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Winter 2013

RECOVERY

Litigation from an insolvency perspective

The story so far

Insolvency litigation funding
The opportunities and pitfalls

Conflict in the pursuit of conflict
Handling disagreements in litigation strategy

Gender equality in the insolvency profession Female representation is not about nice graphs

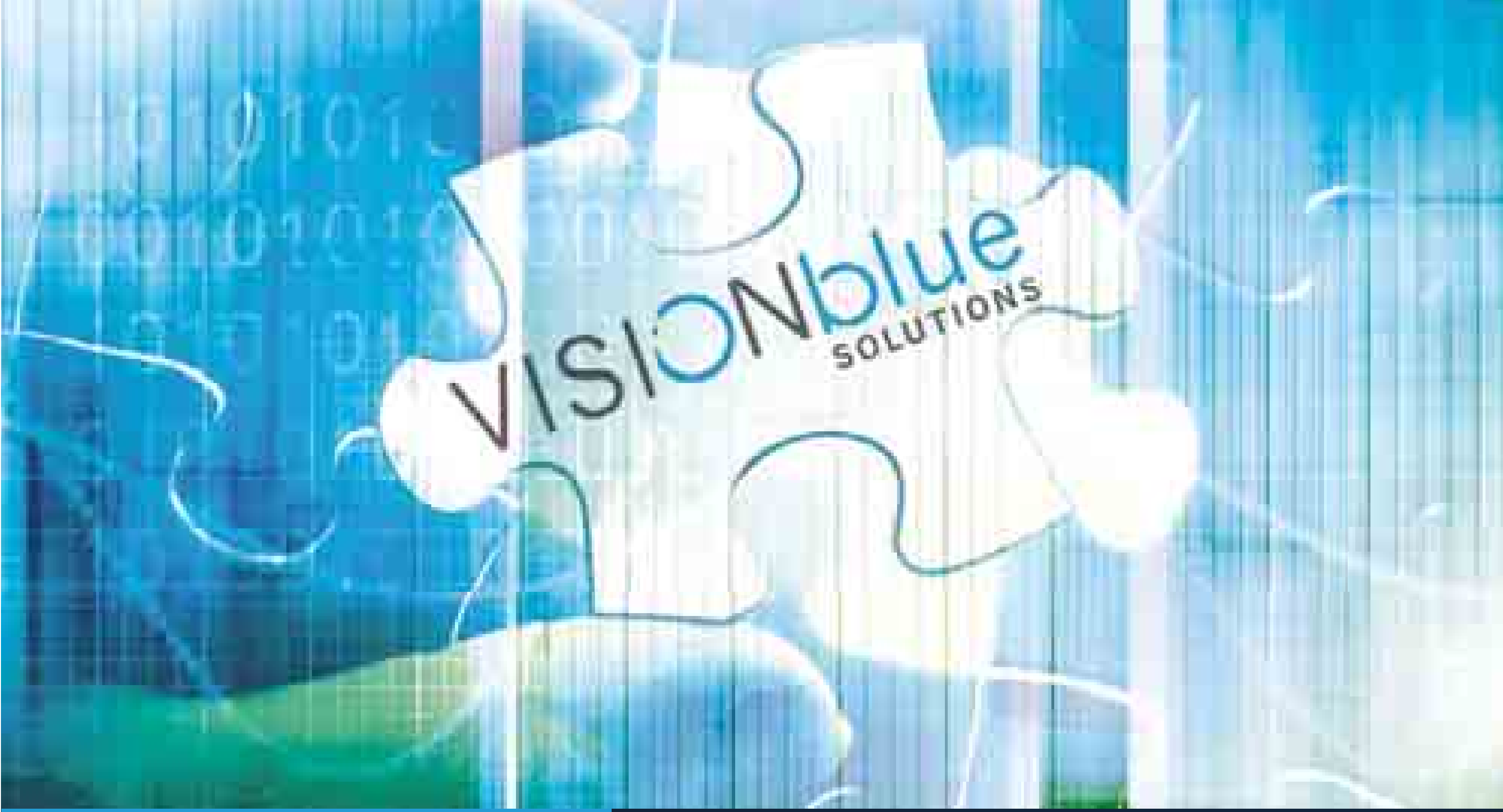
Piercing the corporate veil
A doctrine or a principle?

A winter's tale
Debt and bankruptcy in the 19th century novel

Ch-ch-ch-ch-changes
Borrowing from Bowie in a period of considerable upheaval

Interview with...
The head of IP regulation at The Insolvency Service Nick Howard on regulation and reform in insolvency practice

Plus Legal update, R3 Smaller Practices Group and how research into the Jackson reforms is progressing



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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

Trust and transparency is the current theme of the government's thinking about companies, directors and insolvency and on pages 4 and 5 Phillip Sykes discusses some of the suggestions from Vince Cable that could affect the insolvency profession. Of course, the profession has also been under scrutiny in the Kempson review of remuneration and Teresa Graham is currently looking at pre-packs, as we are reminded by Liz Bingham on page 7 and in the interview with Nick Howard on pages 42 to 44.

Most IPs get right what they do and deserve public trust. Many also constantly demonstrate complete transparency, and so show that they are worthy of that trust. But it is the few who do not live up to these high standards that have led to a perception that there are problems with the profession, as Nick Howard acknowledges. This is not just in relation to fee levels and pre-packs: September's winding up by the Insolvency Service of three companies said to have received introducer fees from IPs may have been in the public interest, but the alleged involvement of a few IPs in such activity added to the negative perception that the profession has to bear.

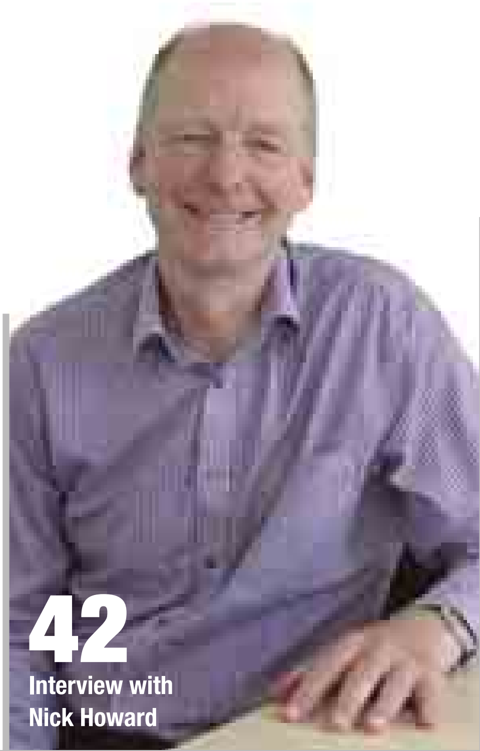
Elsewhere in this issue, Joe Bannister on pages 11 to 13 not only analyses *Eurosail* but considers the subsequent application of the balance sheet test in *Casa Estates* – a piece of insolvency litigation that adds to our understanding of s123 (and a judgment worth reading); Clive Petty on pages 20 to 22 discusses insolvency litigation funding – particularly usefully for those who might need it only occasionally; and Michael Rutstein on pages 24 and 25 explores how to deal with creditors whose views on litigation strategy differ from the officeholder.

Finally, Chris Norman's essay on pages 32 to 34 tempts those who need more debt and bankruptcy than they encounter in real life to dip into the 19th century novel!

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

Regulars

Regulars



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SPRING Professional service firms, including practice management

SUMMER Not-for-profit organisations and insolvency

AUTUMN Business rescue including pre-packs and CVAs

WINTER The leisure industry

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Trust, transparency and the fairness factor

Phillip Sykes details potential pitfalls in the latest proposals to change the IP rule book.

At the Liberal Democrat annual conference in Glasgow this autumn, Vince Cable, the Business Secretary, announced – to much fanfare – new rules aimed at boosting trust and transparency in British business.

That Dr Cable had already announced these new rules – to distinctly less fanfare – back in July didn't seem to matter much to anyone, but that's by-the-by. What really matters is that the proposals entail some potentially significant changes to insolvency practitioners' roles and responsibilities when it comes to errant directors and financial redress for creditors.

Three Rs for IPs

The proposals relevant to insolvency professionals fall into three main categories: those aimed at increasing the transparency of UK company ownership; those relating to the behaviour of directors (including three 'Rs': director responsibilities, director regulation and creditor redress); and director education.

Starting with company ownership issues, the discussion paper outlines a range of proposals to beef up a 'central registry' so that the information held by UK directors is robust and transparent.

> "It's both a little odd and rather concerning that two government departments are proposing such contradictory policies."

R3 is broadly supportive of the measures included in the paper to improve transparency. The insolvency practitioner's ability to get to the bottom of fraudulent directors' behaviour would be enhanced by much stricter proof of identity requirements for those registering new businesses at Companies House (to prevent multiple registrations under differently spelt names, for example), or for companies to be required to list all directors 'howsoever described' at Companies House to help crack down on disqualified directors working behind the scenes as advisors or shadow directors.

Errant directors

Moving on to the behaviour of directors, a key proposal within the paper is to improve creditor redress. The proposals are laudable and welcomed: financial redress is vitally important. But the paper seems to gloss over the fact that very versatile tools are already available to insolvency practitioners to help them pursue errant directors for creditors' benefit.

In fact, it's precisely these tools that Dr Cable's colleagues at the Ministry of Justice plan on removing from the insolvency practitioner's locker when the profession's exemption from the Jackson reforms ends in 2015.These reforms will curtail the use of the 'no-win, no-fee' agreements that are so useful to insolvency practitioners and creditors. It's both a little odd and rather concerning that two government departments are proposing such contradictory policies.

And while the proposal for courts to make compensatory awards against directors is a positive, the Department for Business, Innovation & Skills (BIS) must consider: how practical it would be to make a compensatory order and disqualification order at the same time; whether compensatory orders would deter civil claims for the benefit of the insolvent estate; whether directors would become more likely to defend disqualification actions (currently 80 per cent of cases end in agreed undertakings); and whether The Insolvency Service has the right level of resource to arrive at a figure for a fair compensation order.

In the detail

It's a similar story elsewhere: welcome proposal; difficulties in the detail.

One of the BIS proposals is for relevant sectoral regulators to have the power to make a court order for a disqualification order for a director (alongside The Insolvency Service, that is). At first glance, the idea looks sensible: it's a possible way to relieve some of the burden on The Service, and help keep the number of disqualifications closer to the number of negative D reports filed by insolvency practitioners.

However, there is a danger, no matter how well meaning this proposal is, that it could introduce an element of

> "While a greater emphasis on pre-emptive or ongoing education for directors would be ideal, BIS has mostly got it right on the principles of post-disqualification education."

inconsistency to the system: different regulatory bodies have different levels of resourcing to conduct investigations and certainly different approaches to actually carrying out those investigations.

Better communication needed

To keep consistency – and fairness – in the system, it would be best if responsibility for disqualifications were to remain with The Insolvency Service; although better communication between sectoral regulators and The Insolvency Service would be beneficial.

Similarly, the BIS proposals for more factors to be taken into account when disqualifying directors could stumble on the detail. Creating a finite list of proscribed behaviours will automatically

define an infinite list of behaviours that aren't proscribed (resulting in plenty of scope for rule-bending and arguments over technicalities), while other proposals – such as explicitly requiring a 'wider social impact' or directors' track records to be considered in disqualification proceedings – cover things that are already done in practice, but which may no longer work so well if an attempt to turn *de facto* into *de jure* isn't done exactly right.

And again, BIS is correct that individuals subject to foreign restrictions on company ownership (or similar) should be blocked from involvement in UK companies, but it is also right to ask for advice on whether the ban should apply automatically or after a court hearing. While automatic bans may save money, given the multitude of standards in different jurisdictions in the world, arguably only a court hearing would be fair.

One potentially risky proposal on creditor redress is for liquidators to be able to sell wrongful or fraudulent trading actions: whereas an insolvency practitioner has the interests of creditors at heart, purchasers do not have the same obligation and creditors may lose out in such a situation. Returns would be smaller owing to the purchaser's fee, while a third-party purchase of the claim would prevent the insolvency practitioner from using their investigatory powers (with the intention to litigate pretty clear from the sale in the first place). There is, of course, also the danger of connected parties purchasing claims only to quickly drop them.

Plenty to support

Quibbles aside, there is still plenty in the proposals to support, especially in relation to director education. While a greater emphasis on pre-emptive or ongoing education for directors would be ideal, BIS has mostly got it right on the principles of post-disqualification education.

A training scheme for disqualified directors, floated by BIS, could encourage directors to make the most of their second chance once available; completion could

> "Principle is very different to the hard currency of practicality."

result in smoother access to finance or lower directors' and officers' liability insurance rates, while reduced disqualification tariffs could help incentivise directors to both take the education course and take it seriously.

Fanfare or not, BIS' latest proposals will have an impact on the profession. Without changes, BIS' proposals would, in principle, help insolvency practitioners achieve higher returns to creditors than they do now; but, principle is very different to the hard currency of practicality. It will be interesting to see how BIS' final proposals shape up once published. ◻

PHILLIP SYKES is R3's deputy vice-president and head of corporate recovery at Moore Stephens.

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President's column

Liz Bingham discusses diversity in the insolvency profession, encouraging fresh talent and the need for IPs to share their views.

Often, when people pick quotes to open a column, they choose the words of great playwrights like Shakespeare or statesmen like Kennedy; I'm going to pick Vince Cable. 'I am preparing to legislate to make it easier to prosecute and ban rogue directors who repeatedly walk away from their debts and their customers,' declared the Business Secretary in his speech to the Lib Dem conference in September.

It was just one line in his 20 minute speech, but the inclusion of the Department for Business, Innovation & Skills' (BIS) work on rogue directors in a key speech shows how far up the department's priority list the issue has risen. There are some potentially big changes for the profession tucked away in the consultation document – including extending director disqualification powers to sectoral regulators and enhanced creditor redress – which are looked at in greater detail elsewhere in this edition.

Sharing our views

There's plenty to like in the principles behind the proposals, but BIS do need to get the details spot-on for them to work in practice.

With the window for comments on the proposals now snapped shut, we'll have to wait and see what the final proposals look like. What's encouraging is that government departments and The Insolvency Service are very good at listening to the profession's input when it comes to regulatory changes that can have a big impact on IPs' work.

For example, R3 has been in close contact with the Treasury and the Financial Conduct Authority (FCA) over the drafting of the legislation on the transfer of consumer credit licensing to the FCA from the Office of Fair Trading. There's been a lot of back-and-forth on this, and hopefully we're edging towards wording of the legislation that doesn't create extra red tape for the profession.

We've also had two really great sessions for IPs to share their views with Teresa Graham, who's running the government's latest review of pre-pack administrations. Both sessions were, shall we say, lively, and I know that Teresa found the input from IPs very useful.

Pre-packs and transparency

We all know that pre-packs are a very valuable part of the UK's insolvency landscape, but I think we all also understand the concerns about transparency and connected parties that exist around them. If any of Teresa's eventual recommendations can help lower some of the 'noise' around pre-packs that will be something to welcome.

What will be interesting to see is how Teresa's recommendations fit in with the final proposals from BIS on rogue directors. There are many factors that can create a less-than-perfect pre-pack, one of which can be a rogue director. Both consultations, then, are strands of the same thread, and will need to be considered in relation to each other.

"While there isn't outright discrimination, there are often unconscious biases or suppositions in play."

Diversity in the insolvency profession

For me, the other important IP get-together since my last column was the roundtable I hosted in September on diversity in the insolvency profession. In my day job as EY's managing partner for people in the UK and Ireland, I get to see day-in and day-out the benefits firms can reap from having the right mix of skills and experiences in their teams – and how talent can be wasted if firms don't recognise their employees' different needs.

The roundtable brought together male and female IPs, regulators, and professional bodies to share experiences about how they got into the profession and how they found gender diversity worked in practice.

It was fascinating to hear how similar the experiences of the female IPs at the event were, whether they worked in large firms or small, particularly in terms of the impact that a lack of senior female role models or managers can have on young female IPs' ability to climb up the career ladder.

It seems that no matter how many rules and regulations on diversity that you have within a firm, what really matter are the actions and attitude of individuals that are actually implementing those policies. While there isn't outright discrimination, there are often unconscious biases or suppositions in play, which can be tougher to spot and ameliorate.

Encouraging fresh talent

What also came across from the roundtable was the enthusiasm IPs had for their career and for bringing new people into the profession. I'm sure the same is true for the majority of IPs: once you're in, you're hooked.

IPs' enthusiasm for our work is probably one of the profession's biggest assets when it comes to bringing fresh talent into our teams; what's important is making sure that we're making the most of this enthusiasm, and that, once we've brought talent into the profession, we keep it.

While we can talk the good talk on diversity and talent development, we do need to walk the walk too, so I was very interested to hear about the R3 South West and Wales Committee's school visits project at a recent Regional Communications Committee meeting.

It's still early days, but the trial run – which saw local IPs volunteer to give local schoolchildren a taste of their work – sounds as if it went fabulously well. The committee will be looking to develop the project further over the next few months. It's an excellent initiative and those involved deserve congratulations. □

LIZ BINGHAM is president of R3 and a partner at Ernst & Young.

Danuta Brzezińska wins the Richard Turton Award 2013

The committee is delighted to announce that the winner of the 2013 Richard Turton Award is Danuta Brzezińska from Poland. Danuta worked for Magnusson in Warsaw from 2007 until July 31 2013 and currently works for Dentons in Warsaw, Poland. She is a member of the Polish (Warsaw) Bar Association. As part of the award Danuta was invited to attend the INSOL Europe Conference in Paris. She will be writing a paper that will be published in summary in one or more of the member associations' journals and in full on their websites. The committee congratulates Danuta for her excellent application and also thanks all the candidates who applied for the award this year. There were many excellent submissions and the judges' task was particularly difficult this year.

About the award

Richard Turton had a unique role in the formation and management of INSOL Europe, INSOL International, The Insolvency Practitioners Association and R3. In recognition of his achievements the four organisations jointly created an award in his memory. The Richard Turton Award is an annual award providing an educational opportunity for a qualifying participant to attend the annual INSOL Europe Conference. In recognition of those aspects in which Richard had a special interest, the award for 2013 was open to applicants who fulfilled all of the following:

- Work in and are a national of a developing or emerging nation;
- Work in or be actively studying insolvency law and practice;
- Be under 35 years of age at the date of the application;
- Have sufficient command of spoken English to benefit from the conference technical programme;
- Agree to the conditions below.

This year's applicants

Applications for the award were invited to write a statement detailing why they should be chosen in less than 200 words. A panel representing the four associations adjudicated the applications. The panel members were as follows: Stephen Adamson – INSOL Europe, Neil Cooper – INSOL International, Patricia Godfrey – R3 and Maurice Moses – the IPA. The committee received an outstanding number of applications of exceptional quality for the award this year and it was a very close run decision as the standard of applicants was superb. The committee is delighted that the award has attracted such enthusiasm and response from the younger members of the profession and knows that Richard would also be extremely pleased that there had been such interest.

Blockbuster hits the buffers but it's a different story at Clerys

Video rental company Blockbuster's entry into administration for the second time this year has highlighted the challenges facing high street stores as the public turn to the internet for shopping and services. The company, which had 264 stores before losing out to online rivals such as Netflix and LoveFilm, was sold to Gordon Brothers Europe earlier this year. Despite its strapline of 'creating value where others see none' the global advisory, restructuring and investment firm has taken Blockbuster as far as it could before seeking a new owner.

Meanwhile, in Dublin, the Clerys department store, which has been restored following extensive storm damage, is reopening to the shopping public.

Gordon Brothers Europe bought the total debt, agreed a new working capital facility and created a new plan working with restructuring professional Paul McCann of Grant Thornton.

As a result two out-of-town stores and a discount store are no longer part of Clerys' trading operations, with the department store now the focal point of trading.

Commenting on the purchase and restructure of Clerys, Fraser Pearce, Gordon Brothers Europe's senior managing director, investments, said preserving the heritage and value associated with the store's name had ensured shoppers' return.

'An innovative and sensitive approach alongside a proven operational track record were key drivers for this acquisition,' he said.

In a press release Gordon Brothers said securing employment for all staff, including those from the concession partners, had also been important and through working alongside Grant Thornton, Gordon Brothers had been able to agree settlement claims with trade suppliers in record time retaining confidence in Clerys and ensuring value was preserved for suppliers, concession partners and employees.

More details are available on the **gordonbrotherseurope.com** website.

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

Obituary: Former R3 luminary Mike Stancombe 1940–2013

It was with particular sadness that the many friends and acquaintances Mike had made at R3, among its members, staff, sponsors and other supporters, heard of Mike's passing in August.

Mike was born in Bristol in 1940, later growing up near Taunton in Somerset, before attending Cranbrook School in Kent, where he captained the cricket and rugby teams. After leaving school, Mike joined the Army. When he passed out from the Royal Military Academy, Sandhurst, he was awarded the prestigious Sovereign's Sword of Honour as the top officer cadet in his intake. He was duly commissioned into the Royal Engineers.

Mike's 30-year career in the Army included tours in Germany, Northern Ireland, Belgium, Sudan, Canada and Borneo – where there is a bridge that bears his name. Upon leaving the Army he joined the Institute of Civil Engineers, before moving on to R3.

Key figure

Mike joined R3, then known as the Society of Practitioners in Insolvency (SPI), as general secretary in 1994, retiring as chief operating officer in 2005, and as such was a key figure in R3's development and evolution.

Among Mike's achievements at R3 were overseeing the consolidation of SPI as an association with all-UK coverage; and latterly both the change of name and emphasis that saw the SPI become the Association of Business Recovery Professionals, with its now well recognised shorthand name of R3, standing for Rescue, Recovery and Renewal. Mike also oversaw R3's involvement with the turnaround community via the establishment of the Society of Turnaround Professionals (STP) now the Institute for Turnaround (IFT).

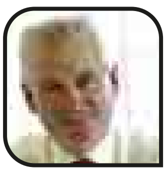
A generous colleague

Mike's funeral took place in August, and I was privileged to attend as R3's representative. Also present were two former R3 presidents, Gordon Stewart and Murdoch McKillop, and a number of others who had worked with him on Council, and representatives of our key sponsors. There was a strong military presence too, as would have been expected.

Mike was a hard-working, generous and compassionate colleague. I knew Mike not just as the person who succeeded him but also through his continued association with the industry via the Insolvency Practices Council, for whom he was secretary from the time he retired until it ceased to exist in 2012.

Mike leaves behind his wife Sheila and daughters Julie, Katie and Nicky and his grandchildren and will be greatly missed by them and his wider circle of friends; and R3 members will recognise Mike's philosophy of life in the words of *Afterglow*, which formed the last part of the order of service at Mike's funeral.

I'd like the memory of me
To be a happy one.
I'd like to leave an afterglow
Of smiles when life is down.
I'd like to leave an echo
Whispering softly down the ways
Of happy times and laughing times
And bright and sunny days.
I'd like the tears of those who grieve
To dry before the sun
Of happy memories
That I leave when life is done.



GRAHAM RUMNEY is the chief executive officer at R3.

Deal behind the Penningtons and Manches merger is made public

The details behind this autumn's deal between Penningtons Solicitors LLP and Manches LLP, has emerged after PwC filed its creditors notice.

In an in-depth investigative article, *The Lawyer* points out that unpaid tax bills pushed Manches towards administration and the merger was a pre-pack deal. The newly merged firm's spokesperson has pointed out that Manches' underlying business was and remains robust and successful. Insolvency advisers at Baker Tilly helped broker the deal, under which the two firms become Penningtons Manches LLP with 115 partners.You can read more details about the deal at **thelawyer.com**

Further fines and disqualification for bankrupt businessman

A bankrupted businessman has been fined £3,000 and disqualified as a director for four years after Manchester Magistrates Court heard he had been running a company in breach of bankruptcy restrictions.

Mark Roy Garner, who was a director of Planet Confidential Limited, breached restrictions and failed to supply information required by the company's liquidator. Mr Garner, 57, also failed to submit tax returns to HMRC, leaving more than £341,000-worth of taxes unpaid.

He gave an undertaking not to act as a director or in the management of a limited company for 12 years, the term of all the disqualifications resulting from criminal proceedings and from civil disqualification proceedings.

Rob Clarke, head of Insolvent Investigations North at The Insolvency Service, said:

'Company directors should be under no illusion that it is a criminal offence to act as a company director whilst an undischarged bankrupt, and Mr Garner now has the criminal record to show for it.

'Directors who breach their bankruptcy restrictions should be in no doubt that The Insolvency Service will investigate and the Department for Business will prosecute those who choose to ignore this warning.'

There are more details of this case at The Insolvency Service website **bis.gov.uk/insolvency** or follow updates via Twitter @insolvencyg.

Get the latest insolvency news and updates by following R3 on Twitter @R3PressOffice.

Insolvency Practitioners Association New Corporate Insolvency Exam

The Insolvency Practitioners Association (IPA) recently announced the launch of a new corporate insolvency examination together with other enhancements to its Certificate of Proficiency in Insolvency (CPI).

The IPA was established over 50 years ago to serve practitioners specialising in insolvency work and to advance knowledge and understanding of insolvency. Its CPI exams have been set annually since 1995 and enjoy strong brand recognition amongst students, employers and the wider profession as an intermediate test of competence and a valuable and worthwhile achievement. Feedback from member firms confirms that the mix of multiple choice, short form as well as essay style and longer computational questions provides an important boost to the skills and abilities of candidates' conducting insolvency assignments in the workplace.

The IPA will for the first time offer exam sittings in December and going forward will run the exams twice annually, with results issued in the month following the sittings. A new syllabus for the suite of exams has now been published and is available to download from our website.

CPCI

Three years ago the IPA introduced the Certificate of Proficiency in Personal Insolvency (CPPI) for those focussing on this sector of the market. In August 2013 it launched a new equivalent paper for those whose work is primarily concerned with procedures for insolvent companies – a Certificate of Proficiency in Corporate Insolvency (CPCI). It is the first examination of its kind at this level and has been warmly welcomed by a number of leading firms in the market place.

We are now accepting bookings for the June 2014 exam sitting please visit our website at www.insolvency-practitioners.org.uk to download your booking form or call 020 7623 5108.

Past the point of no return

Joe Bannister examines the Supreme Court's reassessment of balance sheet insolvency.

On 9 May 2013, the English Supreme Court handed down its decision in the *Eurosail*[1] case, in the process clarifying the meaning and application of the balance sheet test for insolvency under s.123(2) Insolvency Act 1986 (IA 86) (the balance sheet test).

The Supreme Court affirmed the Court of Appeal's decision that Eurosail was not balance sheet insolvent. Of more interest to borrowers, lenders and insolvency practitioners is the Supreme Court's rejection of the 'point of no return' test applied by the Court of Appeal when assessing the balance sheet test. The Supreme Court held that whether or not the balance sheet test is satisfied must depend on the available evidence of the circumstances of a particular case, and the phrase 'point of no return' should not pass into common usage as a paraphrase of the effect of the balance sheet test.

Accordingly, the valuation and evidencing of a company's long-term liabilities may be a challenging exercise. It can never be a 'matter of speculation'.

Background

The IA 86 does not define 'insolvency'. However, under section 123 IA 86, a company is deemed unable to pay its debts:

- If it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due (section 123(1)(e) of the IA 86) (the cash flow test); and
- If it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (section 123(2) of the IA 86) (i.e. the balance sheet test).

> "The phrase 'point of no return' should not pass into common usage as a paraphrase of the effect of the balance sheet test."

The cash flow test concerns a company's ability to pay its debts when they fall due and is therefore relatively straightforward to determine. Conversely, the balance sheet test involves an assessment of future events resulting in an unavoidable element of speculation.

The facts

Eurosail-UK 2007-3BL PLC (the issuer) was a special purpose vehicle set up in July 2007 to acquire a portfolio of UK sub-prime residential mortgage loans. To fund the acquisition the issuer issued £660m of loan notes in several classes and currencies (the notes). The final redemption date of certain of the loan notes is in 2045. BNY Corporate Trustee Services acted as the noteholder trustee (the trustee).

As the notes were in mixed currencies and the mortgages were all in sterling, the issuer entered into both a currency and an interest rate hedge. Unfortunately, both hedges were with a Lehman Brothers entity. Despite this, the issuer could still pay interest on all classes of notes as it fell due. Interest rates under the mortgages were significantly higher than the interest rates under the notes. The issuer did not therefore fail the cash flow test.

However, a class of noteholders (A3) tried to argue that because of the loss of the hedges the issuer was balance sheet insolvent. They asked the trustee to call an event of default. The result would have changed the priority of payments to the various noteholders (in particular in favour of the A3 noteholders).

»

Furthermore, under a Post Enforcement Call Option Agreement (PECO) the trustee had granted an option to Eurosail Option Limited, a company associated with the issuer, to acquire all notes remaining once the security had been enforced and all of the assets of the issuer had been exhausted. The PECO's purpose was to render the issuer bankruptcy remote, necessary to allow the notes to be listed, by achieving the effect of limited recourse without adverse tax consequences.

The Court of Appeal ruling

The Court of Appeal considered two issues:

(a) **Was the issuer 'unable to pay its debts' in accordance with the event of default?**
Counsel for the A3 noteholders argued that the balance sheet test simply required a review of the balance sheet of the company. The Court of Appeal ruled (following the High Court's decision) that the balance sheet test could not be reduced to a single formula or set of principles that applied to all companies. A key consideration in reaching this decision was the need to avoid too literal a reading of the balance sheet test, which would mean many solvent companies (especially those early on in their lives) becoming vulnerable to a finding of balance sheet insolvency.

> "The cash flow test concerns a company's ability to pay its debts when they fall due and is therefore relatively straightforward to determine."

Lord Neuberger considered that a company would (before it could be wound-up) have to have reached the 'point of no return' so that the directors of that company would need to 'put up the shutters'.

(b) **If the answer to (a) was yes, then did the existence of the PECO mean that the issuer should not be deemed unable to pay its debts?**
Because of the commercial reality behind the PECO, Lord Neuberger was satisfied that the court would dismiss a petition presented on the ground of balance sheet insolvency. However, because of certain wording (i) in the prospectus, and the terms and conditions that provided that the noteholders were to have full recourse to the issuer in respect of payments, and (ii) in the Deed of Charge granted by the issuer, which provided that the trustee could enforce the noteholders' rights on enforcement only to the extent of the issuer's assets but that 'shall not apply to and shall not limit the obligations of the issuer to the noteholders under the instruments and this deed' the noteholders' rights were full recourse until the enforcement of the security (at which point the PECO would come into operation) and limited recourse thereafter. Therefore, the issuer could be balance sheet insolvent, but was unlikely to be subject to insolvency proceedings. It was 'bankruptcy remote' but not 'insolvency remote'.

The Supreme Court decision – key aspects

1. Although the case concerned principally the scope and application of the balance sheet test, the Supreme Court also considered the cash flow test. In doing so the Supreme Court confirmed that the cash flow test was concerned not just with present liabilities, but also involved an element of futurity. Expressly approving the decision in *Re Cheyne Finance Plc* (No 2) [2008] Bus LR 1562, Lord Walker confirmed that the cash flow test was concerned:

   '…not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business.'
2. The balance sheet test, on the other hand, would apply once the court had to move beyond the reasonably near future, at which point the cash flow test became completely speculative, and the balance sheet test became 'the only sensible test'.
3. The Supreme Court agreed with the Court of Appeal that, when considering balance sheet insolvency, a company's statutory balance sheet was a starting point only. The comparison had to be of present assets against present and future liabilities, discounted for contingencies and deferment. It disagreed, however, with Lord Neuberger's statement that when looking at balance sheet insolvency the company had to be shown to have reached the 'point of no return'. The burden of proof would be on the person

> "The balance sheet test involves an assessment of future events resulting in an unavoidable element of speculation."

who was claiming that the company was balance sheet insolvent. That person had to satisfy the court that on the balance of probabilities the company had insufficient assets to be able to meet all of its liabilities, including prospective and contingent liabilities.

4. On the facts, because of (i) the long-dated nature of the liabilities under the notes (due in 2045, more than 30 years down the line), and (ii) the impossibility of predicting with any confidence the future health of the UK housing or movements in currencies and interest rates, the Supreme Court held that the issuer was not currently balance sheet insolvent.
5. The Supreme Court also dismissed the cross-appeal on the PECO, for the same reasons as were given at first instance and in the Court of Appeal. The operation of the PECO had no effect on the assessment of the balance sheet solvency or otherwise of the issuer.

Casa Estates (UK) Ltd (In Liquidation) [2013] EWHC 2371

The balance sheet test has subsequently been applied in *Casa*. The case was notable because the company and respondent (who was the person seeking to uphold the validity of an alleged transaction at an undervalue) were connected. In such cases,

US Supreme Court, Washington DC

the burden of proof shifted and it was for the respondent to bear. Warren J went as far as to say he considered that *Eurosail* would have been decided differently had the burden of proof been reversed.

Comment

As well as being used in English insolvency legislation relating to voidable transactions and wrongful trading, the balance sheet test is used in many loan agreements and other commercial contracts as an event of

> "The decision also confirms what many practitioners had believed to be the case, namely that the statutory balance sheet of a company provides only a starting point…"

default giving rise to a right to terminate. The Supreme Court decision will reduce the concern following the Court of Appeal decision (and its 'point of no return' formulation of the test) that balance sheet insolvency was so difficult to prove as to be commercially worthless. The decision also confirms what many practitioners had believed to be the case, namely that the statutory balance sheet of a company provides only a starting point when assessing balance sheet insolvency, and that a careful analysis and valuation of the company's actual position taking into account its prospective and contingent liabilities then has to be undertaken.

So – has the *Eurosail* decision clarified the scope and application of the balance sheet test? The Supreme Court has set out some helpful guidelines but makes the point that each case has to be assessed on its own facts. In the case of a trading company whose liabilities are not 30 years down the line, while proving balance sheet insolvency may remain challenging in respect of trading companies whose liabilities are decades down the line, the judgment is welcome in that it avoids the speculation and ambiguity that the 'point of no return test' previously contributed to the assessment of a company's balance sheet health.

The author acknowledges the assistance given by his colleague Jon Dabbs in the preparation of an initial draft of this article.

[1] *BNY Corporate Trustee Services Limited and other (respondents)* v. *Neuberger Berman Europe Ltd (on behalf of Sealink Funding Ltd) and others (the Appellants)* and *BNY Corporate Trustee Services Limited and other (respondents)* v. *Eurosail-UK 2007-3BL PLC (appellant)* [2013] UKSC 28.

JOE BANNISTER is a partner at Hogan Lovells.

Technical update

New chairman **Mike Pink** considers the challenges and legal cases facing the General Technical Committee.

This autumn I took over the chair of R3's General Technical Committee (GTC) from Giles Frampton. Giles has gone on to a higher calling as vice-president, but has left the GTC in good order with a strong membership drawn from across the insolvency and legal professions and around the regions. I'm an insolvency practitioner with over 27 years of insolvency experience and, while I've always worked for a large firm during that career, I started out doing 'incomplete records' accounts preparation for micro businesses, audit and forensic work and as an IP have advised small and medium-sized enterprises (SMEs), multinationals and government; I recognise that the issues we face affect different firms in different ways. I hope that I can continue Giles' excellent work at GTC; there does seem to be a lot going on!

> "I recognise that the issues we face affect different firms in different ways."

Heavy going ahead

The key legal cases over the past quarter are being covered elsewhere in this journal; therefore, I thought this article would be a good opportunity to remind readers of the work the committee does on behalf of the members, and to bring them up to date on some recent developments.

The committee has a heavy workload, and there is a constant flow of issues that it is called upon to address. Some of these may at first sight appear to have little specifically to do with insolvency, but turn out to have implications for the insolvency profession that need to be resolved. Recent examples of these have included real-time information for PAYE and the automatic enrolment of employees into pension schemes.

In the case of real-time information, lengthy discussions were held with HMRC, as a result of which joint guidance has been issued, and is available both in Technical Bulletin 105 and on the HMRC website. In the case of auto-enrolment, GTC has met representatives of the Department for Work and Pensions (DWP), the Pensions Regulator and NEST (the National Employment Savings Trust). At their request a paper has been submitted setting out the issues that the scheme raises in insolvency cases, which it is hoped will provide a basis for future guidance. Members will also be aware of the guidance that was developed with HMRC on the treatment of VAT on supervisors' fees in the wake of the *Paymex* decision.

Compensation claims

Another difficult area has been how to deal with claims for compensation for the mis-selling of financial products. Guidance on Payment Protection Insurance (PPI) mis-selling claims was issued in April this year, with a Scottish version in November. After that came the various issues surrounding the mis-selling of interest rate hedging products. Following discussions with the Financial Conduct Authorit (FCA) guidance was issued to members in November. The latest scandal concerns the possible mis-selling of card and identity theft protection. The FCA is discussing a compensation process with the principal parties involved and will be seeking court approval of a redress scheme similar to the PPI mis-selling redress. This is likely to become a further complicating factor in personal insolvency cases, and may require further guidance in due course.

> "The committee has a heavy workload, and there is a constant flow of issues that it is called upon to address."

As I write, other matters of concern include:

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Consultation and collective redundancies: This continues to be a major concern, and in an attempt to move things forward a paper has been submitted to the Redundancy Payments Service, which it is hoped will provide a basis for discussion and guidance.

Consumer credit licensing: In April next year responsibility for the consumer credit licensing regime will pass to the FCA, and a comprehensive new legislative and regulatory framework will come into effect. There remain questions over the position of insolvency practitioners under the proposed new regime, and we are currently in correspondence with the FCA and the Treasury.

> “Some of the proposals are welcome, others are less so…”

Money laundering: The Consultative Committee of Accountancy Bodies is considering updating its guidance, and R3 has been asked to provide an annex on insolvency. The hope is to obtain Treasury approval of the revised guidance, but at the time of writing there remain doubts over whether this is likely to happen.

Modernising the taxation of corporate debt: The Treasury published a consultation on proposed changes to the current regime in June, and a response was submitted by the specialist R3 tax group.

The European Regulation on Insolvency Proceedings: The European Parliament's Committee on Legal Affairs has published a report on the Commission's proposals for amendments to the Regulation. The report recommends various amendments to the Commission's proposed changes. This necessitated the submission of a paper to The Insolvency Service at very short notice. At the time of writing it is unclear how this will develop.

The Red Tape Challenge: Following the conclusion of the Red Tape Challenge process, the Insolvency Service issued a consultation document in July. The document invited responses to 68 questions, seeking views on a wide range of possible amendments to insolvency law. Some of the proposals are welcome; others, such as the proposed removal of the requirement for first meetings in liquidations and administrations unless specifically requested by the creditors, are less so. The R3 responses to this, and other consultations, are available on the R3 website.

Technical Bulletin

Technical Bulletin 105 was issued in September. Its contents included:

- Paymex and VAT on supervisors' fees – HMRC notice.
- Real time information in insolvencies – joint HMRC/R3 guidance.
- Senior accounting officer – updated HMRC guidance.
- Compensatory award for unfair dismissal – recent change.
- Contractual collective investment schemes – new legislation.
- Pension liabilities are a provable debt – the *Nortel* and *Lehmans* decisions.
- Consultation on collective redundancies – individual establishments no longer relevant.
- Data Protection Act – liquidators are not data controllers – the *Southern Pacific* case.
- Right of appeal against tax assessment not capable of assignment by liquidator.
- Piercing the corporate veil – guidance from the Supreme Court.
- High Court decision on the removal of chattels, fixtures and other items from leased premises.
- Court of Appeal clarifies meaning of 'establishment' for the purposes of secondary insolvency proceedings.
- Chapter 15 recognition of UK bankruptcy refused by US court.

Significant developments

However, the most significant recent development is the launching by The Insolvency Service of its consultation on the modernisation and consolidation of the Insolvency Rules. The consultation was issued in September and closes on 24 January 2014.

The exercise is a major undertaking. As the Insolvency Service reminds us, the existing rules, which have been amended 23 times since 1986, had been described by Lord Davies of Oldham in the House of Lords as early as 2003 as an 'impenetrable thicket' (HL Hansard, 11 July 2003, col. 582). A major objective of the review process is to reorder the whole structure of the rules on more logical and clear lines, and modernise and simplify the language. It is hoped that this will assist understanding and make it easier for users to find their way to the relevant provisions. The draft revised Rules are also intended to incorporate various changes to the law proposed in The Insolvency Service's Red Tape Challenge consultation referred to above.

> “The existing Insolvency Rules have been amended 23 times since 1986.”

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The draft also makes provision for debtors applying direct to an adjudicator for their own bankruptcy (a development which R3 has argued against). These rules complement the provisions of the Enterprise and Regulatory Reform Act 2013 which deal with this, and which are expected to be brought into effect in 2015/16. The draft also incorporates some further technical changes suggested by stakeholders to make insolvency procedures fairer and more efficient. The Insolvency Service takes the view that no changes to the Rules are needed to deal with the administration expenses issue in the light of the Supreme Court decision in *Nortel* and *Lehmans*.

The consultation is a chance for all practitioners to put forward their views on the proposed Rule changes, and we hope that R3 members will take the opportunity to respond.

And finally…

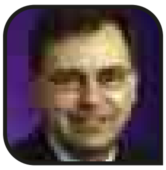
In conclusion, I should like to add a few words about the technical information and guidance that R3 puts out to members. All members, associates, new professionals and students receive R3 Technical Bulletins, and I hope that people find them useful. Recent bulletins have included important guidance on privilege and disclosure of information (Bulletin 103) and the capture, storage, maintenance and destruction of records (Bulletin 104). The

> “I hope that all members, associates, new professionals and students find the R3 Technical Bulletins useful.”

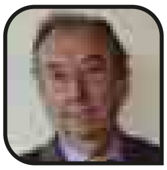
contents of Bulletin 105, including important guidance from HMRC, are shown in the box on page 15.

The technical section of the R3 website is also a fount of useful information, and is being reformatted to make it more relevant and easier to navigate. It includes all the Technical Bulletins, Statements of Insolvency Practice, other guidance, responses to consultations, links to the principal insolvency legislation, bibliography, helpsheets, and most of the statutory forms in editable PDF format. The last is a particularly useful resource for those who do not have access to the forms produced by the commercial software providers, or who need to find one of the more out of the way forms. There are currently helpsheets on remuneration and progress reports; suggestions for other subjects are welcome.

I urge members to make full use of these resources, and to send any comments or suggestions to the technical team at R3. ◻



MIKE PINK is the new chairman of the General Technical Committee and an associate partner at KPMG.



JOHN FRANCIS is the technical director at R3.

Recent case summaries

Personal and corporate insolvency update from **Claire Jackson**.

Personal insolvency

***In the matter of Charnesh Kapoor (In Bankruptcy)* [2013] EWHC 2204 (Ch)**
Kapoor was due to be discharged from bankruptcy on 9 May 2013. His trustee suspected that the bankrupt had not disclosed relevant information about his assets. The trustee therefore issued an application to suspend the discharge from bankruptcy. The application was served short (seven days before the hearing) and hence the first hearing was adjourned.

At the adjourned hearing the trustee sought an order on the grounds that the bankrupt had continued to fail to comply with his obligation to provide information by failing to disclose shareholdings and bank accounts and failing to provide information concerning litigation in India and the ownership of his former matrimonial home.

Penelope Reed QC granted the application to suspend the date of discharge of the bankrupt for a period of one year. The court confirmed that the purpose of section 279 was two-fold. First, it was to penalise a non-compliant bankrupt, and second, it was to aid the trustee in bankruptcy in collecting in, realising and distributing the estate of the bankrupt. The importance of incentivising a bankrupt to comply with his obligations was always relevant when dealing with an application.

> It was not simply enough to look at the bankrupt's lifestyle and to draw conclusions.

The court stated that where the application was brought on the basis of a failure to provide information to a trustee the threshold requirement for the exercise by the court of its discretion was for it to be satisfied that the bankrupt was failing, at the date of the hearing, to comply with an obligation under the Act. It was not simply enough to look at the bankrupt's lifestyle and to draw conclusions.

Therefore the trustee was required to produce evidence based on facts of a failure to comply and not simply suspicions based on inferences. Failures such as those before the court in this case including denials of knowledge of property formerly vested in the bankrupt's name, providing confusing information on shareholdings, withholding relevant information as to assets including properties and bank accounts and a failure to provide details of choses in action were serious failures which had misled the trustee in material respects. As a result the bankrupt should be subjected to the penalty of his discharge being suspended despite the regrettable delay in the application and the recent active engagement of the bankrupt in engaging with the trustee. Accordingly, the discharge was suspended until 9 May 2014.

Corporate insolvency

***In the matter of UK Housing Alliance (North West) Ltd (In Administration)* [2013] EWHC 2553 (Ch)**
The company's business involved the purchase of residential properties from homeowners and leasing them back to the vendors on ten-year assured shorthold tenancies. The company paid 70 per cent of the purchase price on completion, when legal title transferred to it. The remaining balance was payable on the sooner of the vendor's death or the end of the tenancy term, provided that the vendor had paid the rent and complied with other covenants.

The company funded the purchase of each property by means of a loan and debenture with the bank. The bank appointed administrators over the company in exercise of its powers under the floating charge. The administrators continued to collect rents paid by the tenants and to repair, maintain and insure the properties. The administrators made an application for directions as to whether, by doing so, they had adopted liability for the final payments under the contracts of sale.

The bank subsequently went into administration. The bank sought permission to enforce its security under paragraph 43.

The court found that the collection by the administrators of rents under the tenancies did not mean that they had adopted a liability to make final payments to the tenants as an expense of the administration under IR 2.67. If it had been intended that the rents should not fall into and form part of the company's business assets that would have been spelled out in the sale contracts and/or the tenancies. It was not. Rather the final payments were pre-administration debts, which were provable in the ordinary way in the administration as a matter of fairness and equality.

> The company funded the purchase of each property by means of a loan and debenture with the bank.

As to the bank's application the court stated that on such applications it had to balance the interests of the secured and unsecured creditors only if the relevant property was required for the purpose of the administration. The administrators had advanced no such case.

In any event, permission to exercise the security would normally be given if a refusal would cause significant loss. That would be the case for the bank. It would be prevented from realising substantial assets that could then be distributed to its own creditors. In those circumstances, it was just and expedient to grant the bank permission to enforce its securities. The bank was granted permission under paragraph 43 to enforce its security over the company's assets. ◻

CLAIRE JACKSON is a barrister at Kings Chambers.

Legal Q&A

Tim Carter and Rebecca Walker answer your insolvency queries.

I have been approached by the shareholders of a company in members' voluntary liquidation and, following the filing by the liquidators of the return of final meeting at Companies House, the company is due to be dissolved in two weeks' time. An asset has recently been discovered and the shareholders would like me to act as liquidator. Is it possible for me to be appointed before the company is dissolved and, if so, how should I be appointed?

It is possible to appoint you as liquidator before the company is dissolved, but the shareholders will need to act quickly.

You will be aware that the effect of filing the return of final meeting at Companies House is that the previously appointed liquidators have now vacated office (s.171(6)(a) Insolvency Act 1986 (the Act)). As the company remains in members' voluntary liquidation until it is dissolved, there is no technical bar to the appointment of a different liquidator.

> There is no technical bar to the appointment of a different liquidator.

Your appointment should, however, be effected by court order. Although it is clear that the directors' powers ceased on the appointment of the former liquidators (s.91(2) of the Act), the law is unclear on whether those powers were reinstated once the liquidators vacated office and, as such, whether the directors are able to hold a board meeting to swear the declaration of solvency (required for an out-of-court appointment) in the period between the filing of the return of final meeting and the dissolution of the company. In any event, the issue of the impending dissolution of the company will need to be addressed to, among other things, allow you as the newly appointed liquidator time to realise and distribute the recently discovered asset and to make up your account of the conduct of the winding up and lay this before members in accordance with s.94 of the Act. This is only possible by court order.

The shareholders will therefore need to make urgent application to court for an order that you be appointed liquidator pursuant to s.108 of the Act and that the date on which the company is deemed to

be dissolved be deferred pursuant to s.201(3) of the Act. It would also be prudent, bearing in mind the tight timescale, for the shareholders to contact the former liquidators regarding their intention to appoint you as liquidator to ensure that they have no objection.

I am advising a struggling hotel business that is owned and operated by an ordinary partnership (not an LLP). There is a dispute between the individual partners as to the best way forward. Is it possible to pre-pack the hotel business in these circumstances? What other issues might we face?

The Insolvent Partnerships Order 1994 (as amended) (the IPO) governs the insolvency procedures available to partnerships. Since the IPO was amended by the Insolvent Partnerships (Amendment) Order 2005, it has been possible for a partnership to be the subject of an out-of-court appointment of administrators. This presupposes that the hotel business is actually insolvent – it is not sufficient grounds to appoint an administrator that the partnership is likely to become unable to pay its debts (art.12 IPO).

Paragraph 22 of Schedule B1 to the Insolvency Act 1986 (the Act), as amended by the IPO, empowers the members of the insolvent partnership to appoint an administrator. This is analogous to the right of directors to appoint an administrator in respect of a company. Applying the recent case of *Minmar (929) Ltd* v. *Khalatschi [2011] EWHC 1159 (Ch)*, in which it was held (in relation to companies) that directors would need to take the decision to appoint an administrator at a validly constituted board meeting or by acting unanimously, it is essential in this scenario (bearing in mind the dispute between the partners) to review the terms of any partnership agreement as to how the business of the partnership should be conducted. Absent a partnership agreement, then the partners will need to act unanimously for any administrator to be validly appointed (see s.24(8) Partnership Act 1890, the appointment of an administrator generally being considered to constitute a change in the nature of the partnership business).

> Absent a partnership agreement, then the partners will need to act unanimously for any administrator to be validly appointed…

Assuming that the partnership constitution does allow the appointment of an administrator notwithstanding the dispute among the partners, then care should be taken to effect the appointment using the correct forms as an error here may also invalidate the administrator's appointment (see *Pillar Securitisation Sarl and others* v. *Spicer and Shinners [2010] EWHC 836 (Ch)*).

Providing the above steps are correctly followed, then it should be possible to achieve a pre-packaged administration sale of the partnership business. It would, however, be worth informing the partners that the administration moratorium would only protect the business and assets of the partnership and not each partner's personal assets. ▫

TIM CARTER is a partner and head of the insolvency and restructuring group at Stevens & Bolton LLP.

REBECCA WALKER is an associate in the insolvency and restructuring group at Stevens & Bolton LLP.

Insolvency litigation funding: into the future

Clive Petty and **Emma Knights** explore the opportunities and pitfalls for insolvency practitioners embarking on litigation.

For as long as one cares to remember insolvency practitioners have been involved in pursuing directors and others for the return of funds wrongly 'siphoned' out of companies prior to their demise. The Insolvency Act of course provides a broad palate of claims that can potentially be brought.

In these circumstances, directors may be tempted either for naïve or more malevolent reasons to remove funds or assets from their company. Frequently the demise of the company may be as a result of events out of their control – such as a major customer going into administration, or one that simply doesn't pay. The, perhaps understandable, reaction is for the director (who is usually an owner, and therefore possibly part funder of the business) to look to review what effects this will have on his own personal situation: he may have bank guarantees, loans, etc and plainly would seek to obviate the effect of insolvency on himself.

Alas, shutting the stable door after the horse has bolted is usually no defence to the IP's demand for the return of such 'preferential' payments or transactions at undervalue, which will invariably have had an adverse effect upon the general body of creditors.

> "Shutting the stable door after the horse has bolted is usually no defence to the IP's demand for the return of such 'preferential' payments or transactions."

In this article we hope to assist IPs with a review of some of the insurance and cash-funding products, which, alongside other agencies such as investigators, are available to assist IPs in carrying out their duties.

Put positively, a misfeasance, claim, or any other similar claim against a director should not be seen as a 'problem' but more as an 'asset' waiting to be recovered.

Cost and risk-free litigation

1. After the event insurance (ATE)

IPs and their supporting solicitor/counsel colleagues have long been used to winning insolvency claims where there are, effectively, no funds available to pay own-sides costs. Informal arrangements have morphed into formal conditional fee agreements (CFAs) that define the return the solicitor and counsel can expect if the case concludes successfully.

However, that still leaves the problem of how to manage adverse costs when a case is lost: the IP is frequently the claimant and so is potentially exposed to a personal costs liability. The solution is for the IP to purchase an ATE policy that not only protects him against an adverse costs award, but also can be structured in such a way that little or no premium is paid in advance, and any such deferred premium is only payable if the case succeeds and a recovery made. ATE insurance policies can and regularly do provide the following:

- 'A' rated insurers with indemnity limits of £2 million+ per claim.
- Premiums quoted and fixed in advance but only paid when the recovery proceeds are received. By inference if no recovery is made the premium may be in certain instances waived.
- Sliding premiums priced according to when a case concludes.
- Cover for adverse costs, plus own-sides counsel and experts as disbursements.
- Interim cost orders can be paid by the ATE insurer.
- ATE policy pays out if a case is discontinued, abandoned or lost at trial.

> "Mainly through lobbying by R3, insolvency litigation has been excluded from [the Jackson] reforms until mid-2015."

As a general guide, 100 per cent deferred premium policies can be secured when solicitors and counsel are on 100 per cent deferred fees, i.e. all parties are on a level playing field. When that is not the case there can be a nominal 'deposit premium' to be paid in advance to the ATE insurer.

2. Security for costs indemnity (SFC)

During the early part of a claim, the defendant will often try to 'knock out' the claim by applying for security for his own costs should he successfully defend the claim on the basis that the claimant liquidator (or the company in liquidation) has no funds to pay any costs award. Leaving aside the legal niceties of any such application the problem can be overcome. ATE is not really enough for this purpose. Policies can be terminated and the courts have concluded that ATE is insufficient security. In these circumstances, it is possible to buy a 'bond' that is effectively a direct 'promise to pay' from the insurer to the defendant if an adverse costs order is made. In summary, therefore, the SFC bond operates as follows:

- It works in conjunction with an existing ATE policy.
- Limits can be offered up to the ATE policy limit of indemnity.
- The cost of the bond (normally around 10 per cent of the security level required) can sometimes be deferred and conditional upon a successful recovery.

3. Freezing orders: cross undertaking in damages (CUDC)

While freezing injunctions are a powerful tool in certain cases where it is felt that defendants may dissipate their assets, there is still the dilemma faced by IPs in dealing with the requirement of the courts for a cross undertaking in damages that needs to be given to the court when a freezing injunction is granted.

In some cases it may be possible to agree such an indemnity with one of the creditors (e.g. HMRC) but this has proved increasingly difficult.

As a consequence, an insurance-based solution has been formulated and successfully implemented. The CUDC indemnity can be offered alongside the ATE insurance policy such that, if the freezing order is granted, the CUDC policy and ATE policy can be simultaneously incepted as soon as proceedings are issued.

4. Cash funding options

There are a number of third party funders that can fund insolvency matters. However, the difficulty around predicting the asset position of the target defendant (i.e. the Pyrrhic victory problem) has meant that such funders have found it difficult to enter the market in any major way. However, there can be cases where such funding is worth serious consideration.

There are three main types of funding:

- Cash funding for solicitors/disbursements where funders look for typically three to four times return on their investment. This is suitable when a claim value is significant and, should the case win, the recoverability is clear cut.
- Cash funding for disbursements/experts fees which are 'insured' by the ATE insurance policy in addition to adverse costs. This enables the funder to have some capital return if the case loses and hence the demands for upside multiples are significantly reduced.

> "Insurers and funders tend to take a 'portfolio' approach in dealing with IPs and their supporting legal teams."

- Sale or assignment of the claim to a third party who then runs the claim and returns around 50 per cent of the proceeds to the estate. This route is suitable when other avenues have been exhausted.

Jackson implications

As of end March 2013 solicitor and counsel CFA uplifts and ATE premiums for commercial litigation are no longer recoverable from the losing defendant. However, mainly through lobbying by R3, insolvency litigation has been excluded from these reforms until mid-2015. Much » diligent work is being carried out to frame arguments as to why this 'carve out' should become permanent.

The concern voiced by IPs and others who regularly litigate is that the absence of recoverability will enable defendants to drag out cases longer, to have less incentive to settle reasonably, and they will know that lower value cases will therefore be uneconomic to run. There is much to be concerned about if the opt out is removed.

How to get the best out of insurers and funders

All of the above are 'tools' to assist the IP in achieving a cost-neutral solution when embarking on insolvency litigation. We have been involved in this sector for many years and would offer the following observations on how to get the best, most consistent, responses out of insurers and funders.

1. **Relationship building.** While the specific details relating to a particular case are critical in assessing its suitability for insurance or funding solutions, the quality of the existing relationship is also important. This is because insurers and funders tend to take a 'portfolio' approach in dealing with IPs and their supporting legal teams: the IP won't want to expose the insurer/funder to an overly 'risky' case, and, likewise, the insurer/ funder will not want to reject a case from a tried and tested source of work.
2. **Adverse selection.** Linked to the above point, insurers and funders are wary of those IPs who come to them late on in a case or infrequently. The perception is that the insurer/funder is being engaged because things are not quite working out as expected. As a result, either the insurer/funder will decline or at best will quote a correspondingly high premium. As a rule, it is always best to insure as early as possible, especially as the early-stage premiums can be minimal.

> "As a rule, it is always best to insure as early as possible, especially as the early-stage premiums can be minimal."

3. **Retain an experienced broker.** This is important in order to give the IP full exposure to the market as well as providing FSC regulated insurance advice. In addition, you should expect a 'hands-on' response in assisting in structuring a workable solution.

Other potential litigation in insolvency situations

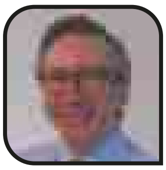
By way of a reminder, the IP should recall that, in the course of his analysis and management of a company in liquidation, there may be other non-insolvency related claims that can be considered, which might indeed have caused the demise of the company in the first place, such as:

- Professional negligence against advisors who may have given bad advice.
- Insurance claims that have not been successfully settled.
- Intellectual property disputes.
- Banking swaps.

These claim types can, broadly speaking, utilise the insurance and funding structures as detailed above: they do in fact have one major benefit and that is that the defendant is likely to be more solid and reliable than a typical insolvency claim against a director.

Conclusion

With the Jackson 'carve out' in place, the insurance funding tools are out there to assist IPs in bringing forward potential litigation. The regular solicitors and counsel that operate in this field of work have huge experience of running litigation in ways that will insulate the IP from personal liability. These, coupled with an experienced broker to assist with the placing of the insurance risks, should give great assurance to even those IPs who are unfamiliar with using litigation. □



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Assigning causes of action, maintenance and champerty, litigation funding: the story so far

Bree Taylor explains how developments in litigation funding are shaping insolvency practice and how the law stands at present.

Maintenance and champerty

Historically maintenance and champerty were torts and, until 1967, criminal offences. To maintain a case was to provide financial support without any legitimate interest. Champerty was to provide financial support in exchange for a share of the action.

Assigning causes of action

A cause of action or a bare right to litigate cannot be assigned because of the rules of maintenance and champerty.

Exception for liquidators

Liquidators are in a special position. Schedule 4, Part III, section 6 of the Insolvency Act 1986 specifically provides a power to 'sell any of the company's property' and a cause of action is property. Therefore liquidators can sell outright a cause of action vested in the company at the date of liquidation. For example, an action for negligence against the company's accountants or an action for breach of contract against the company's supplier.

A liquidator cannot sell a statutory claim such as a claim for wrongful trading under s214 of the Insolvency Act 1986 (see *Re Oasis Merchandising Services Limited* [1997] 2 WLR 765).

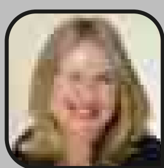
Exceptions for solicitors to 'finance' litigation

Exceptions have been made to the rules of maintenance and champerty that allow for solicitors to help to finance a client's litigation:

- First, in law reforms in 1999, which allowed for Conditional Fee Agreements where solicitors could make their services available on the basis that an element of the fees was to be payable on 'success' with a possible percentage uplift.
- Second, in law reforms in 2012, which allowed for Damages Based Agreements where solicitors could make their services available on the basis that the fees were to be payable on success out of damages recovered.

Exceptions for other funders

Exceptions have also been made to the rules of maintenance and champerty for third party funders (shareholders, creditors and even professional funders) so that litigants can accept financial support from outsiders. The general principles are that the funder must have a 'genuine commercial interest' in the litigation and must not seek to control the litigation or take an excessive share of proceeds.



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Conflict in the pursuit of conflict

Michael Rutstein and **Luke Johnson** ask: Whose view prevails when creditors and office-holders disagree over litigation strategy?

Defining a strategy for dealing with an insolvent company's potential claims can be a tricky issue for an insolvency office-holder (the IP). Inevitably lacking substantive knowledge of the matter and seeking to ensure that the insolvency process proceeds as efficiently as possible, the IP is likely to take a pragmatic approach to bringing litigation. In contrast, one or more of the company's creditors may have a strong view on the matter, especially where they are facing substantial losses and/or they feel aggrieved at the conduct of the company's former management or third parties who are perceived to have brought about the company's demise. This article looks at the impact creditors can have on an IP's litigation strategy.

Overview of the position in liquidations

A situation in which the IP wishes to pursue or compromise a claim is partially legislated for. In a compulsory liquidation, the liquidator will require the sanction of either the court or the liquidation committee (if there is one) to bring or defend proceedings.[1] Where the sanction of the liquidation committee cannot be obtained, the court will consider the views of those creditors who stand to participate in the ultimate distribution of assets[2] but will attach considerable weight to the views of the liquidator himself.[3]

A liquidator in a voluntary liquidation does not, following the holding of a creditors' meeting under Section 98 of the Insolvency Act, require any equivalent sanction but he is likely to seek out the views of major creditors or a creditors' committee, if there is one. It would appear that although a voluntary liquidator should take into account their views, he should not be bound or dictated to by them and should be prepared to bring (or not bring) litigation based on the merits of the case and the interests of the creditors as a whole (assuming that funding is not an issue).

Overview of the position in administrations

The position for administrators is less exact. Paragraph 5 of Schedule 1 of the Act grants an administrator the power to bring or defend any action or other legal proceedings in the name and on behalf of the company and the Act does not require any comparable liquidation sanction to be obtained. That said, the statute gives some limited guidance: the administrator has a general duty to manage the company's affairs in accordance with any proposals approved by the creditors.[4] If the administrator considers that pursuing such a claim would amount to a substantial revision to the approved proposals, he is required to seek the sanction of the creditors to amend them.[5] If the administrator's proposals are built around a litigation strategy but the creditors vote against the proposals (and any subsequent modification of them), then the administrator must apply to court for directions.[6] Although the court has a wide discretion as to the orders it can make, it cannot impose upon the creditors a set of proposals they have not approved.[7] In these circumstances, it may be that the administrator should conclude that the most suitable order to seek is that new office-holders be appointed or that the company be placed into liquidation.

> "The court... cannot impose upon the creditors a set of proposals they have not approved."

There are of course many cases where the administrators are not required to put their proposals to creditors and these are likely to be where the administration is run for the benefit of the secured creditors. In these cases, the IP is likely to be highly influenced by the wishes of the secured creditors in relation to the proposed litigation and only if they support it is he likely to take action.

Creditors want litigation but the IP does not: what then?

In circumstances where the IP does not wish to pursue a claim but one or more creditors feel strongly that he should, the position is less clear. Navigating these circumstances can be tricky for an IP and frustrating for a creditor. A creditor may struggle to understand an IP's reluctance to pursue a claim: surely the chance to enhance the assets of the insolvent estate is one worth pursuing? However, the IP will be balancing a number of factors, including cost, his statutory duties, independence and reputation.

The costs of pursuing a claim and, more importantly, any adverse costs order, will typically be payable out of the assets (other than those subject to a fixed charge) of the insolvent estate in priority to the IP's remuneration, costs and expenses.[8] This concern might be mitigated by the interested creditor agreeing to fund the IP and indemnify him against his own and adverse costs but an unsecured indemnity and the reputational risks in bringing risky or unmeritous litigation may still make the IP nervous and rightly so.

Other issues must be considered. Administrators may feel that an administration is not the most suitable procedure by which to pursue claims either because the ligation might not be consistent with the purpose of the administration or because of his duties to act in the interests of creditors as a whole[9] and to perform his functions as quickly as possible.[10] In these cases, leaving potential causes of action for a subsequently appointed liquidator to deal with may be the better course.

An interesting illustration of the '*administration* v. *liquidation*' issue arose in *Wind Hellas*,[11] where the administrators, having concluded that potential claims against former management, investors and advisors stood no reasonable prospect of success, applied to court to move the company directly from administration to dissolution. The informal creditors' committee (ICC) resisted this application, arguing that a liquidator would be better placed to investigate these claims more fully and, if viable claims were identified, this may result in a better return for unsecured creditors.

> "Surely the chance to enhance the assets of the insolvent estate is one worth pursuing?"

Although the court acknowledged that administrators had carried out extensive investigations (including instructing suitable leading counsel) and had reached rational and lawful conclusions, it agreed with the ICC that the company should be wound-up.

The judge stated that the starting point of any such analysis should be that if creditors of an insolvent company wish it to go into liquidation in order for its affairs to be examined by a liquidator and there is no significant opposition from other creditors, the court will accede to the application. He noted that the court will not order a winding-up after an investigation by administrators if to do so would serve no useful purpose, as the court will not act in vain. However, he concluded that in this case, the liquidator may take a different view to the administrators.

Options available to a creditor who wants to litigate

Waiting until the end of the administration or, if the support of a creditors' meeting can be obtained, compelling the administrator to end the administration[12] and then seeking to move the company into liquidation may therefore be one way for an interested creditor to influence the course of a debtor's post-insolvency litigation strategy. However, although a funded and indemnified liquidator may feel more able to investigate potential claims more thoroughly than administrators, he will still be concerned to act independently and in good faith and the liquidator should not recommend litigation to the committee or the court or otherwise engage in litigation if he considers it to be without reasonable prospect of success given his status as an officer of the court and/or his duty to act independently and professionally. An IP's duties of good faith, independence and to act in the best interests of creditors generally, were reiterated in the context of whether an administrator should exercise his discretion to propose a CVA in *Miss Sixty*.[13] The same principle must surely apply in the context of whether or not to decide to bring litigation.

An alternative option for a creditor may be to purchase the claim from the IP by way of an assignment. The structure of the sale can be suited to fit the insolvent estate's best interests: the consideration could, for example, be cash up front or a share of any proceeds.[14]

However, the principal problem with this solution for a creditor is that the IP is not entitled to assign claims which he is empowered to bring in his capacity as office-holder, such as fraudulent or wrongful trading claims, transaction at an undervalue claims or preference claims. It will often be the case that these are the claims creditors are most interested in because they consider that their losses have been brought about by the dishonesty or negligence of the former management.

Conclusion

Determining a litigation strategy can, therefore, be a tricky task for an IP where the creditors' view conflicts with his own. In circumstances where he wishes to pursue litigation, the path to gaining approval is fairly well trodden and it appears difficult for an IP to proceed in the face of substantial hostility from the majority of creditors. The position might well be different where the IP wants to bring an action and is opposed by a single but significant creditor particularly where the creditor's reasons are not directly to do with his position as creditor (for example, the creditor has a business or economic relationship with the potential defendant that he wishes to protect). Here, if the IP can justify the bringing of the claim as being in the interests of the creditors as a whole, he should find that the court will support him if the creditor challenges the IP's decision. In circumstances where one or more creditors are more enthusiastic about pursuing litigation than the IP, there are a few options that the creditor can adopt; they may involve the transfer of the risk inherent in litigation to him and away from the IP and the insolvent estate. That said, the overriding message that emerges is that it is crucial for an IP to maintain his good faith and independent judgment as to whether the pursuit of claims is in the interests of creditors generally. ◻

> "An IP's duties of good faith, independence and to act in the best interests of creditors generally, were reiterated."

1 Section 167(1) Insolvency Act 1986 (the Act)
2 *Re Greenhaven Motors Ltd [1999]* 1 BCLC 635; Re *Barings plc (No. 7)* [2002] 1 B.C.L.C. 401
3 *Re Edennote Ltd (No. 2)* [1997] 2 B.C.L.C. 89
4 Paragraph 68(1), Schedule B1 of the Act
5 Paragraph 54, Schedule B1 of the Act
6 *Re BTR (UK) Ltd, Lavin* v. *Swindell* [2012] EWHC 2398 (Ch)
7 Sealy, Len and Milman David, eds., *Sealy & Milman: Annotated Guide to Insolvency Legislation 2013* (London, 2013), p.589
8 *Re MT Realisations Ltd* [2003] EWHC 2895
9 Paragraph 3(2), Schedule B1 of the Act
10 Paragraph 4, Schedule B1 of the Act
11 *Weather Finance III SARL (in administration), Crystal Almond SARL* v. *Hellas Telecommunications (Luxembourg) II SCA (in administration), Margaret Elizabeth Mills, Alan Michael Hudson* [2011] EWHC 3176 (Ch)
12 Paragraph 79(2)(c), Schedule B1 of the Act
13 *Mourant & Co Trustees Limited, Mourant Property Trustees Limited* v. *Sixty UK Limited (in administration), Peter Hollis, Nicholas O'Reilly (in their capacity as joint administrators and supervisors of Sixty UK Ltd)* [2010] EWHC 1890 (Ch)
14 The court has previously held that an IP may assign a bare cause of action without falling foul of the rule against champerty and maintenance (*Seear* v. *Lawson* [1880] 15 Ch D 426, CA), including in circumstances where he is to share in the recoveries (*Ramsey* v. *Hartley* [1977] 1 WLR 686, CA).

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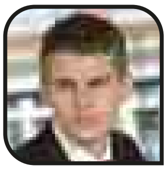

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Unlocking value from insolvency litigation assets

Steven Cooklin highlights IPs' high cash returns, gained in double-quick time.

Insolvency practitioners up and down the country are using Manolete Partners Plc to rapidly realise major cash returns on their insolvency litigation assets. Our clients cover the full spectrum of the profession: the Big 4 firms, insolvency boutiques and regional practices throughout the UK. Case sizes range from £20k directors' loan account recoveries through to £multi-million reported cases against major corporations and government organisations.

Why is the service so popular with IPs?

1) We close cases fast.
2) We realise major cash returns for insolvent companies.
3) Our highly efficient operating model means that a very large proportion of the damages/settlement is available for distribution back to you.
4) We transfer all risk away from the IP.

We always pay an initial cash consideration plus a majority share of the final proceeds. You are given complete protection from all and any costs related to the case.

Your litigation finance partner

Manolete Partners is backed by an array of strong shareholders including: Burford Capital (the world's largest litigation funding company); Jon Moulton (the UK's pre-eminent private equity investor) and the Punter Southall Group (a leading asset management group). Our strategic relationship with Burford also provides Manolete with a bespoke £10m UK insolvency litigation co-investment fund and direct, preferential access to Burford's wholly owned ATE insurance provider (formerly Firstassist).

Buying insolvent company claims

Where the claim is owned by the insolvent company, Manolete will simply buy it. We pay an initial cash sum and then take the claim forward in our own name. The IP is completely removed from any risk. Where a positive settlement or court award is made in Manolete's favour, Manolete returns a pre-agreed percentage (typically 50 to 70 per cent based on a ratchet) of the net proceeds back to the insolvent company. The proceeds are net of external costs only (e.g. solicitors, barristers, experts, ATE premium costs etc). There are no hidden 'time costs' for Manolete's work. Our return (like yours) is simply the agreed percentage of the net proceeds

– so we are completely aligned with you in maximising those proceeds, minimising costs and realising them as quickly as possible.

Funding insolvency act claims

We cannot buy Insolvency Act claims (e.g. wrongful preferences, transactions at undervalue) so in these cases we provide a full-service funding package to enable you and your legal team to pursue them. We pay all the costs of the process and we provide you with a full indemnity. We always ensure ATE is provided to give you an added layer of insurance. The economics work in the same way as buying claims – we pay an initial cash amount to you on signing the funding agreement and we take a pre-agreed percentage of the final successful net outcome.

> "Hundreds of IPs are now adopting Manolete's insolvency litigation model."

How is this different to a CFA?

There are many unavoidable cash costs associated with any serious litigation case that simply cannot be covered by a CFA with your own solicitors:

- Security for costs (often running to £100k – £200k+);
- Expert reports (up to £100k and more);
- Barrister fees;
- ATE insurance premiums;
- Court costs and numerous other associated cash disbursements.

Unless you can convince the debtor that you have the funding in place to address all of these costs the defendant will simply not take your claim seriously and there will be little or no prospect of a settlement.

By contrast, with Manolete as your litigation finance partner, your claim will be fully financed from start to finish. The debtor and his lawyers are now faced with a completely credible, and highly material, litigation risk. This often brings the debtor forward to negotiate sensibly at an early stage. If not, they face a fully-financed claimant through the court process.

Supporting your solicitors

We are here to support the strong relationships IPs have with their tried and trusted legal advisers. Rather than the solicitors having to take the full financial risk of their own costs (as they do on a CFA), from the outset we agree a case budget so they are paid monthly, in cash, while the case progresses. Most importantly, by adding our financial resources to your cases, we can help you and your legal team move forward with meritorious cases that were previously stalled purely for the want of funding.

Getting started with us

The process is very quick and simple. If counsel's opinion is required, we always pay for that as part of our standard review process. If we like the case, within just a few days you will have an unconditional offer from us to buy or fund your case.

Conclusion: leave no stone unturned

Whether your case is large (£millions) or small (£20k), the Manolete model is proven to be the most effective tool in the IP's tool box: it gets results fast, in cash and at no risk to you.

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Female representation is not about nice graphs

R3 president **Liz Bingham** examines gender equality in the insolvency profession.

When I took over the R3 presidency last year, I became the third woman in six years to hold the role. If you look a step down the R3 ladder at Council, nearly 40 per cent of members there are female. If you look even further down the membership ladder, 41 per cent of our latest JIEB passes were female.

In the wider scheme of things, this is pretty good going. The latest 'Women on Boards' report on gender equality in the City, for example, found women accounted for only 6.1 per cent of FTSE 100 executive directors, and that it would take 195 years for equal male–female board representation at the current rate of change. The House of Commons can muster only a miserly 143 female MPs, 22 per cent of the total (in Sweden, it's 45 per cent), while, despite a recent reshuffle partly designed to boost female representation, only slightly over 20 per cent of government ministers are women.

However, it's in the middle where it's a different story for insolvency. Female insolvency practitioners make up just 20 per cent of R3's membership as a whole, and, outside of R3, it isn't rare to come across firms with few or no female restructuring partners.

Retaining the talent

Where are our women going? And are we keeping hold of enough female talent for the gender diversity at the very top of the profession to be sustainable?

> "It would take 195 years for equal male-female board representation at the current rate of change."

The diversity issues for the profession stretch much wider than gender diversity too: the age range of the profession is an issue, for instance. Given the difficulty in both entering the insolvency profession and completing the qualification process – on average, those passing the profession's exams are 33 years old, while 67 per cent of members admit to 'falling into' insolvency – the profession faces a challenge to maintain a supply of new blood to bring new ideas and fresh talent into it.

For our profession, this is not just about corporate social responsibility. It's not about having nice graphs and pictures in our annual reports; it's about making sure our profession has the right mix of ideas of talent to keep us in touch with the UK's businesses and consumers. It's also about making sure that we don't unnecessarily lose talent as a result of inflexible working practices and blinkered corporate cultures.

Lack of female role models

To address some of these issues, I chaired a roundtable of insolvency practitioners and regulators in September. We had two main goals: to look at how the profession can encourage more women to enter and progress within it and to look at how the profession can encourage the next generation of insolvency practitioners to make insolvency a career of choice.

On the gender diversity side of things, there were three main issues that came through loud and clear: the difficulty for women of breaking through from senior manager to partner; corporate culture; and, importantly, the lack of senior female role models for younger insolvency practitioners.

One panel member referred to a review meeting where only male candidates for promotion from senior manager to director, and later partner, were discussed. She said: 'Despite the fact we bring in 50:50 [male:female employee ratio], by the time they got to senior manager, we had a third to two-thirds women to men. And out of those two parts, equal numbers had potential to progress to partner, and equal numbers got rated [highly in performance reviews]. At least a third of the people we should have been talking about should have been women.'

Career v. family

When it came to corporate culture, one of the recurring comments from the roundtable was the fact that many women's career paths did not fit in with the 'traditional' corporate career path, which expects insolvency practitioners to be most productive in their 20s and 30s – often the time that many women are trying to start a family, for example.

Indeed, the very idea of pregnancy can sometimes be seen as a death knell for partner prospects. As one panellist put it: 'The default challenge came from the men, saying "Oh my goodness, X is pregnant with her second child. What's that going to do to her partner prospects?".'

This sort of attitude also highlights the problems that some larger firms experience: they can have all the rules and guidelines on diversity in the world, but that often can't legislate for the behaviour of individual line managers or colleagues.

One of our female roundtable participants said: 'There's a slight perception that when you come back from maternity leave – if you're coming back part-time or reduced hours to finish at five, but even if you're back online again [later], and probably online all day of your day off and Sunday night on the emails as well – that you're mentally written off because not only have you had one baby but you're going to go away and have a second baby as well and then you might not come back at all. And there is that perception, I think, still.'

No one to shadow

The most pressing issue for young female insolvency practitioners though appears to be a lack of female role models. While male insolvency practitioners may face the same problems as their female colleagues with corporate cultures, at least they will often have someone senior like them on hand that can offer advice.

One of the younger female roundtable participants said: 'There are no female

appointment takers in my office for me to see how they got there, to talk to them about their experience, to work out what I need to do. There are only guys who will take all their protégés aside and say, "Here's what you've got to do, mate," when the boys are kicking up a fuss because

> "The danger is that the lack of female role models becomes a vicious circle."

they've been passed over for promotion. I'll just keep my head down and come up with my own ideas and do my job, and hopefully doing my job well will be enough, but I don't have anyone to bounce those ideas off, or anyone's path to shadow.'

The danger is that the lack of female role models becomes a vicious circle: the fact there are so few role models today to help this generation of young, female insolvency practitioners will mean even fewer senior female role models tomorrow.

What can you do?

Solutions to these problems are out there: job shares; back to practice refresher courses; and a role for R3 in providing structured networking opportunities for young insolvency practitioners to put them in touch with role models when none are available within their own firm.

In terms of bringing new talent into the profession in the first place, restructuring teams – and R3 – must make the case to graduates that insolvency is an option worth exploring as they embark on their careers, whether through placement opportunities, or making clear the sometimes convoluted routes into the profession.

So, while our headline statistics, in terms of presidents, or council, or JIEB passes compare well to other walks of professional life, there is much work to be done to keep this up.

As you're reading this, think about how many female partners you have in your team or firm; think about whether your young insolvency practitioners, male or female, have the right role models to help them develop; think about those graduates in tax and audit you think would have fitted into your team, and ask yourself: what more could we do? ◻

R3 president LIZ BINGHAM is an ambassador for diversity and inclusiveness and an advocate for women in business as well as a partner at EY.

Piercing the corporate veil – a doctrine or a principle?

Simon Duncan considers legal implications and difficulties following recent judgments.

Introduction

On the 12 June 2013 the Supreme Court handed down judgment in the case of *Prest* v. *Petrodel Resources Limited* [2013] UKSC 34 (*Prest*).

The issue of fundamental importance was whether English law recognised as a matter of principle that the court could pierce the corporate veil and, if such a principle existed, the circumstances in which it could be applied.

The importance of this issue was such that the appeal was heard by seven law lords. Lord Sumption gave the leading judgment in a unanimous decision by the court.

In this article I examine the distinction made by Lord Sumption between the use of a company for 'concealment' and 'evasion' and consider how this bifurcation assists an understanding of the application of the true principle. I go on to consider whether the principle as now narrowly defined could support the decisions in two other well known cases in this area, *Gilford Motor Co Ltd* v. *Horne* [1933] Ch 935 and *VTB Capital Plc* v. *Nutritek International Corporation* [2013] UKSC 5 and one lesser known case, *Re Darby Ex Parte Brougham* [1911] 1 KB 95. The facts of the first two cases are well known and will not be described in detail. The third case requires a more detailed treatment.

I go on to consider whether the attendant difficulties, particularly as regards *Re Darby*, suggest that the court has a wider residual jurisdiction. I then consider the implications.

Concealment v. *Evasion*

The starting point is that 'piercing the corporate veil' is per Lord Sumption 'an expression rather indiscriminately used to describe a number of different things,' or a 'label' per Lord Walker.

The expression means disregarding the separate personality of the company.

That legal personality could be disregarded by the court if it were being abused for the purpose of perpetrating some wrongdoing. The difficulty is then identifying the wrongdoing when various terms used to describe it, for example 'sham' or 'façade' lack specificity.

For Lord Sumption, two distinct principles lay behind such protean terms, the concealment principle and the evasion principle.

'The concealment principle is legally banal and does not involve piercing the corporate veil at all. It is that the interposition of a company… so as to conceal the identity of the real actors will not deter the courts from identifying them… In these cases the court is not disregarding the 'façade', but only looking behind it to discover the facts the corporate structure is concealing. The evasion principle is different. It is that the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is

> "That legal personality could be disregarded by the court if it were being abused for the purpose of perpetrating some wrongdoing."

interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement.'

The evasion principle is a limited one. It cannot be invoked so as to create a new liability that would not otherwise exist. In other words it applies 'when a person is under an *existing* legal obligation or liability or subject to an *existing* legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control' (at paragraph 35, though my emphasis).

That the legal obligation or liability must pre-exist the interposition of the company is an important distinction in the application of the evasion principle as the following three cases show.

Gilford Motor Co Ltd v. *Horne*

Mr Horne, as the former managing director of Gilford Motor Co Limited, was under a pre-existing contractual obligation not to engage in a competing business with the company for five years. He elected to set up a competing business and then incorporated it as JM Horne & Co Limited. This company was owned by his wife and a business associate.

At first instance, the claim against Mr Horne was dismissed because the court found the restrictive covenant to be void and the case moved up to the Court of Appeal. Here, the appeal succeeded and the court granted an injunction against both Mr Horne and the company.

As against Mr Horne, Lord Sumption considered that the injunction was granted on the concealment principle. This is because Lord Hanworth MR had held that the company was a 'mere cloak or sham' because the business was really being carried on by Mr Horne.

However, as against the company, Lawrence and Romer LJJ applied the evasion principle. The company was being used to enable Mr Horne to obtain the advantage of using the claimant company's customers for his own benefit. Thus the company was similarly restrained in order to deprive Mr Horne of this benefit. The benefit would have otherwise flowed to him simply as a result of his imposition of the company's separate legal personality between his own pre-existing legal obligation and his business.

VTB Capital Plc v. *Nutritek International Corporation*

VTB claimed that the controller of Nutritek, Mr Malofeev, should be treated by the court as if he were, or had been, a co-contracting party with VTB *ab initio*. The essential problem for VTB, whose appeal failed on this point in the Supreme Court, was that the principle of piercing the corporate veil could not be stretched this far, and with good reason. This was not a case where a company had been imposed in the face of a pre-existing liability that was sought to be avoided. Mr Malofeev's companies already existed and it was these companies with whom VTB entered into the contract.

> "Lord Hanworth MR had held that the company was a mere cloak or sham because the business was really being carried on by Mr Horne."

Lord Neuberger described this as follows:

'There is simply no justification for holding A responsible for B's contractual liabilities to C simply because A controls B and has made representations about B to induce C to enter into the contract. This could not be said to result in unfairness to C; the law provides redress for C against A, in the form of a cause of action in negligent or fraudulent misrepresentation.'

In other words to do so would run counter to the principle established in *Salomon* v. *A Salomon & Co Ltd* [1897] AC 22.

Prest

The difficulty in this case given the confines of the principle was that the husband's properties had vested in the companies long before the marriage broke down. In other words the legal obligation to the wife did not pre-exist the conveyance of the properties to the companies. In an analogous way to the claim in *VTB* to expect the court to stretch the evasion principle far enough to appropriate the companies' assets to satisfy a personal liability of its shareholder to its wife in these circumstances would itself have been a 'remarkable break with principle'.

(The wife's appeal nevertheless succeeded on the grounds of a resulting trust analysis.)

A difficulty arises, however, when the principle enunciated by Lord Sumption is applied retrospectively to other cases where the corporate veil has been said to have been pierced.

Re Darby

Mr Gyde and Mr Darby were fraudsters. They incorporated a company, 'A'.

A then contracted to buy a licence to work a Welsh slate quarry for a small sum of money. A company 'B' was formed whereupon A sold the newly acquired licence to B, which was later renamed Welsh Slate Quarries Limited. B's funding to make this acquisition came from the sale of debentures to subscribers who had been persuaded to participate on the strength of A's representations. A was both the promoter and the vendor. Perhaps somewhat unsurprisingly, B went into insolvency once the subscribed funds had been paid over to A. Sometime later, Gyde and Darby were convicted of fraud and both made bankrupt. Darby's estate had considerable assets. The Official Receiver, Mr Brougham, lodged a proof in Darby's bankruptcy for £8,950. The Trustee rejected the proof because Mr Darby was not the promoter, A was the promoter.

Pausing here, one might have expected that this was not a case where the evasion principle could be said to apply. There was no pre-existing legal obligation on Gyde and Darby that they later attempted to distance themselves from by the imposition of a company between themselves and the fraud. A was formed first albeit with the fraud in the contemplation of the promoters of A.

For Phillimore J the OR's proof was to be admitted. 'They (Gyde and Darby) made that profit either directly or through the agency of the company, it does not matter which, and they may hold it if they disclosed it at the proper time. They may not hold it if they did not disclose it.' In other words, had the transaction been sanctioned and ratified by all the shareholders it might have survived.

Discussion

For our purposes, the issue is whether the corporate veil could be said to have been pierced. I submit that it was. A was formed to enter into a transaction and while that transaction involved serious impropriety that does not, as we know, allow the court to disregard the separate legal personality of A for this reason of itself. It is contrary to the *Salomon* principle.

One explanation of this apparent paradox is that the case was decided on the principle of agency, not the evasion principle as we now understand it.

In *Prest*, Lady Hale was clearly of the opinion that such cases were far from rare. Commenting on *Re Darby*, Lady Hale observed:

'I am not sure whether it is possible to classify all the cases in which the courts have been or should be prepared to disregard the separate legal personality of a company neatly into cases of either concealment or evasion. They may simply be examples of the principle that the individuals who operate limited companies should not be allowed to take unconscionable advantage of the people with whom they do business…' (at paragraph 92).

Lady Hale then introduced *Stone & Rolls Ltd* v. *Moore Stephens (a firm)* [2009] UKHL 39 as an example where the court went behind the separate legal personality of the company in order to 'get at' the person who owned and controlled it. This was done in order to attribute his knowledge to the company so that the auditors could raise a defence of *ex turpi causa* to the company's allegation that they had failed to detect the fraudulent nature of the business.

Lord Mance considered that 'the number of other tools that the law has available mean that, if there are other situations in which piercing the veil may be relevant as a final fall-back, they are likely to be novel and very rare.'

Lord Clarke considered that there was a doctrine that could be described as 'piercing the corporate veil' but 'its limits are not clear'. That said, he agreed with Lord Sumption and Lord Mance that it is only likely to be done in the case of evasion.

> "In *Prest*, Lady Hale was clearly of the opinion that such cases were far from rare."

That did not mean that there would not be other cases in which a further exception would be applied but such occasions would be very rare. Arguably, this allusion to a further exception would encompass the *Stone & Rolls* case in the opinion of both Lady Hale and Lord Walker.

Conclusion

I submit that 'piercing the corporate veil' is a doctrine and to some extent it is the 'label' or the title given to this doctrine that is unhelpful in this analysis. The doctrine refers to a collection of principles. The principles can be applied by the court to allow them to disregard the separate legal personality of a company when the controllers of that company have acted unconscionably. The word 'disregard' should not automatically be construed as meaning 'pierced'. This could refer to either the evasion principle or the concealment principle. Alternatively, a different principle may be applied that achieves the same end but nevertheless forms part of the doctrine.

In addition, even as tightly defined, the evasion principle of itself appears to admit of further exceptions, as the decisions in *Re Darby* and *Stone & Rolls* show. Accordingly, the preferred approach must necessarily be a broad one in prosecuting such claims, rather than proceeding by an analysis of any particular principle in isolation.

SIMON DUNCAN is a solicitor at Moon Beever Solicitors.

Debt and bankruptcy in the 19th century novel

Chris Norman describes the themes of debt and bankruptcy in some of the foremost novels of the 19th century and in the personal lives of their authors and suggests why financial distress is such a salient feature.

The degree to which debt and its terminal consequence of bankruptcy feature in the great 19th century novels, both as a narrative device and as a metaphor of moral and social dysfunction, is striking. It is similarly notable that debt and bankruptcy had a profound effect upon the personal lives of many of the great novelists of the age.

> "Mrs Dickens' Establishment did not enrol a single pupil."

Among the major novelists of the 19th century, and their respective countries of birth, were Charles Dickens (England), Honoré de Balzac (France), and Fydor Dostoevsky (Russia). Debt and bankruptcy had an impact on each of their lives and their art.

A tale of two halves

Charles Dickens (1812–1870) is widely regarded as the pre-eminent novelist of the Victorian period. His works include *A Tale of Two Cities*, *Bleak House*, *Great Expectations*, *Oliver Twist* and *The Pickwick Papers*. He achieved widespread fame and critical acclaim during his lifetime, both in Great Britain and the United States.

Dickens was born in Portsmouth, the second of eight children. His father, John Dickens, who worked as a clerk in the Admiralty Office in Portsmouth, was described by his son Charles as 'a jovial opportunist with no money sense'. In February 1824 John Dickens was imprisoned in the Marshalsea Debtors' Prison in London, under the provisions of the Insolvent Debtors Act of 1813, on account of his failure to discharge a debt of £40 and 10 shillings owed to a baker, James Kerr.

John Dickens' wife, Elizabeth, attempted to raise funds to pay her husband's debts by setting up a school called Mrs Dickens' Establishment; however, the school did not enrol a single pupil. In April 1824, with all of the family's possessions pawned, Elizabeth and her three youngest children joined John Dickens in Marshalsea, as the conditions there were preferable to the family's straitened circumstances outside prison. Charles lodged with a family friend, and acted as a messenger for his father in the latter's attempts to raise funds to discharge his debts.

In May 1824 John Dickens' mother died. In expectation of a legacy of £450 under the terms of his mother's will, John Dickens petitioned for, and was granted,

> "Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

release from Marshalsea, conditional upon the payment of his creditors (although John Dickens was imprisoned again for debt several years later, and was released only when Charles had borrowed funds on the strength of his salary as a legal clerk).

Incarceration and death

Dickens' anger at the social lot of the poor informs many of his novels. His seared experience of his father's incarceration in Marshalsea is dramatically expressed in the novel *Little Dorritt*, published by Dickens in serial form between 1855 and 1857.

Little Dorritt is written in two parts, the first entitled *Poverty* and the second entitled *Riches*. The central character in *Poverty* is William Dorritt who has been imprisoned for so long in the Marshalsea Debtors' prison that his three children, Fanny, Edward and Amy (the latter also known as Little Dorritt) have all grown up within its walls. The narrative of *Poverty* bristles with bailiffs and debt collectors. The dénouement of *Poverty* is the discovery by the character Arthur Clennan that William Dorritt is the lost heir to a large fortune, which enables the latter to pay his debts and obtain his release from debtors' prison.

> "[Balzac] was saved from bankruptcy at the time by the financial support of a friend, Mme de Berny."

In *Riches* Dickens presents the character of Mr Merdle, an investment banker. Merdle is feted for his ability to generate spectacular returns for his client investors. However, his genius is illusory; his profits are generated by stealing from one investment fund to pay for the required returns of another fund, and by issuing securities in companies with no assets. When his fraud is discovered Merdle drinks laudanum and commits suicide by stabbing his jugular vein with a pen-knife.

The collapse of the Merdle Bank results in the bankruptcy of Merdle's family and many of the investors in his schemes. One of these investors is Arthur Clennan, who is incarcerated in Marshalsea. When Clennan's debts are eventually paid he settles for 'a modest life of usefulness and happiness' by marrying Little Dorritt.

Happiness and misery

In his novel *David Copperfield* (1850) Dickens presents the character of Wilkins Micawber. Like John Dickens, Mr Micawber is sent to debtors' prison (in this case the King's Bench Press prison) for failure to pay his debts.

Mr Micawber describes his financial code as follows: *'Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.'*

Samuel Pickwick, the protagonist of *The Pickwick Papers* (published by Dickens in serial form between 1836 and 1837) is committed to debtors' prison (in this case the Fleet debtors' prison). In *Dombey and Son* (published in serial form between 1846 and 1848) Dickens describes the slide into insolvency of a substantial shipping business through the misguided personal relationships of the firm's owner and the misdeeds of its general manager.

The Debtors Act

The spectre of the debtors' prison loomed large in England up to the mid-19th century. Traders were allowed to discharge their debts by an equitable and independent distribution of their business and personal assets, but non-trading debtors were liable to custody. The Debtors Act of 1869 abolished imprisonment for debt, although debtors who had the means to pay their debts, but who chose not to do so, could still be imprisoned. It is conceivable that the passing of the Debtors Act in the year before Dickens' death was due, in part, to his depiction in his novels of the exigencies of the debtors' prison regime.

Balzac and bankruptcy

Honoré de Balzac (1799–1850) wrote a sequence of nearly 90 novels and novellas collectively entitled *La Comédie Humaine*. The major novels in the oeuvre include *Eugénie Grandet* (1833), *Le Père Goriot* (1835), *Illusions Perdues* (1843), *Le Cousin Pons* (1847) and *La Cousine Bette* (1848).

The works of *La Comédie Humaine* are characterised by a high degree of social realism and narrative description. Taken together, they present a landscape of French social, political and commercial mores in the first half of the 19th century. The main social drivers are class, status, advancement and money. Characters (of whom there are more than 2,000) are drawn from all walks of life, and many appear and reappear in more than one work. It was a perpetual work in progress and remained unfinished at the time of Balzac's death.

Saved by wealthy women

Throughout his life Balzac was a speculative entrepreneur. His commercial ventures included publishing, printing and magazine businesses. He was an impulsive businessman, and borrowed heavily from friends and family to finance his projects. By the age of 29 he owed his creditors some 124,000 francs, including a debt of 50,000 francs due to his mother. He was saved from bankruptcy at the time by the financial support of a friend, Mme de Berny. On more than one occasion he avoided imprisonment from debt by the intervention of his lady of the moment.

All of his commercial projects failed, and he carried the debts from these businesses throughout his life. Undeterred by these reverses, even towards the end of his life he devised a business plan to import timber from Ukraine to France. He was rumoured to have fitted his house with a secret back door through which he could flee his creditors.

In 1850, five months before his death, Balzac married Ewelina Hanska, a Polish noblewoman with whom he had conducted a relationship by correspondence since 1832. At the time of his death Balzac's debts amounted to more than 200,000 francs. Ewelina settled these debts, provided for Balzac's mother's living expenses, and financed the publication of new editions of Balzac's works.

Creditors' meetings and trustees in bankruptcy

In *Eugénie Grandet* Balzac recounts the administration of the bankrupt estate of the speculator and suicide, Guillaume Grandet. Balzac's description of the process includes a meeting of creditors, the appointment of trustees, the proving of bankruptcy debts, dividend distributions to creditors and the interminable duration of bankruptcy proceedings.

The protagonist of Balzac's novel *César Birotteau* (1837) is an honest, successful but naïve Parisian perfumier of provincial origins. He becomes bankrupt following ill-judged plans to expand his business and engagement in property speculation, both financed on borrowed money, but his downfall is also due to manipulation of the bankruptcy process by a disgruntled employee. There is a chapter in the novel entitled 'A general history of bankruptcy' in which Balzac describes the bankruptcy laws as they operated at the time.

> "Dostoevsky fled to Europe, where he lost his (and his wife's) remaining funds and possessions by gambling."

In *Illusions Perdues* Balzac included a chapter entitled 'Imprisonment for debt in the provinces' in which he describes how the arrest of a debtor is procedurally prohibited while the debtor is in his own home. He also describes the creditor remedy of distraint over a debtor's furniture and other possessions.

Gambling debts

The works of Fyodor Dostoevsky (1821–1881) include *Crime and Punishment, The Gambler, The Idiot* and *The Brothers Karamazov*. Throughout his life Dostoevsky was deeply indebted. In 1863 he assumed the debts and dependents of his deceased brother, Mikhail. Like his compatriot novelist Leo Tolstoy (1828–1910) *War and Peace, Anna Karenina*, Dostoevsky was a compulsive and unsuccessful gambler. He suffered gravely from epilepsy (his first epileptic attack occurred in 1839 when he was informed of the murder of his father). »

In 1865 he signed an agreement with a bookseller, Stellovsky, to whom he was indebted, to deliver the manuscript of *Crime and Punishment*. In the event of default of this agreement, Stellovsky would acquire the rights to all of Dostoevsky's past and future works. Dostoevsky complied with the agreement and delivered the novel in 1865. He then fled to Europe to escape his other creditors, where he lost his (and his wife's) remaining funds and possessions by gambling.

Crime and impoverishment

The protagonist of *Crime and Punishment* is Rashkolnikov, an impoverished student, who plans and carries out the murder of an elderly pawnbroker and money-lender, Ivanovna, to whom he owes money. The self-serving motive of his crime is to release himself from the debts he owes to Ivanovna, but he also rationalises the planned murder on the premise that the pawnbroker serves no useful moral or social purpose, and that he can perform virtuous deeds with the money he intends to steal from her. He murders Ivanovna with an axe, and during the course of the murder he is discovered by the pawnbroker's sister, Lizaveta, whom he also kills.

> "Thackeray satirises greed, social climbing and the pursuit of fashionable society life funded by unsustainable credit."

Rashkolnikov initially escapes culpability for his crime. However, he is psychologically hunted down, by Petrovich, a detective (upon whose character Columbo, the American television detective, is partly based). Rashkolnikov ultimately confesses to his crime and is sentenced to penal exile. Towards the end of the novel he achieves a measure of moral redemption, largely due to the chaste and virtuous love of Sonya, a prostitute who has been compelled into her occupation by her family's impoverishment.

Lovers and arsenic

The theme of financial default features in the work and lives of many other 19th century novelists.

Emma Bovary, the protagonist of *Madame Bovary* by the French novelist Gustave Flaubert (1821–1880), in reaction to her perception of the sterility of provincial life in Normandy, embarks upon a series of adulterous affairs and purchases luxury consumer goods on credit she cannot afford, taken from a usurer, Lheureux. Lheureux contrives to arrange for Emma to obtain power of attorney over the estate of her husband Charles, a kind-hearted but naïve village doctor. Lheureux inevitably demands repayment of Emma's debts. Emma pleads for funds from her former lovers, but she is rebuffed. In despair, she commits suicide by ingesting arsenic.

Fashionable fraud

Vanity Fair by the English novelist William Thackeray (1811–1863) satirises greed, social climbing and the pursuit of fashionable society life funded by unsustainable credit leading to bankruptcy; two chapters of the novel describe 'How to

> "Emma Bovary commits suicide by ingesting arsenic."

live well on nothing a year'. The English novelist Anthony Trollope (1815–1882) was the son of a bankrupt barrister. His novel *The Way We Live Now* portrays share ramping and forgery as devices for removing assets from the reach of creditors. Similarly to the character of Merdle in Dickens' *Little Dorritt*, the fraudulent investment banker, Melmotte, commits suicide when his financial artifice collapses and is exposed. *L'Argent* by the French novelist Emile Zola (1840–1902) depicts bankruptcy, stock market speculation and manipulation, and the deceitful promotion of companies.

Prominent novelists of the age who were declared bankrupt include the French novelist Alexandre Dumas (1802–1870) *The Count of Monte Cristo, The Three Musketeers*; and the American writers Edgar Allan Poe (1809–1849) *The Fall of the House of Usher, The Murders in the Rue Morgue* and Mark Twain (1835–1910) *Adventures of Huckleberry Finn, The Adventures of Tom Sawyer*.

Debt in death

The Scottish novelist Sir Walter Scott (1771–1832) *Ivanhoe, Waverley, The Heart of Midlothian* was a victim of banking crises in London and Edinburgh in 1825. Scott had invested significant monies in a printing business which failed, resulting in his public insolvency. As an alternative to declaring himself bankrupt, Scott pledged to repay his debts to his creditors by prolific writing. He arranged for his house and his income to be placed in trust for his creditors, and he continued to write until ill health overtook him in 1831. Although he died in debt his novels were commercially successful, and his debts were all posthumously repaid from the proceeds of their sale.

Henry Austen, elder brother of the English novelist Jane Austen (1775–1817) *Pride and Prejudice, Mansfield Park, Persuasion* funded the publication of Jane's first novels. Henry had achieved early prosperity as a merchant banker. In 1804 Henry and two business partners founded the Austen, Maunde and Tilson Bank in London, but the bank failed in 1815 and Henry was declared bankrupt. Some commentators have speculated that the trauma of Henry's bankruptcy contributed to a rapid decline in Jane's health and her death in 1817.

Fiction reflecting real life

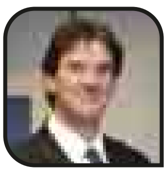
Debt and bankruptcy are therefore recurrent features of the 19th century novel and frequent events in the lives of their creators. One possible reason for this characteristic is the broadly parallel development of the genre of the novel over the latter centuries of the second millennium with the evolution of political economics.

From the 16th century to the mid-18th century the principal economic doctrine in Europe was that of mercantilism, whereby government control and expansion of foreign trade was seen as the primary means of promoting national prosperity, security and growth. During that period works of fictional prose evolved from the use of highly stylistic, deferential language to a more personal style of communication and narrative realism.

> "Although Scott died in debt his novels were commercially successful and his debts were all posthumously repaid from the proceeds of their sale."

By the mid-19th century the prevailing economic dynamic in Great Britain was the industrial capitalist, *laissez-faire* model, supported by the development of commercial corporations, commercial and contract law, professionalised finance houses, and the concept of limited liability. It is perhaps unsurprising that in the 19th century the novel evolved as a literary device that described and explored how individuals are compelled to experience, manage and endure the consequences of their own decisions and actions, frequently through the device of debt and its penalties in the event of default.

With thanks to my colleagues Lorna, Donna, Emma, Caroline, Ian and Andy, for their valuable contributions to this text.



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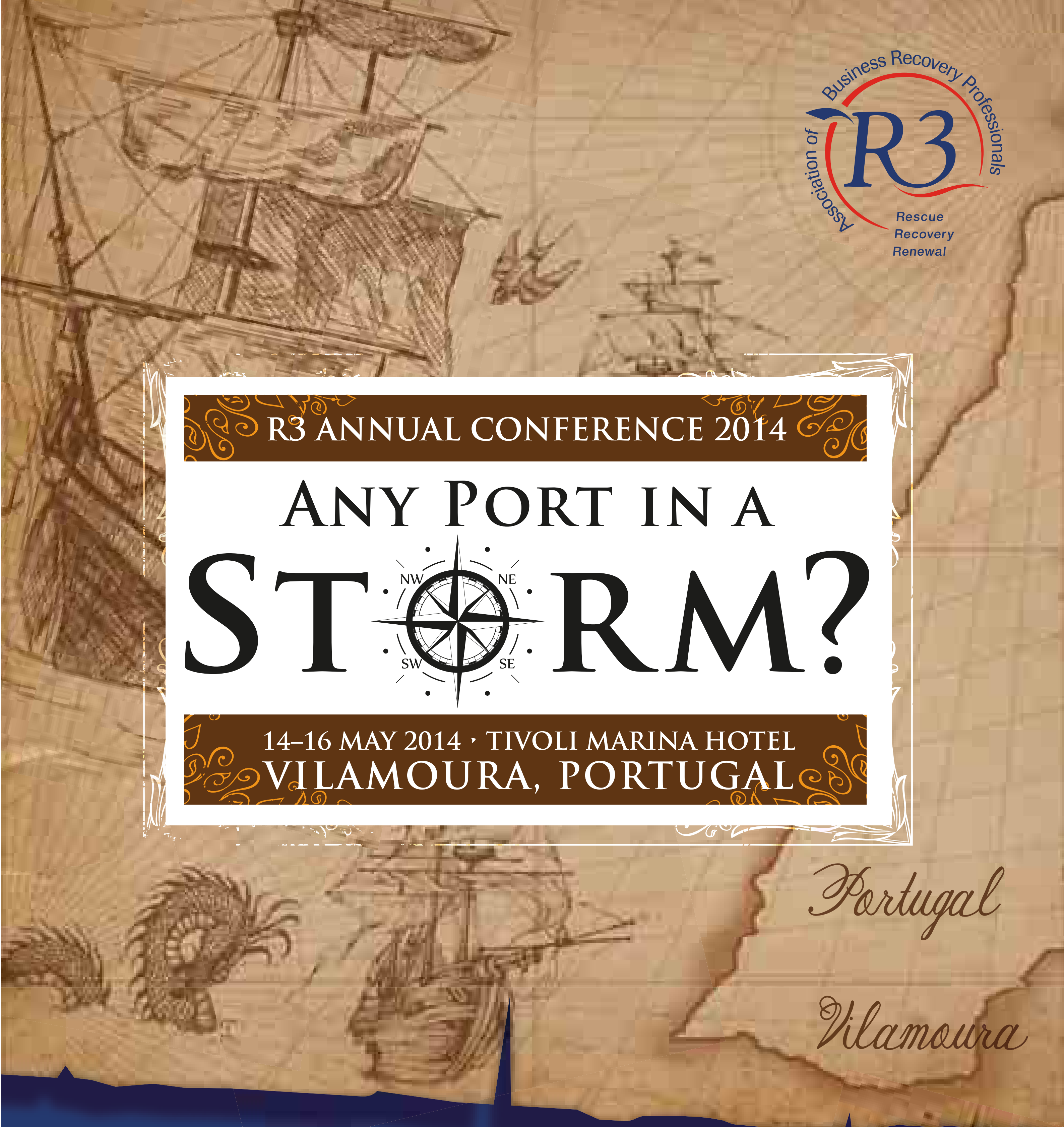

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Jackson reforms: an update

Francis Coulson explains how research into the Jackson reforms is progressing.

R3 has been working hard to call for a permanent carve-out for the so-called Jackson reforms. Professor Peter Walton reported on R3's work and made a plea for all R3 members to complete a survey to underpin research on this topic in the Summer 2013 edition of *RECOVERY*. Professor Walton aims to produce a draft report of his findings by the end of 2013. But in the meantime, he is happy to share some of his preliminary findings, which are outlined below.

A recap on the Jackson reforms

The Legal Aid, Sentencing and Punishment of Offenders Act (LASPO), which was introduced in 2012, curbs the use of Conditional Fee Arrangements (CFAs) and After the Event insurance (ATE). LASPO generally prevents a winning claimant from claiming the CFA uplift and the cost of an ATE insurance premium from a losing defendant. Such costs, under LASPO, must come out of any award of damages. Insolvency practitioners use CFAs and ATE to swell the assets available to creditors. Action is frequently taken in relation to culpable behaviour by individual debtors or errant company directors. Such action recovers money that rightfully belongs to creditors, including HMRC.

> "The research project also seeks to monetise the impact of the change in law on the ability of IPs to recover funds for creditors."

R3 cautioned that the changes introduced by LASPO would severely restrict creditors' ability to recover money. Litigation of this kind returns a significant amount of money to HMRC, smaller businesses as well as consumers. Due to the likely effect of LASPO on insolvency litigation, in particular the concern that public money would often by retained by errant or fraudulent directors, the government granted an exemption for insolvency cases until 2015.

The Parliamentary passage of LASPO did not permit for an impact assessment on the changes in respect of insolvency and as such, R3 has commissioned independent research to provide this information. Professor Peter Walton, the co-director of the Law Research Centre at the University of Wolverhampton, is leading the research, which is supported by R3, ICAEW, ACCA, IPA, ICAS, Moon Beever, Moore Stephens and JLT Specialty.

The findings so far

R3 issued an R3 members' survey in August 2013, where 236 individuals responded to a series of questions on the use of CFAs. The survey confirmed anecdotal evidence that the majority of IPs (70 per cent) do use CFAs with a majority of that number (58 per cent) taking on between one and four CFA-backed cases per year, 19 per cent taking 5 to 19 cases and eight per cent taking on 20 cases or more a year. These results support the feeling in the profession that most IPs will be affected by the Jackson proposals.

In terms of the size of the cases, the survey findings show that the majority of cases (54 per cent) are for 'small' amounts of less than £50,000 in terms of value per case (with just seven per cent of cases considered 'large' for amounts over £200,000).

As most IPs will be aware, the majority (83 per cent) of CFA-backed cases settle prior to hearing, with the overwhelming feeling that they would not have settled without the use of a CFA.

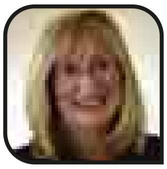
The research project also seeks to monetise the impact of the change in law on the ability of IPs to recover funds for creditors, in particular the potential loss to HMRC. The small cases, with a value of up to £50,000, would seem to be the cases most likely to be affected, should the temporary exemption for insolvency end in April 2015 as proposed.

Many thanks to those of you who responded to the initial word form survey: the case studies provided are invaluable and several of them will be included in the final report to illustrate the research findings.

The report findings will be shared with government to help make the case for a permanent carve-out for insolvency in the new year.

It's not too late

If you have any cases that you feel would add to the research, please do contact Peter Walton at R3researchproject@wlv.ac.uk. For further information on the survey and R3's work on the Jackson proposals, please go to the R3 website: **www.r3.org.uk/index.cfm?page=1764**



FRANCES COULSON is R3 past president; member of R3's Jackson research group; and partner at Moon Beever.

Ch-ch-ch-ch-changes

Taking the immortal words of David Bowie in vain is not something **Andrew Tate** would normally approve of but it seemed such an apt title in a period of considerable upheaval that he couldn't resist.

There have been swathes of reports issued in the last few months seeking to change various areas of our work. The R3 Smaller Practices Group will support carefully considered changes to the framework we work in but we also strive to ensure those who are proposing reforms recognise that for smaller practices in particular, changes place considerable added burden on the practitioner to assimilate and implement new working practices.

I have taken this opportunity to highlight just a few of the areas where proposed reforms have been suggested that we believe will have an impact on smaller practices. If you have any comments about how these or other areas where change is proposed will affect the work of smaller firms, please do get in touch with myself or Emma Hobson at R3.

Deregulation Bill/ partial insolvency licences

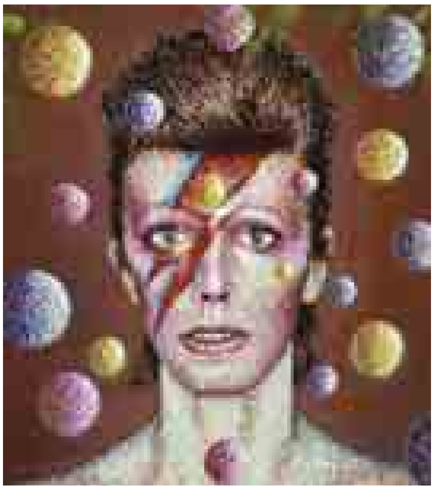
The Deregulation Bill was issued by the government for consultation via a call for evidence in July. A response has been submitted by R3 based on input from the Smaller Practices Group, the Policy Group and the General Technical Committee.

One of the main areas covered in the response is the proposal within the bill for partial licences to be issued to insolvency practitioners, for example, a practitioner would be authorised to undertake corporate insolvency only or personal insolvency only. Some of the concerns regarding this proposal include:

- insolvency is already quite a narrow field (albeit impacting on many wider areas);
- that an insolvency practitioner can easily find themselves in a position where a meeting starts off advising a corporate entity but the personal position of those involved becomes pertinent;
- that partial licences could create an uneven playing field within the insolvency market. Commentators have recognised that the appetite for partial licences is more likely to come from larger practices with specialist business models. The burden of cost, training and compliance could then be skewed towards smaller practices;
- the deregulatory nature of this change is questionable.

Red Tape Challenge

A consultation was issued by The Insolvency Service in July outlining a large number of reforms proposed to remove 'red tape' from the insolvency framework. A number of the proposed reforms are eminently sensible and the Smaller Practices Group and R3 are supportive of the initiative. Once again, however, the changes proposed need to be carefully thought through and in particular, the balance between reducing the paperwork we send to creditors and eliminating meetings of creditors at a time when some advocate more creditor engagement is difficult to judge.



> "If you have any comments about how these proposed changes will affect the work of smaller firms, please do get in touch."

On a purely technical basis, many of the changes will make life simpler and will streamline casework where, as is so often the case nowadays, asset realisations and costs are limited.

Two proposed reforms warrant some further brief comment.

Uneconomic dividends

This is a topic that was brought to the Red Tape Challenge team by R3 and arose out of Lee Manning's presidency. The proposal seeks to eliminate the need for an IP to send a dividend cheque or make a dividend payment to a creditor where the cost of doing so outweighs the amount involved. The proposal is that the retained funds are used for insolvency investigation and enforcement purposes. The Smaller Practices Group is supportive of the initiative but we need to ensure that the final proposals are pitched at a level that provides a workable solution covering both:

- cases where large numbers of small claims exist; and,
- smaller cases where dividend payments may be low due to limited asset realisations but any return to creditors is valued by the creditor body.

Directors' disqualification

The proposed reforms to director disqualification procedures are, I would have thought, to be welcomed by most. They will, however, require extensive changes to the way IPs deal with the reporting regime and the tighter, three month deadline will require attention and focus to ensure that the books and records and other data are available to provide the details of relevant behaviour by the deadline.

Kempson Review

Finally, just a few words regarding the Kempson Review. IP fees are often an emotive, controversial subject and probably will always remain so. It was with some trepidation that I read the review by Professor Kempson but I was pleasantly surprised at the commentary she provided. For the first time, I felt that the review recognised the commercial reality of insolvency practice i.e. that our recoveries against headline costs incurred are often compromised.

There was also an element of commercial reality in Professor Kempson's comments regarding 'buying power'. For many smaller practices, panel membership is not part of our business model and so we are dependent on individual creditors engaging with us. The potential introduction of creditor organisations from a template operated in other jurisdictions would be an interesting development for our work.

The Smaller Practices Group will continue to engage with any further proposals derived from Professor Kempson's work. I believe that her report is a good starting point for a robust debate around making IP fees more understandable in the world of smaller businesses.

Once again, if any IPs in our community wish to contact me to discuss the impact of any reforms on our practices, I would be delighted to speak to you.

ANDREW TATE is a partner at Reeves & Co and is chairman of the R3 Smaller Practices Group (SPG) Committee.

SAVE THE DATE

19 March 2014
R3 Annual Dinner
Royal Lancaster, London

14–16 May 2014
R3 Annual Conference
Vilamoura, Portugal

R3 events, courses and conferences

December

Date	Event	Venue
2	North West Regional Meeting	Manchester
3	South West & Wales AGM & Christmas dinner	Myristica Restaurant, Bristol
5	Personal Insolvency	Hyatt, Regency, Birmingham
10	Construction Insolvency	Hilton Tower Bridge, London
10	Property Insolvency	Hilton Tower Bridge, London
10	Southern Regional Meeting	Blake Lapthorn, Eastleigh
12	Advanced Restructuring	The Queens, Leeds

January

Date	Event	Venue
15	Rescuing Solicitors Firms in Financial Distress, Breakfast Briefing	Pinsent Masons, London
20	Eastern Regional Meeting	Ravenwood Hall Hotel, Bury St Edmunds

February

Date	Event	Venue
5	North East Regional Meeting	Baker Tilly, Tenon House, Sunderland
6	Joint R3 & IFT Midlands Region Meeting	Aston Villa Football Club, Birmingham
11	Introductory Series: Non-Insolvency Issues	Deloitte LLP, Birmingham
11	Introductory Series: Non-Insolvency Issues	Irwin Mitchell Solicitors, Leeds
11	Introductory Series: Non-Insolvency Issues	Prospero House, London
13	CVAs	The Midland, Manchester
13	Football Finance and Sports Insolvency	The Midland, Manchester
25	South West Regional Meeting	City Hall, Bristol
27	Key Stakeholders	Cheltenham Chase Hotel

Regional events

R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2013/14 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

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

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

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

Full members are invited to contribute to the development of insolvency, business recovery and turnaround professions at both local and national levels.

Benefits include: use of the designatory letters MABRP and a certificate of membership, inclusion in the *R3 Directory* and a copy of it, membership of INSOL International.

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

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

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Manchester office of Smith & Williamson announces the arrival of **Matt Dunham** as partner in the restructuring and recovery services team.

Smith & Williamson

Matt Dunham, a business restructuring practitioner and former Regional Chairman of R3 has joined the Manchester office of accountancy and investment management group Smith & Williamson to lead the restructuring and recovery services team. He will be working closely with Andrew McKenna, head of the Manchester office, to further develop the firm's services across Manchester, Merseyside and the North West.

Matt is a specialist in turning around and restructuring a variety of organisations and he has over 20 years' experience, with cases including national and regional retailers, manufacturers, telecoms and technology businesses and the receivership of the 5-star Free Trade Hall Hotel.

Greg Palfrey, head of restructuring and recovery (regions) said: *"Matt has a proven track record in dealing efficiently with organisations under financial stress, providing optimal results for creditors and other stakeholders.*

"We are increasingly becoming seen as trusted advisers of choice in these kind of fast-moving and often complex situations, and Matt is highly regarded for the way he works closely with management teams, funders and fellow professional advisers."

Matt commented: *"Smith & Williamson has a really great reputation; what clinched it for me was the way the firm brings together a range of specialists from its departments, from tax and audit to recovery and forensics to provide clients with a seamless service."*

Matt Dunham, Partner
0161 871 6612 | matthew.dunham@smith.williamson.co.uk

Smith & Williamson LLP Regulated by the Institute of Chartered Accountants in England and Wales for a range of investment business activities. A member of Nexia International. The word partner is used to refer to a member of Smith & Williamson LLP.

Interview with…

Nick Howard

Sandra Kessell talks to Nick Howard, the head of IP regulation at The Insolvency Service.

Are you satisfied with the speed with which regulators deal with complaints?
When you get a complaint it must be looked into thoroughly and everybody must feel they have been dealt with fairly. I appreciate that can take time. But, having said that, speed is also vitally important because if delayed too long, no matter what the outcome, people still feel that justice hasn't been done.

Insolvency professionals carry out vital work with great influence over other people's money and lives. If something needs to happen, speed is important.

Having introduced the new complaints gateway we will start to gather information about how well complaints are handled including how speedily they're handled – that's a vital part of the process. Once we have that information then we can focus on whether there are particular problem areas.

> Insolvency professionals carry out vital work with great influence over other people's money and lives. If something needs to happen, speed is important.

When there is a complaint against an IP, who perhaps isn't working within the rules or hasn't delivered a very satisfactory result to creditors, is it important that they are sanctioned?
Where someone is doing wrong we must have a system that holds them to account. If we do that, and make sure the sanctions we apply are properly publicised, then that breeds confidence, then people who come into contact with the insolvency profession – which may happen only once or twice in their lives – will feel, 'This is a process I can have confidence in'. That's in everybody's interests.

How can you deal with spurious complaints and what proportion of complaints are made by someone aggrieved because in the process of insolvency they haven't got the percentage back in the pound they felt they should get?
I am told that quite often these complaints come about because a creditor involved in insolvency doesn't have a full understanding of the case. In those cases there is an obligation on the profession to make sure we go out of our way to explain the process.

The number of complaints made with no grounds whatsoever are fairly small, normally something sparks them off. That is one of the reasons why the Complaints Gateway was set up, to filter out quickly the complaints that really don't warrant further attention and then focus in on the complaints that do deserve further attention.

Do you believe there's enough detail and transparency in the disciplinary reports published by the regulators?
I'm very interested in talking to stakeholders about this as in many ways issues around detail and transparency are for their benefit. I'm also interested to hear creditor and debtor organisations' views on those sanctions that they do see publicised. But the key word is transparency. It's not just about having a process in place to apply a sanction but also about making everybody realise that a sanction has been applied. I come back to this idea of confidence in the profession. Sanctions, where warranted, if you can find out about them, breed confidence in the profession. I do think the majority of people in the profession would support that concept.

How much does that problem lie with the wider media that would pick up a story, for example, from tweeting when HMV was in administration, but wouldn't follow up anything about regulation? As an organisation and regulatory body don't you struggle to get that sort of information across because, in comparison, it's a bit boring, really?
If the press have an angle on a particular issue then they're going to run with it. We may not always make the media headlines with our message about a good regulatory system, but we can try to get to the people who really matter. As a starting point, the creditors in a case should be getting the right levels of information about that case. We are making use of as much media as we can, to ensure that underneath the headline when other things are happening, the wider picture is also covered. As head of IP regulation at The Insolvency Service, part of the job is to help people understand how regulation works, and I will continue talking to representative bodies to make sure that accurate messages get out.

By what date will IPs have to move from the secretary of state to a new regulator and will that be an umbrella regulator – how's that going to work?
Currently there are the seven recognised professional bodies plus the secretary of state. The intention is the secretary of state will no longer have a role in the direct authorisation of IPs. The Insolvency Service already has a role as an oversight regulator and if we're overseeing ourselves that seems a fairly obvious potential conflict. It's a role we've been uncomfortable with for a while and one we're very keen to get away from but there are still around about 60 IPs for whom we're directly responsible.

> The number of complaints made with no grounds whatsoever are fairly small, normally something sparks them off.

Legislation is going through parliament making it clear we will be withdrawing from that role. That will become law next year, we hope, and there must be a period of transition to allow those currently regulated by the secretary of state to join and be licensed by another regulatory body. I estimate the whole process should be completed by 2016 – possibly earlier.

Some IPs have complained that The Insolvency Service does not disqualify as many directors as it should following reports of misconduct.
There is a slight misconception here about the number of directors we disqualify from IP misconduct reports. The reality is that we look at all reports sent to us, but we have to prioritise cases where there is enough evidence to succeed and where it is in the public interest. We disqualify around 100 directors a month, some 1,200 a year, and this has been a reasonably consistent figure over many years. Of these, around half are from cases that IPs report and the others from our own investigations.

If there's one thing you believe IPs could do better, what would that be?
A number of recurring themes come across my desk. My list includes pre-packs, which are always in the news – it's really

important that the profession gets things right in terms of both the practice and the perception.

> Sanctions, where warranted, breed confidence in the profession.

Then there was recent action to wind-up introducer firms. It is vitally important for the profession to make sure it deals with these things properly, so that leads don't come from the wrong places and scams are not set up by IPs operating in concert with others.

Perhaps the toughest nut of all to crack is the IP fee issue. Elaine Kempson's report makes clear there's a problem in terms of the controls unsecured creditors in particular are able to exercise over IP fees. In insolvency there's no direct client relationship so I think it's vital that we get this right, and obviously a government response will be coming out in the fairly near future.

Unsecured creditors don't get involved in the process, not as a result of apathy but for a number of very real reasons. They may not understand the processes; they may be owed a relatively small amount; they may feel they're powerless to impact on the process. The danger is, all those things mean they don't get involved and, according to Kempson's report, that's allowed fee levels to rise. If proper controls were in place, they wouldn't have done.

So how do you get that engagement? Elaine Kempson has come up with a range of suggestions. Partly around the information that IPs can supply to creditors. For a range of reasons, and it's not the IP trying to obfuscate, it's just they have to put so much information out, in the end the poor creditor has a report they can't make head nor tail of. In thinking of ways to improve information flow to creditors, Elaine has come up with some innovative ideas, including:

> We may not always make headlines but we can try to get to the people who really matter.

- Getting IPs to quote for the work. That may be difficult at the beginning of a case but I think generally there is a good point there.
- Explaining to creditors how they can influence the process. Through the Red Tape Challenge we are trying to simplify and modernise insolvency processes in ways that we think would help – by encouraging electronic communication, for example.
- Looking at the way in which remuneration is charged and making more use of percentage of realisations method.

Professor Kempson also offered some stronger solutions. She used the example of Scotland where, if there isn't a creditor committee, IP fees are reviewed through the court reporter system.

Isn't it the role of The Insolvency Service to explain the insolvency process to the man in the street?

We all have a part to play, including anyone who has direct contact with creditors. Information sent should be straightforward to understand. It's very important that our own website has decent information on different situations and it is vital we also have clear signposting there. IPs and regulators should also have clear information for those wishing to find out more about the process.

Do you think the Joint Insolvency Committee can be improved? If so, how?

A lot of improvements have been made in the way the Joint Insolvency Committee carries out its work. I've been very pleased to see an element of lay membership brought into the committee itself. It's no longer just a group of regulators and IPs around the table, stakeholders are getting involved in conversations and I've seen how that works in practice and the benefit that getting an external perspective brings to the experts in the room. The JIC has » also introduced consultation into the standard setting process. That's a really welcome move, so that standards are not something produced in a small room by a small number of people; the wider community has had a chance to contribute to the statements produced on insolvency practice. But that's not to say that there isn't scope for further improvement. One of the things that concerns me most is the pace at which standards can be produced. With seven recognised professional bodies plus the secretary of state all involved in trying to agree standards for the profession it's understandable, I think, that the process takes some time. We have a strategy day coming up for the JIC in December, so that's a good opportunity for us to have a look at the way in which we do things and work out what we can improve upon. In the meantime, I am keen to hear stakeholders' perceptions and what they would most like to see improved.

Graham Rumney has pointed out that the strength of regulation is not necessarily a problem, but the perceptions of strength are. Who holds those perceptions?

I hear those perceptions day in and day out, sometimes from ministers but often via comments from members of the public and from representative bodies. There's definitely an issue around the perception of regulation of the profession. And that perception broadly is, that it's not tough enough, that it doesn't have enough bite.

> "We disqualify around 100 directors a month and this has been a reasonably consistent figure over many years."

Interestingly, when I talk to members of the profession itself many of them say they would like to see tougher action taken, on occasion. They're fed up with a small minority bringing the whole profession into disrepute. It's very important, to my mind, that stakeholders get involved in this. The system is there for the benefit of people such as creditors and debtors, who go through the process – as well as the profession itself. And if it's not seen to be working right, then the profession suffers from that.

We are also part of a wider regulatory framework. Across the range of professions other regulators are involved. It's important we are seen as part of that – the overarching regulatory frame – there are regulators for accountancy and for the legal profession. At present, as oversight regulator we have very few powers available to us, so if we're not happy there's very little we can do. We can de-recognise a regulator – though obviously it

would take very serious misconduct for us to go down that route. But most of the regulators have a range of powers available to them, including reprimands and fines. So, I am looking to enhance the powers we have as an oversight regulator. I think most stakeholders would see that as a step in the right direction.

Do you think the introduction of the Debt Relief Order regime has improved the lot of personal insolvents and if yes, how?

First of all, Debt Relief Orders have been in place for four years and we are about to carry out a proper evaluation of the scheme. We will be more informed once that evaluation has taken place. For a segment of those in debt it already has had great benefit. It has enabled those at the most vulnerable end of the spectrum – people with no assets and no income; it has given them a way, at relatively low cost, to get out of the cycle of debt. I think one of the signs of success of the scheme has been the take-up. The number of DROs has risen – people have realised this is a useful way out. It has, broadly, obtained a level of acceptance.

How effective are the measures to restrict the ability of essential suppliers to terminate supply on insolvency?

The provisions we've had in place have tried to strike a balance between the needs of struggling business to have a continuity of essential supplies in particular, things such as utilities, while trying to give those suppliers some safeguards because they feel they're in a riskier scenario in an insolvency situation. In most businesses IT is now an essential supply so we think it's right to extend the requirement for continuity of supply to the IT industry and that's the provision the Enterprise and Regulatory Reform Act has tried to achieve. We are in the process of consulting on exactly how that works because the power in the Act is fairly broad and we want to ensure we achieve the desired effect. In all, it's about balance – we want essential supplies to continue, because they help rescue the company, but we recognise suppliers feel they are taking a risk in continuing to supply so we want to find what safeguards would reassure them.

> "There's a danger when IPs are in the public eye that they're seen to be in at the crisis point."

An IP interviewed on a BBC business news slot recently pointed out much of his job involves rescue and restructuring yet that's not something that people, including the interviewer, immediate think of IPs doing.

It's a great profession to be in, the work is always interesting, constantly challenging and quite often in the public eye. And that's in a large part thanks to the rescue work that IPs undertake upstream of formal insolvency. There's a danger when IPs are in the public eye that they're seen to be in at the crisis point. And sometimes they're blamed for that and not rightly. IPs are not responsible for the company's failure – they're trying to sort out the mess. ◻

Nick Howard

Nick Howard is the head of IP regulation at The Insolvency Service. On his appointment he was tasked with strengthening the oversight regulatory function performed by the agency. Previously he worked as director of policy and for many years worked in the service's operational arm as an official receiver and a regional director. He was responsible for overseeing the introduction of the Debt Relief Order regime for personal insolvents.

He has been involved in measures to strengthen the regulatory regime for insolvency practitioners, taking the lead in discussions with the Recognised Professional Bodies over a package of reforms including the introduction a single gateway for complaints against IPs. He has overseen the progress of measures in the Enterprise and Regulatory Reform Act introducing a streamlined process for debtor petition bankruptcy. He was also instrumental in establishing the new Debt Management Protocol.

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

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