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EDITORIAL

Review of the Insolvency and Restructuring Landscape in the UK

Lee Manning, Partner, Restructuring Services, Deloitte LLP, London, UK

The demise of Comet (followed quickly by Jessops, HMV and Blockbuster) cast a dark shadow over the high street, harking back to the collapse of Woolworths in November 2008. Up to 6,000 employees were made redundant, meaning the government will have to pay GBP 23.3 million in compensation. The company has debts of GBP 233 million which is owed to many dozens of unsecured creditors, and over GBP 26 million is owed to HM Revenue & Customs (HMRC) which won't be paid. These two businesses fell victim of changing retail markets and consumer shopping habits which is a reality that other retailers will have to face.

This prompted some soul searching from Vince Cable, the Business Secretary as to whether to change the insolvency rules, but he did concede that 'in general the British insolvency regime is regarded as one of the best internationally.'

In fact the collapse of Comet raises questions about governance of Comet pre-insolvency, more than the insolvency process itself. Moreover, the suggestion of importing some Chapter 11 proceedings and thereby leaving management in place has prompted many restructuring professionals to warn this could prolong the life of certain 'zombie companies', but more of the zombies later.

R3 has been consistent in its calls, now backed by the shadow business secretary Chuka Umunna, that more delinquent directors need to be disqualified following an insolvency. Whilst the number of delinquent directors being reported by insolvency practitioners to the Insolvency Service has risen dramatically in recent years, the percentage of those reports resulting in disqualification has more than halved – from 45% a decade ago to just 21% in 2011-12.

With a New Year dawning, it is time to comprehensively get a grip on 'dodgy' directors and protect the UK economy from the damage they cause. Directors that escape liability have a negative impact on UK plc as they are able to set up elsewhere. The Insolvency Service estimate a net benefit of GBP 88,000 to the market for every company director disqualified in terms of potential damage they might have otherwise caused.

You would think we were in a period of high corporate insolvency from the bloodshed on the high street (and splattered in the national press), but really the situation is very different, and atypical to previous recessions.

In fact there should be very little talk of corporate 'bloodbaths', 'massacres' or 'collapses'. The insolvency hearse has remained parked as a predicted surge of collapsing businesses actually never materialised. Many doubt now it ever will, although some banks are planning for more business failures in the longer term. But what has capped corporate insolvencies so far? There were nearly 8,000 fewer corporate insolvencies in 2009 compared to 1992, while personal insolvency has seen far bigger increases.

Instead we are given to believe that an army of undead, 'zombie businesses' is lurking in the shadows, undetected by official corporate insolvency figures. Some credence to the zombie theory comes from a poll by insolvency trade body R3, revealing that 8% of businesses are barely managing to pay interest but not reduce their debt, which would equate to some 146,000 zombie businesses stalking the UK. The survey was repeated in November, when another 14,000 zombies had been created, bringing the total to 160,000. More outspoken industry commentators have called for lenders to accelerate the slow death of many of these companies, so that their assets can be recycled for better use, but this is unlikely to happen in such a benign economy.

In recent years, a popular and sensible approach to dealing with companies overburdened with debt is for lenders to exchange debt for equity which in many cases has succeeded, typically so long as management retain a sufficient stake in the business to motivate them to turn it around.

In the past we saw an 'insolvency lag', with liquidations rising three years after the end of the 80's recession, and two years at 90's recession, as creditors felt able to improve on their returns. This hasn't happened this time, with the liquidation rate currently at 0.7%, against a peak of 2.6% in 1993.

Rather than harp on about a low interest rate environment, HMRC's 'Time to Pay' scheme or a general reluctance to pull the plug by the banks, I would point to the now overlooked Enterprise Act, introduced ten years ago.

When I was fighting to save the long established UK off-licence chain Oddbins, we were faced with a loss-making Company with over GBP 20m worth of debt and a substantial unprofitable store portfolio, which a CVA proposal was created to address. The Act allowed an

Administration contingency plan to be developed that could be implemented quickly and without substantial administrative cost, should the CVA fail to be approved by creditors. Post-Enterprise Act, we didn't have to prepare an additional and expensive pre-administration report for the Companies Court to place the company in administration after the CVA was rejected. And were able to move seamlessly into a trading administration as an alternative route to rescuing the core business.

In the end HMRC, owed more than 30% of the debt, voted down the CVA, but we had a viable second option. Despite the failure of the CVA proposal, under the consequent Administration, we were able to save 43 stores, of which 35 still trade under the Oddbins name.

The origins of the Enterprise Act came from Peter Mandelson's visit to Silicon Valley in 1998 to import the American 'entrepreneurial' spirit to our business culture, whilst reducing the stigma of failure entrenched in UK business. In 2002 the Enterprise Act fundamentally altered our insolvency regime, reducing bankruptcy from three years to one, while favouring 'business rescue' over liquidation.

From my perspective, the Act introduced a streamlined administration procedure, with the principal aim to rescue a Company rather than it subjecting it to a break-up or liquidation process, thereby preserving jobs. The Act reduced procedural costs by removing the requirement for a detailed report to be presented at Court to have an administrator appointed.

Acting in the best interests of all creditors overtook those of just the secured creditor (bank) as the duties of care for the appointment taker evolved. The new regime promoted the rapid rescue of ailing businesses or even the restoration of the Company itself through a CVA, which is being used more this year. Businesses in the retail sector since the start of 2011 have emerged from administration with over half the jobs and stores intact on average. Corporate insolvencies have not spiked, which is good for employment, even if some now argue that zombie firms are tying up useful employees and assets that could be better recycled elsewhere.

With over 25 years' experience in retail insolvency I believe that the Enterprise Act formed the landscape of a rescue culture in which this recession occurred. We may not have entirely adopted the American laid-back attitude towards corporate failure, or Chapter 11, but the fact there was no insolvency boom this time around shows the Enterprise Act did its job in maintaining a world class insolvency system. World Bank data June 2012 states that the UK's 'resolving insolvency ranking' is the 8th best in the world - better than the US, France and Germany's rates.

As President of R3, my current focus is on developing a range of initiatives which can be loosely themed 'clarity for creditors', where the emphasis is on the insolvency practitioner community working with Government influencers and legislators to introduce changes to the myriad of insolvency laws which will improve the outcome for the main 'victims' of an insolvency, the creditors. These measure include: a significant extension in the limits of employee preferential claims for arrears of wages (currently only GBP 800); doing away with the cost of agreeing and paying 'uneconomic dividends' where the amount of an individual dividend is vastly outweighed by the professional cost of paying it; obtaining clarity on what are 'expenses of an administration' and when they apply (in particular rent) and improving the rate at which the disqualification of 'unfit' directors is pursued by the Insolvency Service. One more would be maintaining the ability for an IP to recover conditional fee agreements and after the event insurance from a defendant in order to maintain the pursuit of worthy litigation claims in many insolvencies where there are insufficient funds available to the office holder. While no major overhaul is required, insolvency in the UK is a landscape that is constantly evolving.

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International Corporate Rescue

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