INSOLVENCY BITESIZE

Insolvency statistics may be down, with total corporate insolvencies in England and Wales at their lowest level since Q4 2007, but there has been no shortage of insolvency law developments in the last few months. The Court of Appeal, in its "Waterfall I" judgment, has grappled with some of the complex issues arising out of the distribution of a surplus of assets in the Lehman administration. A number of insolvency related changes made by the Small Business, Enterprise and Employment Act 2015 have now come into force. The European Parliament has now formally approved the Council's position at first reading on the revised European Insolvency Regulation. Subject to signature and publication in the Official Journal, the recast Regulation is considered to be adopted, although its provisions will not, on the whole, apply until 2017. For discussion of these, and other topical issues, see our list of recent client publications in the table to the right.

A reminder of Linklaters R&I publications in the last quarter

Insolvency Bitesize Q1 - a focus on law reform.
Issues relevant to the secondary debt market - use of non-public confidential information, cleansing provisions, "big boy" terms and information barriers.
EIR reforms - how significant are they really?
Treatment of a surplus in administration - the Court of Appeal judgment in the Lehman Waterfall 1 appeal.
DTEK exchange offer and scheme of arrangement - impact on bondholder incentives and future high yield bond restructurings.
Small Business, Enterprise and Employment Act 2015 - insolvency changes which came into force on 26 May.

The broad theme in this edition of Insolvency Bitesize concerns recoveries - not just for creditors, but also for IPs, of assets from third parties and, importantly, of their fees.

Recoveries from directors – did they just get easier? No, but at least they have not become harder. The Supreme Court in *Jetivia* has made clear that directors should not be allowed to attribute knowledge of their own fraudulent wrongdoing to their company. This means that a company will be able to bring a claim against those directors based on their wrongdoing and those same directors will not be able to raise the defence of "illegality". The Supreme Court also clarified that fraudulent trading claims can be brought against persons, including directors, whether they reside in the UK or abroad, in the same way as wrongful trading claims and actions for undervalue transactions and preferences.

Beware of foreign time limits on bringing claims. The ECJ decision in *Lutz* means that IPs need to be aware not only of substantive defences but also limitation periods or other time-bars relating to actions to set aside transactions under the local law governing the relevant act. The decision means that where an IP is looking to use English insolvency law to overturn a transaction which is governed by, say, French law, an understanding of French law procedural and substantive defences will be necessary. Such defences will even apply where the payment being challenged is of a sum of money attached before the opening of the insolvency proceedings, but made only after the opening of those proceedings.

Good faith and its role in s127 validation orders. Equal ranking creditors should share equally. That is the key policy behind s127, as confirmed by the High Court recently. To preserve the insolvency estate, the court will be slow to validate any post petition transaction which resulted in a significant reduction in the company's assets. Even where full value had been provided, if one creditor benefitted at the expense of the others in the same class, validation is unlikely. A transaction made in good faith in the ordinary course of business without knowledge that a winding up petition had been presented will normally be validated. But not always. A transaction which significantly depleted the company's assets to the detriment of the general body of creditors is unlikely to be considered as made in good faith.

Pensions and cross border insolvency. There have been two interesting developments highlighting the significance of pensions in a cross border insolvency context. Nortel pensioners globally will benefit from the fairness-driven judgments in the US and Canada allowing them to pro-rata share certain post insolvency sale proceeds based on creditor claims against each estate. The Supreme Court decision in Olympic Airlines on when a company has an "establishment" illustrates the need for UK pension trustees to act quickly to preserve value where an EU employer commences insolvency. The concept requires a subsisting business ascertainable by third parties and not mere internal administration.

Collective redundancy post Woolworths. The ECJ decision supports the principle that making fewer than 20 employees redundant at each of several individual stores will not trigger collective redundancy obligations. Ultimately, however, whether they arise must be viewed on a case by case basis. Redundancies made across stores located in, for example, the same shopping centre, could well be treated differently from redundancies made at stores spread across the UK's major city centres.

Customer recovery from an insolvent retailer. Following a number of high profile retail collapses in recent years, the Law Commission is currently considering the treatment of customer deposits and gift vouchers on insolvency. As well as examining the scale of the problem, it will consult on a range of possible solutions. For example, the project is likely to look at the ranking of claims on insolvency, whether administrators should have greater discretion – or duties – to protect consumer interests and whether changes could be made as to when title to goods passes. The Law Commission has indicated that it will publish a consultation paper on the issue this summer. Actual changes to the law (if any) are likely to be some way off.

IP fees – more transparency. From 1 October, IPs will be required to provide upfront estimates of the cost of working on insolvency cases. This will require a summary of estimated costs, the work to be undertaken and, where an hourly rate is proposed, an estimate of the expected time. These estimates will act as a cap on fees as, once agreed, they can only be changed by agreement between the IPs and those that are owed money.

IP fees – the PPF sets out its stall. In its new guidance, the PPF makes clear its interest in ensuring IP fees represent value for the insolvency estate with recoveries impacting PPF funding. Where there's a DB pension scheme, the guidance leaves IPs in no doubt that the PPF will scrutinise their remuneration carefully. Among other points, IPs must involve the PPF early on in a pre-pack. Otherwise, if the deal results in the scheme entering a PPF assessment period, the PPF will look to nominate alternative liquidators and exercise whatever creditor rights it may have. The PPF says that, as a majority unsecured creditor, it will not generally propose or support the creation of a creditor committee. But, if an IP thinks there ought to be one, they must show why and the PPF will normally want a seat at the table.

English schemes continue to evolve. The creation of jurisdiction by changing the governing law of New York high yield bonds to English law in DTEK and the running of two parallel and inter-conditional schemes in Towergate are the most recent examples of the creativity possible under an English scheme of arrangement. We consider further the DTEK transaction in our client alert (see publications table) and discuss what it reveals about the importance in complex liability management exercises of structuring bondholders' incentives, as well as what it might mean for future high yield bond restructurings.

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