INSOLVENCY UPDATE

MESTON REID & Co
CHARTERED ACCOUNTANTS

Introduction

One market commentator described the North East economy as being in an interesting state of flux, which seems quite apt when one looks around. For example, there is talk of significant investment in the renewables sector whilst those in the mainstream energy sector, from oil majors to small service companies, rub their hands with glee as the oil price seems to be fairly steady at a price that comfortably exceeds extraction costs. Great…..so where is the money?

There are plenty retailers who complain about the lack of footfall and general spend, whilst bars and restaurants clamour to attract an ever decreasing number of people who can afford regular nights out. Conversely, car dealers complain that they cannot source new vehicles and comment that second hand ones are holding their value.

Is it a case of a slight disconnect in timing between a higher level of spending over the next couple of years, and a government wish for immediate consumer spending to boost the economy without the public being given the extra cash by way of wage increases?

We are told that a gentle rise in the rate of interest is meant to create a fall in inflation, but that is not yet happening. Again, perhaps it is a question of timing and explains "the interesting state of flux".

Economic uncertainty is always unwelcome and one effect is that some businesses decide that they no longer wish to face the challenges ahead, thereby consulting the Meston Reid & Co insolvency team, because the last two years have killed the last bit of business enthusiasm and determination due to the exceptionally challenging circumstances.

Statutory debt solutions : Scotland

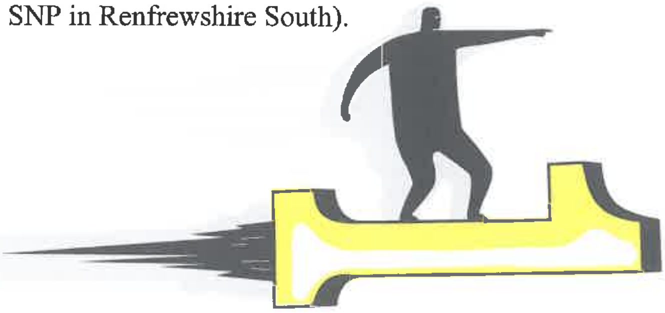
In October 2020 the accountant in bankruptcy "aib" issued a discussion paper seeking views on whether the various debt solutions currently available in Scotland are fit for purpose. The consultation document followed meetings with various stakeholder working groups which include the protected trust deed standing committee, the debtor application working group, the Scottish Common Financial Tool working group, the Institute of Chartered Accountants of Scotland, Citizens' Advice Scotland and Money Advice Scotland.

The process is now at stage two as a result of reports published by three working groups. The reports deal with issues such as the existing moratorium period available to an individual seeking breathing space from creditor pressure before deciding how to proceed with a plan of action, and whether the Common Financial Tool (used to determine a person's ability to pay a regular contribution as part of the bankruptcy process) remains appropriate. For example, the aib analysis reflects that only 15% of Scottish bankruptcies result in payment of a contribution at the outset of the process. Further, the Common Financial Tool produces a requirement for a bankrupt to pay the trustee the full amount available each month i.e. income less essential expenditure, whereas experience indicates that an element of common sense/latitude is required given the fact that no two months tend to be the same from an expenditure viewpoint.

Substantial time has been spent reviewing the existing trust deed process in terms of eligibility e.g. a "cooling off" period after a trust deed has been signed and seeking to quantify the appropriate level of pre-trust deed fees charged by advisors.

Looking at the broader subject of bankruptcy in Scotland, another report queries whether the minimum debt level of £1,500 to access the Minimal Asset Process bankruptcy should be removed, and whether the maximum debt level of £25,000 remains fair.

Discussion has also taken place around how the bankruptcy discharge occurs and whether there should be a difference between uncooperative/untraceable bankrupts compared with those who assist the trustee throughout the period of bankruptcy. One thought is that the period during which a bankrupt should pay into the bankruptcy estate is reduced from four years to three years. These matters, and others, will be considered by the minister for public finance, planning and community wealth (currently Tom Arthur MSP who represents the SNP in Renfrewshire South).



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It remains to be seen what recommendations find their way into legislation, but it is helpful to know that steps are in place to ensure that the Scottish statutory debt solution framework remains both flexible and evolutionary in terms of helping those in personal financial difficulty.

Director Disqualifications

In response to a recent Freedom of Information question regarding the director disqualification process, The Insolvency Service "TIS," the UK government body that deals with all director disqualification actions, reported that for the years ended 31 March 2017 to 2022 inclusive, around 60% of reports submitted by a licensed insolvency practitioner in a formal insolvency process were investigated further. The process is referred to as "sifting in" and occurs when the liquidator submits the required report to TIS and the system decides that the answers to various questions require review.

Clearly, not every formal insolvency means that the directors are worthy of disqualification and the fact that the nine month period ended 31 December 2021 reveals a lower figure of 42% could suggest that the impact of Covid-19 caused a number of companies to fail for reasons that were not attributable to the actions of a delinquent director.

Indeed, the Freedom of Information Act 2000 response also indicates that the average number of director disqualifications per company is 1.2, from which one may surmise that the proverbial one-man company is either easier to pursue, or there tends to be one dominant director in a company whose actions require to be considered more closely rather than those of the entire board.

I can't afford to sue : but you can if you wish

In recent years it has become more common to see liquidators obtain funding from various sources in order to pursue a claim/asset, particularly when it is thought that there are insufficient resources within the liquidated estate to pay all of the anticipated costs in the event of an unsuccessful outcome. This often creates frustration amongst liquidators in terms of not being able to pursue claims, exacerbated by the natural inclination of creditors being unwilling to provide funding for court action despite the fact they would be the beneficiaries in the event of success.

Indeed, when invited to provide funding for a legal action, the creditor response is often that speculative action should not be embarked upon and that whatever cash exists in the liquidated estate should be distributed by way of dividend. Thus, does the liquidator risk resources in the hope of achieving a positive financial outcome, or pay a reduced (but certain) dividend ?

When a third party litigation funder is identified, the normal route is for such funder to buy the claim from the liquidator, but it is becoming more popular for the funder to simply agree a division of any successful recovery between the funder and the liquidator i.e. preserve the cash available for the court case. Typically, the litigation funder is a company operating in this sector, but there is nothing to stop a liquidator assigning a potential claim to an individual.

In a recently reported case, the directors of a company in liquidation (an English company : but it is generally thought that the result will apply equally to Scotland) tried to stop a liquidator from assigning a claim against them to a third party. Indeed, the directors argued that the liquidator should have offered them the opportunity to purchase the assignation, which seems a curious position on the basis that the liquidator's claim was against the directors! The court found in favour of the liquidator in terms of being able to approach whoever he deemed the most appropriate assignee.

The continuing growth and popularity of litigation funders may well mean that there are more assignations of potential claims e.g. no-win/no-fee organisations, meaning that directors who think that they have escaped being pursued because they have left no assets in the company to fund legal action, will not escape the long arm of the law.

GDPR

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Conclusion

This Update is provided for general interest purposes and does not purport to offer definitive advice. Thank you for taking the time to read this Update and feel free to pass it to anyone who you think might be interested in reading it.

Meston Reid & Co

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