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## Recovery Matters



### Revival or Survival?

There have been many mixed messages in the press of late. Some analysers say that we are in the early stages of recovery whilst others are less optimistic. The “no gain without pain” budget turned out to be fairly predictable. The changes in VAT rates and capital gains tax rates certainly won’t help consumer spending, but help was on hand to UK PLC and so again, there are mixed messages there.

On the insolvency front, we have not seen the huge increase in insolvencies that had been widely predicted. I think the main reason for this has been the low interest rates, which have allowed problems to continue largely unchecked. My concern is that the low interest rates are postponing a problem, and not solving one. If and when interest rates start to rise, UK PLC may find the financial burden too great to bare and insolvencies may rise again.

Statistical evidence on insolvencies, as depicted in the chart on the next page, seems to back up this. Liquidations, whilst still by far the most common form of insolvency regime, are falling but CVAs are rising. Over the last year of so, the CVA has become more popular again, and may now be replacing the

administration as the “rescue culture” instrument of choice. At first this may appear surprising. If we go back to the introduction of the Enterprise Act in 2003, when the new process of Administration was heralded as the new horizon for the rescue culture, you would have expected such a simple and cheap procedure which has such immediacy of protection to be a very popular regime. In addition, the new “small company moratorium CVA” which appeared on the scene in 2006 was very unpopular amongst the profession because it required the nominee (the insolvency practitioner) to be personally liable for the failing company’s trade in a 2 to 4 week hiatus period before the CVA was voted in by creditors.

#### *So why the current turnaround?*

Many administrations of small companies become too expensive to run, should the administrator take charge at the helm and trade for several weeks whilst a market sale is progressed. In addition, trading in administration can often lead to business suicide as the mere “A” word causes clients and key employees to walk. Because of that, many administrations become “pre-packs” to ensure costs are kept down and a “seamless transition” is effected. Pre-

packs, as you know, have been scrutinized and heavily criticized by the media and some industry watchdogs. In my opinion, the pre-pack has its place in insolvency and should not be treated as some “dodgy” deal which is not in the interest of creditors. This is more a perception problem than one of reality, but it’s caused administrations to become less popular and given a boost to CVAs. These are not “small company moratorium” CVAs but a standard CVA where the company directors of any size company can retain management control and pay over monthly contributions into a CVA pot for possibly 5 years. In my opinion, CVAs are often the wrong advice to directors.

Sadly they are offered up by some insolvency practitioners as an “easy fix” but the reality of the CVA is that its far easier to sell to a director than administration, but it can be a noose around the company’s neck for several years. Its no surprise that many CVAs fail as its very difficult to manage cash flow successfully for a period of 5 years and predict market changes and external forces that can effect a business over such a long period of time. HMRC, whose claims are usually large enough to determine whether a CVA is accepted or rejected, will demand a 5 year CVA. The prepack

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administration is over in a day, so at least the outcome is certain, even if the perception is that creditors may be losing out!

We are now likely to enter a period of 18 months to 2 years of slow recovery, with no doubt some hiccups on the way. Insolvencies will increase and the CVA will become a very visible tool in the eye of the director to solve all their problems – but please be aware that the CVA may not always be the saving grace that it seems!

### How is our industry doing?

The Office of Fair Trading (OFT) has conducted a market study into the Corporate Insolvency Industry and its report was published in June 2010. The study focused on the appointment, actions and fees of corporate Insolvency Practitioners (IPs) and analysed whether the market and regulatory framework provides IPs with appropriate incentives to operate in the long term interests of creditors, what harm may be caused if they do not and what changes to the operation of the market might increase its efficiency.

The main findings of the OFT study are:

- Since most IPs compete by building and maintaining strong relationships with secured creditors, such as banks, as long as banks do not recover their assets in full, the market works reasonably well. This is because the banks in the main control the choice of IP and agree the fee scale.
- However, when the secured creditor is paid in full, the remaining unsecured creditors find it hard to control or influence the process and may be harmed as a result.
- In a typical administration, fees paid to the IP are around 9 per cent higher when secured creditors recover their debt in full and the fee is effectively borne by the unsecured creditors. This is evidence of the weak position of unsecured creditors and the possible failure of the regulatory regime to correct for this.
- A survey of IPs finds that 41 per cent believe the current regulatory system does not deal effectively with rogue IPs, 45 per cent believe

that it deals with poor behaviour inconsistently and 75 per cent believe that regulations are ineffective in engaging creditors.

In order to deal with these findings, the OFT makes the following recommendations:

- To establish an industry funded independent complaints handling body with broad powers to review IPs fees and actions, impose fines and return overcharged fees to creditors.
- To reform the regulatory system by repositioning the Insolvency Service as a regulator of the Recognised Professional Bodies and decreasing its role as direct regulator of IPs.
- To set objectives for the regulatory regime against which its performance can be measured and streamline the way in which it makes decisions.

We note that aside from the regulatory reforms recommended, the OFT concludes that the industry needs no radical overhaul, which we broadly welcome.

