted parental guarantees to be stripped out in an insolvency regime. It had a negative effect on valuations; many leases are guaranteed by a parent company and it would have permitted unscrupulous companies to strategically strip out guarantees and get rid of leases that weren't performing very well. Landlords won that one. The Stylo CVA followed; again, considered prejudicial, because it commuted all the revenue on all the Stylo units across the country to three per cent turnover. That would have meant a massive income hit to the landlord community. Either of these would have established a dangerous precedent.

CVAs are only as good as the last one because people tend to build on what's been established. If the Stylo one had got through and had been approved by the creditor groups, various other retailers or companies would have used that same model. If you have six distressed companies and three per cent turnover on all their units within major landlord centres, that's a huge hit on income and valuation and investors would not be happy. Pension funds would evaluate whether their money was in the right place.

KPMG came up with a model, the first JJB Sports CVA, after engaging with landlords and developing more interaction and understanding. After that was voted through, various other CVAs followed using the same model: Focus, the Speciality Retail Group and Blacks. The second JJB CVA introduced some compensation clauses for the compromise leases when it came along, because the cuts hadn't been deep enough first time around. Unfortunately it didn't work.

We've done five now and insolvency firms are coming to the BPF with unpublished CVA models, usually under a non-disclosure agreement (NDA) – a confidentiality agreement. They ask us, as a major creditor group, if it includes anything that would cause landlords to vote against it. We've done Bowlplex, Fitness First, LA Fitness and Café Rouge. In each case we've gone back and said, for example, that we would like to see more rates mitigation if you're closing a unit and rates protection for a year at least. Giving a voice to our dilemmas and problems, and highlighting things that IPs may not have thought of is a major development – it helps IPs as well. However, the BPF can't endorse any of these models. What we can say is that there's nothing contentious or prejudicial, but we have to be very careful with cartel arrangements. All landlords have to vote individually based on their own portfolios and their own investors' models.

Is there a feeling that landlords can take a hit in a worst case scenario because they gain from both the increase in property or site values and the income from rents as well?

The idea that the landlord just builds property, a centre, a retail park or an office building, then sits back and collects the rent, is not accurate. Most big landlords spend a lot of time and money micro-managing their assets to drive value for their tenants. Business models are established, the lease lengths have come down to ten years – they used to be 15. There's also a myth about over-renting. An IP may say, these rents are above market value because they're a desirable unit, you had various tenants bidding for it and got the best deal. That may have happened, but usually the reason for above-market value is because the tenant has received a long rent-free period, or a big capital contribution such as landlords' works or an escalator, for example. There's a large amount of capital to pay back and the landlord's business model will work out what rental level is required to pay this money back and give the desired level of additional income – profit – over that period of time or up to the first break notice, when the tenant can legitimately leave. Assuming that bringing a lease down to market rent won't affect the landlord ignores that investment. If the tenant goes bust after two years, that's a major impact on the landlord because they're not going to get their money back on their investment.

> "Most big landlords spend a lot of time and money micro-managing their assets to drive value for their tenants."

Would you like more tenants to come to you when there's an initial problem rather than waiting until there's a critical problem?

We want to encourage dialogue when a problem is genuine and discourage it when it's strategic. Landlords are not a bank – the first point of free loans – and borrowing landlords' rent to pay other suppliers » rather than going to the tenants' own bank is not the way. We can generally reconfigure something if there's a major problem and they provide financials, so we can make a forensic decision. We might give them a concession in exchange for a landlord break, for example.

How can the industry develop constructive agreements that are seen to be fair? The recent Mamas & Papas proposal is being held up as an example.

The Mamas & Papas CVA was a typical KPMG model, with a few extra bits in it. The landlord community is used to seeing this type of CVA model. There is only so much money – the level of investment, the number of units and the manageability of that portfolio are all going to be different. However, certain terms of these CVAs seem to be common ground now and it would seem a good idea if R3 could say, 'This is a standard form, we recommend…' – almost like a standard CVA. Anything that differs from that could be highlighted very quickly and evidence to justify it could be sought.

What more can IPs do to improve confidence in the insolvency regime for landlords?

Scrutiny. If you go back ten years or so, when a company went into administration, you would have a meeting with the IP and the new buyer of the business. Nowadays you see the buyer of the business and their highly incentivised letting agent. You don't see the IP anymore and we are pressing for the IP to retain a seat at the table to stress-check the rental proposals and the new proposals to ensure they are watertight and not prejudicial – to ensure this is a genuine attempt to rescue an existing business and save what they can, rather than strategically increasing profits downstream for a new investor or a new owner.

> "CVAs are only as good as the last one because people tend to build on what's been established."

It applies to administrations and CVAs as well. We would like to see the IP at the table right up to the point where leases are assigned to the Newco. Thinking about CVAs – as an example the JJB CVA – Dick's Sporting Goods put £20m into JJB, just as a toe in the water in the UK, and it wouldn't have hurt them to pay KPMG to have someone sitting at the table at JJB to make sure that CVA was working properly. We would like IPs to have that level of scrutiny, to have more power. We would like them to have more authority over the Newco and what the Newco is doing. Because they are, in a way, protected by the moratorium, against any legal action or the recovery action, and yet there's very little that the landlord can do to ensure fairness and make sure the rental levels being proposed aren't ridiculously low. The IP's presence would instil a lot more confidence in the system as it stands.

If landlords were to see three changes to the insolvency regime, what would they like them to be?

Coming on from the last point, certain parts of the sale and purchase agreement between the IP and the Newco should be published and seen by the landlords. Any that are sensitive can be done through a non-disclosure agreement or you could just publish the categorisation of the leases. But more publication, more visibility, that's one.

Two: perhaps limiting the moratorium, after the Newco has bought the assets of the business, so they can negotiate on an open market basis, rather than being protected and saying, we will walk away from that lease unless you give us a deal on it. That would make things better. As soon as the sale has been completed to the Newco, the moratorium is lifted because then we're dealing on an open market basis. They can say, we will take the lease or we won't take the lease and we can say, we will give it to you, or we won't give it to you. It becomes a straight property deal then rather than all the cards being stacked in favour of the Newco.

Number three is something that I've spoken to Giles Frampton about before – notices of intention. These are not public notice documents at the moment and they should be. We've suggested that they are either published on The Insolvency Service website when they're filed or, more preferably, they should be gazetted. We want to see the same level of disclosure as for a winding-up petition or a meeting of creditors. If necessary, let's get the primary legislation because at the moment these things are invisible and can be used strategically – often the landlord doesn't know they've been filed. We have had situations where up to four have been filed, one after another. What happens is: notice of intention goes in; after ten working days, another one goes in; after ten working days, the excuse is the deal wasn't done in time. Some are put in place strategically. The administrator is appointed after that and he will only take on the responsibility from that point onwards. So while these repeated notices are being filed, more of the landlord's rent is becoming unsecured. He can therefore end up with a month's worth of income disappearing under notices of intention because he can only claim for it once the administrator is installed. Insurances might deter investment. All these things sound very nice, but you're trying to get investors to put money into these businesses. We've already seen HMRC asking for VAT deposits on failed and phoenix companies, where there's a history of insolvency. Who would pay for the insurance and would the Newco pay for what is effectively an insurance bond? Who would insure them? It would fall down on the 'real world' test; a landlord isn't going to pay for the insurance; the premiums are prohibitive, it's cheaper to take the hit, actually.

Why should IPs build a relationship with the BPF? What do they get from understanding your viewpoint and what's in it for them?

Fewer challenges for a start, and a much easier life. Better cooperation from the landlord community. I was talking to an IP recently about a small matter, not a national issue, and we sent him a lot of information he didn't otherwise have. Whenever there is a big insolvency now, the first thing I do is send a schedule off to the

> "Let's get the primary legislation because at the moment these things are invisible and can be used strategically."

lead IP explaining our portfolio, rental levels and service charges to show what they are dealing with. They can come back and we can make rational decisions about it. It's very much a collaborative approach and I'm sure it's just as helpful to them as it is for us. KPMG is on the front foot with this. The others are catching up and there's a lot of goodwill there.

Is there anything you want to add?

At the time of the interview, we're still waiting for the decision of the Supreme Court on the Game trial. Even though it's only an outside possibility that the Court of Appeal decision will be overturned, all IPs have to act as if it could happen. So we're still working as if it's the bad old days. With the Mamas & Papas situation, for example, all those units would have closed in administration just before the next quarter day if that CVA hadn't gone through because IPs don't want to pay three months' rent. If the Supreme Court decision and the Appeal Court decision had been overturned, even if the IPs had only traded for two days, they would have had to find three months' money.

SANDRA KESSELL is the publishing manager of *RECOVERY* magazine.