BenedictMackenzie
Chartered Accountants • Business rescue and recovery

rescue
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REDUCING THE STIGMA OF BANKRUPTCY

The Enterprise Act was brought in to reduce, but not remove, any unnecessary stigma regarding bankruptcy. In a recent report, the DTI shows a proven link between entrepreneurship which helps our country to thrive and grow, and the length of time someone remains a bankrupt[1], but despite the Enterprise Act, we still have pieces of legislation affecting bankrupts that date back 300 years.

In June 2006 therefore, 23 pieces of legislation will be altered or abolished to reduce the stigma of bankruptcy under the Enterprise Act (Disqualification from office: general orders 2006). The alterations will allow undischarged bankrupts to remain in certain offices that bankrupts were not previously allowed to hold.

The new legislation will be discussed by parliament in the next few weeks and it is proposed that bankrupts with mandatory disqualifications will now be able to continue as school governors, to remain in office for other education foundation bodies and in some health bodies such as the National Patent Safety Agency.

There are exceptions however. The law will not change with regard to charity and pension trustees, where the ban on bankrupts being able to hold any roles will remain. Additionally, if a bankrupt is deemed to be culpable, or at fault, and has therefore become the subject of a 'Bankruptcy Restriction Order', they will continue to be removed from office including office as school governors and from health and education bodies.

It remains to be seen whether these increased "carrots" will benefit creditors or merely make it even easier to abrogate their responsibilities to others.

[1] *Bankruptcy Law and Entrepreneurship by John Armour and Douglas Cumming*

Website goes live!

The Benedict Mackenzie website **www.benemack.com** has been given a major revamp. We have listened to the needs of business owners, individuals and their advisers and have given each a specific area on the site.

We believe the site is easier to use and now provides a solvency predictor and regular information including our newsletters at the touch of a button.

We hope you will see what is new at **www.benemack.com**. We are always keen to hear your feedback so let us know what you think by dropping us an email to info@benemack.com to your contact partner or by clicking on the 'feedback' button on the website.

CHANCELLOR'S DEBT LEGACY

As Gordon Brown looks set to leave behind the mantle of Chancellor and take up that of Prime Minister, those left to manage his £1 trillion plus debt legacy must take radical action before more pain and despair follow and the very stability of our economy is jeopardised.

This level of borrowing is a serious problem; not only to the individual who becomes trapped in a spiral of debt, but also to businesses. The over-borrowed individual will eventually reduce spending – even those who have not budgeted properly – this will reduce spending in the retail sector which will have a knock on effect on other industries in the distribution and manufacturing sectors.

The marketing of loans and credit cards together with the number of new players entering the market on a regular basis makes it difficult to regulate, for example how many credit cards a consumer has and quite how much debt they are getting into. However, there are a few beneficial steps that could be taken to alleviate the debt burden, these include:

(1) making it more difficult to obtain new cards when credit limits are reached

(2) increasing minimum repayments

(3) actively managing customers who are at the highest risk of default; giving them breathing space to take professional advice, reduce spending and prepare an affordable way to reduce their debt.

The insolvency profession has vast experience of assisting businesses and individuals on actions to

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mitigate or even overcome debt problems, but inevitably people leave it too late or take poor advice from unscrupulous and unregulated individuals who are more interested in a fee than genuinely helping people.

It appears that with the large profits being made by clearing banks and credit card companies they can currently afford to provide against the bad debts and therefore not take a proactive approach to helping their customers.

What is needed now is positive action not more talk. Lenders and the insolvency profession should work together to reduce debt back to reasonable levels and pave the way for a culture of more responsible lending and borrowing.

A NASTY STING IN THE TAIL

This is a clear case where the director, in total ignorance of the legislation, committed an offence which may result in her being made bankrupt

Directors can be personally liable for debts of a company they have established with a similar name to one that has previously gone into liquidation. This can cause very serious consequences for the individual and may result in personal bankruptcy. Lawyers and accountants should be aware of this sting in insolvency law, known as 'Section 216' and advise their clients of the risk they face.

Mrs Smith was a director of a company called ABC Construction Limited and found out about this law the hard way. Due to trading difficulties ABC Construction was placed into creditors' voluntary liquidation. Just four months prior to the winding up, she formed a new company called Off The Shelf Limited which traded as ABC Construction. Unfortunately Mrs Smith was not warned about 'Section 216' of insolvency law. Off the Shelf traded for five years as ABC Construction until it was also placed into creditors' voluntary liquidation.

Beware the Revenue & Customs!

In July 2005 HM Revenue & Customs wrote to Mrs Smith and stated that, as the companies had traded under very similar names, it appeared that they were trading in contravention of Section 216. Mrs Smith, was therefore personally liable for the debts of the subsequent company, Off The Shelf Limited. The Revenue demanded repayment of just over £87,000 from the director personally.

This is a clear case where the director, in total ignorance of the legislation, committed an offence which may cost her dearly and could result in her being made bankrupt.

It is up to creditors to take action under these circumstances and not the liquidator. This form of action is likely to become more common, as clearly HM Revenue & Customs are going to be looking in much more detail at such cases in the future. All directors should be aware that, since government departments lost their status as preferential creditors in September 2003, they are looking at all possible ways to recover unpaid taxes.

This is a very potent weapon in the Revenue's armoury and directors of insolvent companies and their advisers must tread extremely warily before setting up a company with a similar name, or as in this case, using a similar trading name.

Escape routes

So how could Mrs Smith have avoided such a situation? There are escape clauses contained in the Insolvency Rules 1986 which state that there are three exceptions:

(1) Where a successor company buys the whole business or most of its assets from the insolvency practitioner.

(2) Where the director makes an application to court for leave to use a similar name.

(3) Where the company referred to, although known by a prohibited name, has been known by that name for a whole year and has traded for the whole of that period.

There are complicated rules as to procedure and timing in respect of all these cases and professional insolvency advice should be sought by anyone contemplating using a similar name.

The names in this case have been changed to preserve anonymity

CAN YOU BANK ON A CVA?

A Company Voluntary Arrangement (CVA) should be a straight forward procedure, but this was far from the case when a company under our supervision was placed in jeopardy by its bankers who did not seem to understand how the CVA worked.

We assisted the director of a design and manufacturing business who proposed a CVA to his creditors. They were to receive 80% of their debts over five years.

Support and approval

The company banked with a large clearing bank and had a loan which had been converted from an overdraft the previous year. No new security was taken, but the bank had a personal guarantee from the director supported by a charge over his assets. The company also held a current account with the bank, which it kept in credit.

The bank initially indicated its support for the CVA reserving its right to pursue the director under his guarantee for any shortfall, but did not lodge a vote in the CVA. The proposals were approved by the majority of creditors following which the bank proposed that it should be treated as a secured creditor as it had the personal guarantee of the director.

Banking on misunderstanding

After discovering it was not a secured creditor, the bank said it would not accept the CVA. Unfortunately for the bank, the CVA was binding on them as it was for all other unsecured creditors.

After three months of the CVA running without any problems, the bank decided, without any prior warning, to stop the company's bank account and return all cheques and direct debits unpaid. This all took place just before Christmas and had a disastrous effect upon the company's trading which was already subject to pro-forma payment arrangements often required when operating under a CVA.

We immediately contacted the bank, who said that the account had been incorrectly transferred to their insolvency section and was being treated as a "dead account". They eventually agreed to reverse the position but not until the New Year. This left the director in a very awkward and embarrassing position, having to speak to suppliers, to whom cheques had been issued, requesting they delay banking them. Naturally, this did not help the director's relationship with suppliers, who were already subject to the CVA payment terms and nervous of their position.

To compound problems, following the CVA approval, the bank transferred payments from

the company's current account in reduction of its loan. This preferential treatment put the bank in a better position than other unsecured creditors; it also seriously reduced the company's cash surplus. After some discussion, the bank eventually accepted payments had to be reversed but said they would pursue the director at the end of the CVA for the shortfall under his personal guarantee - all of which they had agreed when they indicated their initial support for the CVA!

It could all have been so different. Were it not for our vigilance and expertise, coupled with the director's determination to succeed, the company might have folded under the pressure of dealing with the consequences of the bank's actions.

A relieved director was pleased with the boost the refunded loan repayments gave to the company's cash flow but amazed when the bank then advised that the company would have to find alternative banking for its current account.

Guaranteed problems

Unfortunately, the problems did not end there. Again without warning, the bank served formal demand on the director for repayment of his guarantee liability which on top of everything else, left the director completely confused and anxious about his ability to continue with the CVA.

Following our remonstrations, the bank confirmed that the letters to the director had been issued incorrectly on an automated system! On the plus side, they also said there would be no further problems because the matter was at last with their CVA department.

This however was not the end of the company's banking problems. Problems arose when the director attempted to open a new current account with another High Street Bank. This bank agreed to set up an account - but only subject to an independent accountant's review of the company's financial situation. This of course would have to be funded by the company.

This was totally absurd given that the company was merely looking to open a current account, with no overdraft facility, and therefore, no exposure to the bank. The new bankers also suggested transferring the existing loan to get over what they called "split banking". This made no sense as they would merely have stood in the shoes of the original bank and been an unsecured creditor in the CVA.

Once these ramifications had been explained, the new bank agreed to simply provide a current account with no borrowing facility so that the company could trade.

Obligations fulfilled

In all, it took five months for these problems to be resolved, at a time when the company was particularly vulnerable, but fortunately the business is now doing well and fulfilling all of its obligations under the CVA.

It could all have been so different. Were it not for our vigilance and expertise, coupled with the director's determination to succeed, the company might have folded under the pressure of dealing with the consequences of the bank's actions. As Insolvency Practitioners, we will often operate in difficult circumstances to rescue businesses in financial difficulty; it would be helpful if we could count on our major institutions to understand the mechanisms which we use to achieve this goal.

INSOLVENCY STATISTICS
(ENGLAND AND WALES)

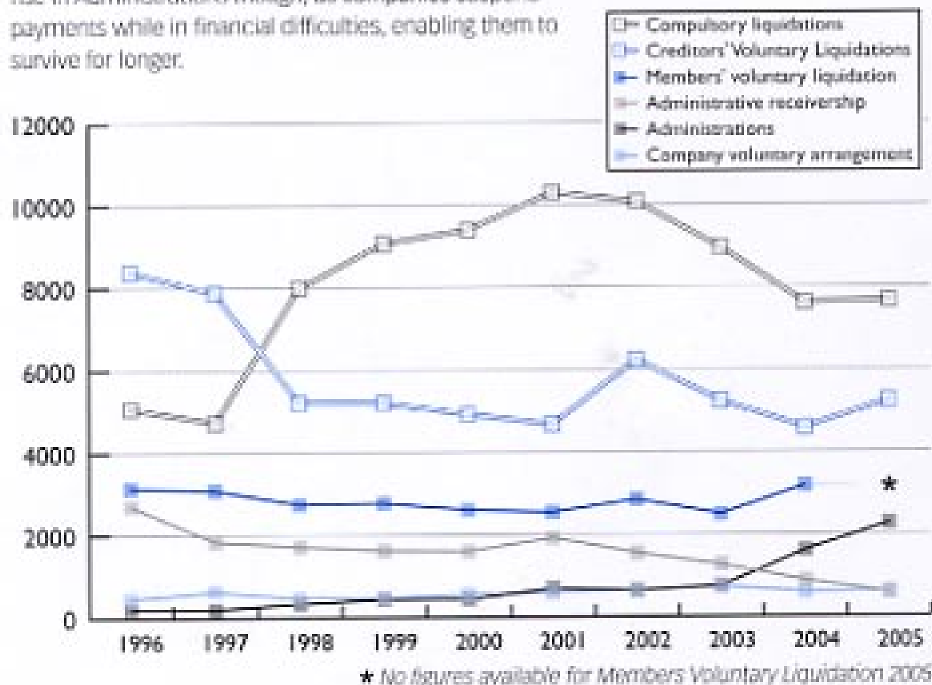
Our graphs this issue chart the events over the past ten years to give you an overview of how the financial landscape is changing for both companies and individuals.

Company liquidations

The picture for companies does not look as bleak as that for individuals although some companies, especially in the retail sector, are starting to report a knock on effect from the increasing number of bankruptcies and IVAs.

Although compulsory liquidations have risen by two and a half thousand over the past ten years to current figures, the number has actually declined since 2001, which means that fewer companies are being forced into liquidation by their creditors.

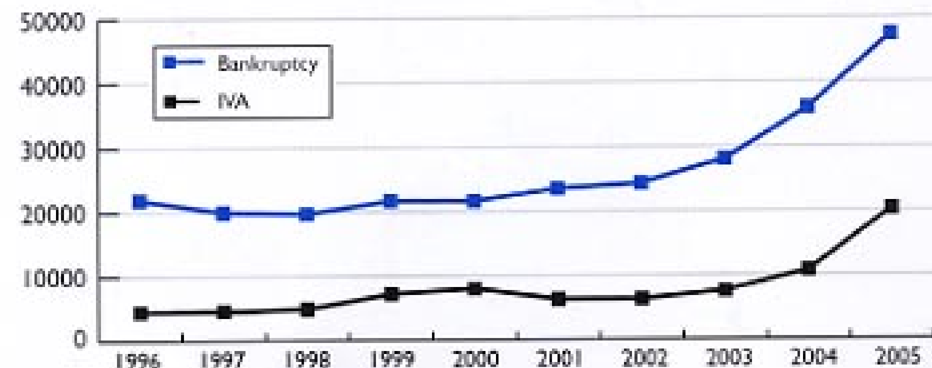
Both members and voluntary liquidations have shown an uneven path over the past ten years, but are on the rise again now. Banks are negotiating repayment of debt much more now than in the past, so there has been a dramatic drop in Administrative Receiverships, down to just 590 in the whole of last year. There has been a corresponding rise in Administrations though, as companies suspend payments while in financial difficulties, enabling them to survive for longer.



* *No figures available for Members Voluntary Liquidation 2005*

Individual insolvencies

This graph charts the well documented rise in individual voluntary arrangements and bankruptcies over the past ten years. With access to easy credit, bankruptcies being cleared within a year and the government making it even easier to enter individual voluntary arrangements; we expect this upward trend to continue significantly.



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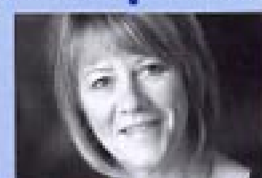

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