



FinancialRecovery

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THE ZOMBIE BUSINESS PHENOMENON

The idea of zombie businesses has proved to be popular since the phenomenon was noted in 2011. So, what is a 'zombie business'? - Those businesses that can only afford to pay off the interest on their debt, not the capital element of the debt itself. Being unable to pay debts when due is a technical definition of insolvency. There are now believed to be approximately 108,000 businesses in the UK capable of paying only the interest on their debts, down from 146,000 in June last year, and well down from the peak of 160,000 last November.

The decline however has been matched by an increase in the number businesses reporting greater signs of financial distress. Around 137,000 businesses report having to negotiate payment terms with their creditors, up from 130,000 a year ago.

Zombie businesses have been able to operate due to the low interest rate level. However, once the current benign credit environment changes, the majority will be pushed over the edge into a formal insolvency situation. It is believed that zombie companies are stifling the growth of viable, otherwise healthy businesses, and in turn economic recovery, as they dilute the market.

Pillar Denton Ltd & others v Jervis & others ('Game' or 'Game Station') case

The case related to the treatment of rent in administration and whether and to what extent it should be treated as an expense or as a debt. This is relevant to insolvency stakeholders as insolvency expenses must be paid in full before returns can be made to creditors, including preferential or floating charge creditors.

Previous case law had established that rent payable was calculated with reference to the date the rent fell due and the date that the company entered into administration. The Court of Appeal has overruled these earlier cases and found that an insolvency office-holder must make rent payments for the period in which he or she retains possession of the property in question (calculated on a day by day basis), with such payments treated as expenses. Good news for landlords.



THE LAW FIRM BUBBLE

Currently there are approximately 125,000 solicitors in England and Wales spread over 10,000 law firms. The legal profession has not seen the consolidation that has taken place in other professions. The number of law firms has, in fact, increased in recent years, in contrast to a reduction in accountancy firms.

Why then has the legal profession been protected from commercial reality for so long? It appears that banks have been keen to lend to law firms, often on an unsecured basis. There were no large law firm failures immediately following the financial crisis of 2007-08, which helped reinforce the view among the banks that law firms don't fail. The high-profile collapse of Halliwells in 2010 was considered by many to have been caused by a property issue. However, when Cobbetts, an old established, respectable law firm, went into administration in 2013, banks and secondary lenders are beginning to understand that if a firm such as Cobbetts can collapse, then there are likely to be other firms facing financial distress.

To compound problems, there has been a tightening of legal aid funding, banning of personal injury fees and changes to the recoverability of conditional fee agreement (CFA) success fees. Competition is also gradually being introduced, the Co-op being the first major consumer brand receiving approval from the SRA.

Clients are also seeking more for less and some larger firms, having gradually lost fee income, find themselves occupying expensive properties they signed up to in prosperous times on long leases. As external financial support may not be as readily available as it has been in the past, many believe that the legal profession is about to experience its own liquidity crisis.

Fashion retailer Internacionale enters administration

The company, which employs over 1,500 staff, across 89 stores throughout the UK, entered administration due to continued poor trading and increasing creditor pressure. Internacionale narrowly escaped liquidation in July 2013, when the business and assets of the company were sold as a going concern to former chief executive Raj Sehgal, Naresh Abrol and William Milton.

Despite a turnaround plan effected in early 2014, which included 90 redundancies, the economy remained flat and the company did not achieve the expected levels of growth. As a consequence, company shareholders decided they can no longer support the business and have taken the difficult decision to wind down the business through administration. Administrators were appointed on 28 February.



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MISSING TRADER DISQUALIFIED FOR 12 YEARS

A man who allowed his company to play a missing trader role in VAT fraud has been disqualified from acting as a director for 12 years following a decision by the High Court. The Director, whose Watford based company sold PlayStations, cannot promote, manage or be a director of a limited company until 2025. The court was told that Harbour Brands Ltd sold PlayStations wholesale bringing them VAT free from other European countries but charging VAT to a single UK customer. No provisions were made for payment of VAT to HM Revenue & Customs during the four months the company traded.

The judgement followed an investigation by a specialist team of The Insolvency Service, whose involvement started with the winding up of the company for unpaid VAT. For more details and further cases, visit The Insolvency service website at www.bis.gov.uk/insolvency/

BANKS TO BE MORE BANKRUPT FRIENDLY

Banks will be exposed to fewer financial risks from undischarged bankrupts who open a bank account, if an amendment to insolvency law announced by Business Minister Jo Swinson is approved. The efforts to enable undischarged bankrupts to open a bank account and receive wages, pay bills or shop online, follow concerns from consumer representatives that aspects of the old law prevented people from making a fresh start following bankruptcy.

Banking representatives have been concerned that a trustee in bankruptcy could make a claim against them if a bankrupt person failed to declare any of the funds going through their bank account.

The amendment to safeguard the banks was included in the draft Deregulation Bill published on 1 July 2013 and will mean that unless a bank has received a specific notice from a bankruptcy trustee about an asset that will benefit the estate (and which the trustee has an interest in,) they are protected against claims from that trustee.

This newsletter is for general information only and is not intended to be treated as advice to any specific person. It is recommended that appropriate professional legal advice is sought before acting or relying on any information contained in this publication.

SERVICES WE CAN PROVIDE

Administration:

Usually instigated by the Directors or the bank, and used to provide protection whilst a solution is found.

Company Voluntary Arrangement:

Useful where a company has accrued aged debt which it is unable to service, but is profitable moving forward. An offer is then made to creditors for settlement based on affordability (requires 75% of creditors voting to vote in favour).

Liquidation of solvent or insolvent companies:

Results in the formal closure of the business entity.

Re-finance:

Seek new funding via bankers and private investors.

Individual or Partnership Voluntary Arrangements:

An alternative to bankruptcy, which allows individuals to offer to repay what they can afford to creditors and freeze the aged debt (requires 75% of creditors voting to vote in favour).

Bankruptcy advice:

The options available and implications of bankruptcy on the individual.

REGAIN CONTROL, SECURE THE FUTURE

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