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INSOLVENT ABUSE:

**REGULATING THE INSOLVENCY
INDUSTRY**

Association for Accountancy & Business Affairs

*Working for an Open and Democratic Society
Shedding light on darker practices*

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**INSOLVENT ABUSE:
REGULATING THE INSOLVENCY INDUSTRY**

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SUMMARY

There are no state guaranteed markets for mathematicians, scientists, engineers, designers or computer experts, but the insolvency practitioners enjoy a market guaranteed by the state. All bankruptcy, administration, receivership and liquidation work is required to be carried out by just over 1,800 insolvency practitioners belonging to a few accountancy and law trade associations.

The insolvency practitioners do not owe a 'duty of care' to the stakeholders affected by their actions. They are highly secretive and rarely publish any meaningful information about their affairs. Unlike the railways, telecommunications, gas, electricity, water, food and the financial services sectors, the insolvency industry does not have an independent regulator. Instead it is regulated by the accountancy and law trade associations (known as the Recognised Professional Bodies or RPBs). These organisations were formed to advance and protect the economic interests of their members rather than the rights and well being of stakeholders. The RPBs do not owe a 'duty of care' to anyone affected by their actions. The system of regulation is inevitably 'captured' by the very interests that it was supposed to regulate. It is not accompanied by an independent system for investigating complaints or compensation for the victims of poor insolvency practices. There is no independent ombudsman to adjudicate complaints against insolvency practitioners or their trade associations. In this environment, insolvent abuse has become institutionalised.

This monograph draws attention to the shortcomings of the insolvency industry. It draws attention to real-life cases showing that the insolvency industry is out of control. Numerous businesses have been unnecessarily placed into receivership to boost the income of insolvency practitioners. Many people have lost jobs, homes, families, investments and savings. Each of the cases cited in this monograph has been referred to the regulators. None have taken any decisive action. The final responsibility for perpetuating the insolvent abuse rests with the Department of Trade & Industry (DTI), but it has shown little interest in eliminating the 'conflicts of interest' and abuses that have become an institutionalised feature of the insolvency industry. The DTI sees itself as the promoter, defender and protector of the insolvency industry. It has failed to safeguard the interests of stakeholders.

CHAPTER 1

THE BUSINESS UNDERTAKERS

Death and taxes were thought to be the only certainties in life. To this must be added, 'insolvency'. Insolvency is an inevitable feature of market economies. Whether due to bad luck, competition, poor management, poor products, lack of investment in marketing, research, unfriendly bank, delays by major creditors in paying bills and other factors, many businesses will sooner or later be placed in the hands of an insolvency practitioner, trading as a receiver, administrator, liquidator or a trustee in bankruptcy¹.

Insolvency is a traumatic experience² for employees, shareholders, creditors and other stakeholders (Financial Mail on Sunday, 11 July 1999, p. 6; Financial Times, 22 November 1999, p. 5). It results in loss of jobs, savings, homes, investments, family life, customer deposits and pensions for millions of people. Insolvencies result in loss of taxation revenues and destruction of the local economies. The misery of so many people is a boon for the insolvency practitioners (Aris, 1986; McQueen, 1992; 1994). Insolvency is a highly profitable business as the practitioners have a prior claim on any cash generated by the business placed under their control i.e. they are paid first and before all creditors³ are paid.

A large number of insolvency practitioners (with minimal interference from the courts) are appointed by major banks⁴ that are reluctant to see many businesses through leaner times (Christer, 1992). Banks lend millions to those placing 'clever bets' in the stock market and/or speculating in land, derivatives, financial instruments, exchange rates and interest rates. But they do not accept the need to devote a designated part of their resources to helping small businesses or regenerating inner cities. When they do lend, the UK banks do not become actively involved in promoting and sustaining local economy or firms. Instead, they protect their financial interests by imposing fixed and

¹ The legal aspects of insolvency are discussed in books, such as Snaith, 1990; Fletcher, 1996 .

² "Overdose kills wife whose retirement was ruined by bankruptcy" (Daily Mail, 21 October 1999, p. 27); "A father who apparently stabbed his wife and three children to death may have been driven to despair by debts ... Police said that Peter Stafford's bankruptcy was the biggest clue to his tragedy" (The Times, 6 October 1999).

³ Unsecured creditors of Versailles will recover none of the £37 million owed to them by the failed finance group (The Times, 20 April 2000, p. 29)

⁴ The feudal idea that men of money have special legal rights and can force others to submit to their will is alive and kicking in the UK's insolvency laws.

floating⁵ charges on business assets. At the slightest sign of a problem, they all too readily pull the financial plug. In generating wealth, the risks are shared by the providers of finance capital (shareholders, creditors), the providers of human capital (employees) and the providers of social capital (family, society, community), but the law does not recognise the equal rights and obligations of all the stakeholders. Anyone owing as little as £750 can be the subject of a bankruptcy order. With little notice, banks can appoint an insolvency practitioner. In the event of liquidation or receivership, the banks confiscate most of the assets of a business.

Insolvency practitioners have enormous statutory powers (see the Insolvency Act 1986). They decide whether a business will be rescued, broken up and its assets sold piecemeal, or whether jobs will be lost or saved (Flood and Skordaki, 1995; Flood et al, 1995). They recommend to banks whether a business should be supported, or the financial rug pulled from underneath it. These corporate undertakers can do virtually anything, ranging from sacking company directors to selling the insolvent party's house and raiding their personal possessions. Insolvency practitioners can make people homeless and make their families dependent on charity and social security, causing stress, anxiety, illness and ruination. The insolvency practitioners are likely to be the final arbiter of the rights of various stakeholders'. Yet they do not owe a 'duty of care' to all stakeholders. The court cases such as *Lathia v Dronsfield (1987)* *BCLC 321* show that at best an insolvency practitioner only owes a 'duty of care' to the party appointing him/her - most likely to be a bank. As long as the banks recover what is owed to them, they don't really care what happens to the rest of the assets.

Following the Insolvency Act 1986, accountants and lawyers enjoy the monopoly of the insolvency industry. But they do not owe a 'duty of care' to all the stakeholders affected by liquidations, receiverships and administrations. They are not required to publish any meaningful information about their own affairs. Rather than subjecting the industry to independent regulation, successive governments have abdicated their responsibilities and have delegated the regulation to accountancy and law trade associations. In this self-regulatory regime, there is little effective check on the efficiency or effectiveness of insolvency practitioners. The insolvency practitioners can take as long as they like to finalise an insolvency. By prolonging the receiverships, administrations and liquidations, insolvency practitioners stand to collect even

⁵ Countries such as Japan, the USA and Germany do not have the concept of a floating charge. For a discussion of the major differences in insolvency procedures in the USA, UK and Germany, see Franks and Torous (1996) and Franks, Nyborg and Torous (1996).

more fees. Not surprisingly, some of the liquidations started nearly thirty years ago are still not finalised. For example, the liquidation of Stone Platt began in 1981 but is still not finalised. Barlow Clowes began in 1988, Coloroll in 1990, British & Commonwealth and Polly Peck in 1990, Bank of Credit & Commerce International (BCCI) and Maxwell in 1991, but none are yet finalised.

A steady stream of new casualties, such as Atlantic Computers, Barings, J.S. Bass, British & Commonwealth, Essex Furniture, Exchange Travel, Euroscan, Garston Amhurst, Helene, Maples, Wallace Smith and Boo.com continue to provide easy-pickings for the insolvency industry. The stakeholders lodge complaints with the law and accountancy trade associations, but there is no independent complaints investigations procedures. They could ask an independent ombudsman to adjudicate their complaints, but the insolvency industry does not have one. Not surprisingly, insolvent abuse flourishes. In the words of Lord Evans,

“Under today's insolvency laws, insolvency practitioners do not break any laws or regulations when they force viable businesses to close, sell assets at a fraction of their real worth and charge fees which are more related to the amount of cash available than the work which has been undertaken insolvency practitioners, in their guise as receivers, gorge themselves on the cash and assets at the expense of the main body of ordinary unsecured creditors and shareholders.

Source: Hansard, House of Lords Debates, 26 January 1999, col. 942.

Increasingly, television⁶ and radio⁷ programme makers, politicians (Coombs, 1994; Mitchell, 1994) and Parliamentary Committees (Social Security Committee, 1993; 1994) are concerned about the operations and accountability of the industry. Concerned members of Parliament have forced debates on the excesses of the insolvency industry (for example, Hansard, House of Commons Debates, 28 March 1995, cols. 837-839; Hansard, House of Lords Debates, 26 January 1999; Hansard, House of Commons Debates, 3 February 1999; Hansard, House of Commons Debates, 7 May 1999; 15 July 1997, Hansard, House of Commons Debates, 7 March 2000). Yet successive governments have turned a deaf ear to calls for fundamental reform. None have taken any interest in investigating the insolvent abuse that many people suffer from the hands of insolvency practitioners.

This monograph is a contribution to an expanding literature (for example see,

⁶ Channel 4 Dispatches programme broadcast on 19th June 1996.

⁷ BBC Radio 4 ‘File on Four’ programme broadcast on 21 and 25 June 1994.

Aris, 1986, Christer, 1992; McQueen, 1992; 1994; Sikka, 1996a, 1996b) and draws attention to some of the shortcomings of the insolvency industry. The responsibility for the abuses must rest squarely on the shoulders of the accountancy and law trade associations responsible for regulating the insolvency industry. The attention of the regulators has been drawn to each of the abuses mentioned in the monograph, but none have shown any inclination to take effective action. The final responsibility for regulating the insolvency industry rests with the Department of Trade and Industry (DTI), but it has no independence from the insolvency industry. It is expected to be the protector, overseer, defender, investigator and prosecutor of the industry. It cannot discharge these competing responsibilities. As a result, insolvent abuse remains unchecked.

This monograph is divided into five further chapters. Chapter 2 explains the regulatory framework applicable to the insolvency industry. This framework was provided by the Insolvency Act 1986. Rather than appointing an independent regulator to oversee the work of the insolvency practitioners and their enjoyment of the state guaranteed monopoly, the legislation delegated regulatory responsibilities to accountancy and law trade associations. They have proved only too willing to sweep inconvenient facts under their dust-laden carpets.

The consequences of self-regulation are highlighted in Chapter 3. It provides a case study relating to the receivership of Polly Peck. In this case, contrary to the recommendations made by the Institute of Chartered Accountants in England & Wales (ICAEW), partners from Coopers & Lybrand (now part of PricewaterhouseCoopers) became receivers of Polly Peck. They already had extensive links with Polly Peck and thus conflict of interests were inevitable. Coopers & Lybrand stood to make some £30 million in fees from the Polly Peck receivership. After dragging its feet for nearly two years, the ICAEW was finally forced to discipline the partners. It fined them the princely sum of £1,000. Subsequently, it also changed the rules and made it easier for accountants to accept receiverships even when there is a prima facie case of conflict of interests.

One of the aims of the Insolvency Act 1986 was to curb “the ease with which a person can allow a limited liability company to become insolvent, form a new company and then carry on trading much as before, leaving behind him a trail of unpaid creditors and in the worst cases repeating the process several times” (Hansard, House of Lords’ Debates, 15 January 1985, col. 878). This practice is known as 'phoenixing' and Chapter 4 shows that “phoenixing” is alive and well and that it is facilitated by the insolvency practitioners. The evidence is

presented through a case study relating to the demise and rise of Corporate Communications Plc, a company which entered receivership at midnight, but within hours the management bought the company at a knockdown price. Unsecured creditors received little.

Chapter 5 examines the consequences of the ‘conflicts of interest’ which have become prevalent in the insolvency industry. It has been argued (for example see, McQueen, 1992, 1994; Christer, 1992) that the reporting accountants’ close relationship with banks and their desire to have a steady supply of clients and income has been responsible for unnecessarily placing some businesses into receivership and liquidation. The scenario is that due to a recession and seasonal fluctuation of cash flows many businesses often run into temporary cash flow difficulties. At this juncture, the banks usually appoint a reporting accountant to report upon the borrowers financial affairs. If the reporting accountants conclude that the business does not have deep financial problems they are only likely to receive a one off fee payment. On the other hand, if the reporting accountants conclude that the business ought to be placed in receivership and if on the grounds of prior knowledge they are appointed as receivers, they stand to receive fees until the receivership is finalised. So the critics argue that reporting accountants cannot act objectively and that a conflict of interest is inevitable. As the managing director of a finance company put it, “Insolvency Practitioners have overheads and aspirations like every other business. Consequently, they need a constant supply of new clients”. In big firms, managers are set targets for generating fees and income. Their salaries and promotion are linked to their performance (Hanlon, 1994). This invariably generates pressures to place sound businesses into receivership.

Chapter 6 concludes the monograph by presenting a summary and proposals for reform.

CHAPTER 2

REGULATING THE BUSINESS UNDERTAKERS

THE LEGISLATIVE FRAMEWORK

Until the early 1970s, most of the powers for dealing with insolvent businesses lay with the Official Receivers and the Insolvency Service housed by the Department for Trade and Industry (DTI). These officials could investigate frauds, dispose of company assets and enforce compulsory liquidations of companies though private practitioners handled voluntary liquidations. However, with the mid-1970s quadrupling of the oil prices and the secondary banking and property crash (Reid, 1982), the number of bankruptcies and liquidations began to increase. The government was busy bailing out troubled businesses and concern grew about the loss of jobs and rescue of businesses. At the same time public concern mounted about the rogue double-glazing, financial, travel and other companies that took money from the public but delivered little. Television programmes, such as Esther Rantzen's "That's Life", BBC's Checkpoint, Watchdog and others, highlighted cases of individuals who traded whilst insolvent, or without filing any information (Aris, 1986). Some individuals liquidated one company and then promptly carried on their businesses through another, leaving unpaid liabilities to creditors, employees and other stakeholders.

In 1977, the then Labour government appointed a committee to review the insolvency legislation which had more or less been in place since the beginning of the twentieth century (Cork and Barty-King, 1988). The Committee was chaired by Sir Kenneth Cork, a partner in Cork Gully (subsequently part of PricewaterhouseCoopers). Whilst the Cork Committee was deliberating, the Conservative Government came to office with an ideological commitment to prioritise private sector solutions (Halliday and Carruthers, 1996).

The Cork Committee's Report (Review Committee on Insolvency Law, 1980, 1982) recommended that more emphasis should be placed on business rescue. It also recommended that the state should reserve the lucrative insolvency market for accountants and solicitors belonging to a handful of trade associations⁸. Instead of recommending an independent regulator for the insolvency industry, the Cork Committee recommended that insolvency practitioners should be regulated by accountancy and law trade associations.

⁸ There are no state guaranteed markets for mathematicians, engineers, scientists, designers, information technology experts and other wealth creators.

The government accepted (Department of Trade and Industry, 1984) most of Cork's proposals and the Insolvency Act 1986 was introduced. The legislation was clearly driven by the government's concern to reduce public expenditure. In promoting the legislation, the Ministers argued that the Act would "result in a reduction of 40 staff [at the DTI] and a corresponding decrease in staff costs of £280,000 per year. There will be some reduction in the fee income in the Insolvency Service" (cited in Hansard, House of Commons Debates, 30 April 1985, col. 197). The savings could have been used to develop an independent system of regulation, or at the very least an independent ombudsman to investigate and hear complaints. But such countervailing structures never materialised.

To facilitate a 'rescue' culture, the Insolvency Act 1986 supplemented the traditional receivership, liquidation and a variety of voluntary arrangements with a new insolvency procedure; the company administration (see Flood and Skordaki; Flood et al, 1995; Souster, 1998 for further details). This procedure enables the company, its directors or creditors, to seek a court's permission to initiate procedures somewhat similar to those of a receivership. The aim is usually to enable the business to survive as a going concern, or to enable the company to reach some arrangement with creditors, or to secure a more advantageous realisation of assets.

The Cork Report anticipated that the government would develop legislation which would require the insolvency practitioners to consider society's broad interests and employment considerations in discharging their tasks. Yet the 1986 Insolvency Act did no such thing. Under the Insolvency Act 1986, almost all of the insolvency practitioners had to belong to one of the accountancy and law trade associations (known as the Recognised Professional Bodies, or the RPBs). The Insolvency Act turned the accountancy and law trade associations into public regulators. Only their members could act as insolvency practitioners. The Insolvency Act 1986 gave no thought to the possibility that insolvency practitioners may be dishonest, or excessively self-serving, or that in the pursuit of higher fees and market share, they may indulge in unethical practices.

Chaps Regulating the Chaps

Reflecting the deeply ingrained antagonisms and politics of the world of accountancy and law, seven separate bodies (known as the Recognised Professional Bodies or RPBs) and the Insolvency Service of the Department of Trade and Industry (DTI) became regulators.

**INSOLVENCY PRACTITIONERS AND THEIR REGULATORS
at 31st December 1999**

Regulating Body	Number of Practitioners
Institute of Chartered Accountants in England & Wales (ICAEW)	784
Insolvency Practitioners Association (IPA)	330
Law Society of England & Wales	196
Institute of Chartered Accountants of Scotland (ICAS)	156
Association of Chartered Certified Accountants (ACCA)	155
Institute of Chartered Accountants in Ireland (ICAI)	68
Law Society of Scotland	20
Secretary of State for Trade and Industry	<u>125</u>
Total	<u>1,834</u>

Source: Hansard, House of Commons Debates, 20 June 2000, col. 138.

Of the 1,834 (around 95% are male) licensed insolvency practitioners (firms cannot be authorised under the Insolvency Act 1986) only "some 1,270 are currently understood to take appointments" (Hansard, House of Commons Debates, 20 June 2000, col. 140). Most are general practitioners. They handle all UK receiverships, administrations, liquidations and bankruptcies, and are regulated not by one, but by seven Recognised Professional Bodies (RPBs) and the Department of Trade and Industry (DTI).

The RPBs are trade associations and their main mission is to secure economic advantages for their members. They were not formed to safeguard and advance the interests of stakeholders, but under the Insolvency Act 1986 they are expected to act simultaneously as defenders, promoters, prosecutors, judges, juries and reformers of the industry. In any case, puny trade associations are in no position to regulate giant accountancy firms. The multiplicity of regulators, inevitably, results in duplication, confusion and a waste of resources that could otherwise be used to enforce good practices. Though functions such as monitoring are shared by some regulators⁹, various bodies jealously guard their autonomy and functions such as authorisation and disciplining processes are duplicated by all of them. The RPBs are public bodies (as defined in clause 6 of

⁹ For example, the ICAEW, ICAS and ICAI jointly operate Joint Insolvency Monitoring Unit Limited (a private company), an organisation used for monitoring the insolvency practitioners licensed by them.

the Human Rights Act 1998), but the public has no say in their affairs¹⁰, or access to relevant reports or submitted evidence.

Neither the public nor any Parliamentary Committee elects, nominates or scrutinises officers of any of the RPBs. Since 1994, the RPBs have been monitoring the work of insolvency practitioners, but are not obliged to immediately name any practitioner whose work is found to be deficient in the course of monitoring. On occasions, they go through the charade of a disciplinary hearing, but the injured stakeholder cannot appeal against their decisions. The fines, if any are levied, fill the coffers of the RPBs¹¹ and provide funds for their public relations exercises. The RPBs licence the insolvency practitioners, but are not required to compensate the injured stakeholders.

For regulators to be vigilant and even-handed with all parties, adequate economic incentives are essential. But the RPBs do not owe a ‘duty of care’ to anyone. The Minister for Corporate Affairs admits that under the present legislation,

“it is unlikely that the courts would find a duty of care I am content that it is not necessary to legislate at present”.

Source: Letter from the Minister for Corporate Affairs, dated 20 June 1996.

The RPBs boast ethical rules, but have never required their members to publish any meaningful information about their affairs. All stakeholders are affected by the conduct of insolvencies, but none have a right to examine the working papers and files of the RPBs or any individual insolvency practitioner.

For a number of years, insolvency practitioners did not need any specialist qualifications. Since 1990, aspiring insolvency practitioners have been required to pass an examination organised by the Joint Insolvency Examination Board (JIEB). These exams remain technical. They do not require practitioners to learn the peculiarities of the business (e.g. jewellery, plumbing, retailing, banking, etc.) which they in their capacity as receivers and administrators, may be asked to run. The education of insolvency practitioners does not promote any sense of social responsibility (Puxty, Sikka and Willmott, 1994). It rarely encourages any reflection upon the social and human consequences of their quest for more fees and profits. As Hanlon (1994) notes, “Today, the emphasis is very firmly on being commercial and on performing a service for the

¹⁰ They don’t even let their own members elect the leadership. Most do not admit the public to their council meetings.

¹¹ It is akin to a judge finding someone guilty and then pocketing the fines.

customer rather than on being public spirited on behalf of either the public or the state. [accountancy firms] have finally ditched any pretence of being public spirited” (page 150).

REGULATION AND MONEY

This statutory monopoly provides steady income and job security for insolvency practitioners. Around 40% of the UK’s insolvency practitioners operate from major accountancy firms¹², such as PricewaterhouseCoopers, KPMG, Arthur Andersen, Deloitte & Touche, Ernst & Young, Grant Thornton, BDO Stoy Hayward and Pannell Kerr Forster. Their income is estimated to run into hundreds of millions of pounds. Their public accountability takes the form of ‘beauty parades’ in which they impress each other by revealing unverifiable income figures¹³.

INCOME OF MAJOR ACCOUNTANCY FIRMS			
FIRM	2000 TOTAL FEES £ms	INSOLVENCY INCOME	
		2000 £ms	1993 £ms
PricewaterhouseCoopers	1,843	55	114
KPMG	1,038	31	58
Ernst & Young	713	28	38
Deloitte & Touche	684	28	42
Arthur Andersen**	563	N/A	25
Grant Thornton	164	24	29
BDO Stoy Hayward	160	N/A	23
Pannell Kerr Forster	98	13	16

**Excludes Andersen Consulting; N/A = Not Available.
Sources: Accountancy Age, 10 June 1993; 6 July 2000.

The late 1980s and the early 1990s recessions were an absolute boon for

¹² Most of these firms are also implicated in major audit failures and have been the subject of DTI inquiries (Sikka and Willmott, 1995; also see Hansard, House of Commons Debates, 12 May 1999). Despite this, their standards of work have not been the subject of any independent investigation. The government continues to award lucrative consultancy contracts to the same firms.

¹³ In recent years, KPMG has started publishing audited financial statements.

accountancy firms. They made millions from corporate undertaking. Their income continues to be swelled by the huge fees from headline scandals. The accountancy firms, in their capacity as auditors, collected fees, but did not notice that barrow loads of monies were going walkabout. Then the same big firms come in as receivers and liquidators to collect even more fees. The BCCI liquidators have so far collected US\$244.5 million (Hansard, House of commons Debates, 19 June 2000, col. 72) and could top \$500 million. Various Maxwell receivers and administrators are expected to charge fees of more than £100 million (Social Security Committee, 1993, page v). and the Polly Peck receivers will make more than £30 million.

Insolvency practices are shaped by the internal culture of firms, but the accountancy firms are highly secretive. Little is known about their charge-out rates, conflicts of interests, internal organisational structures, training, efficiency, effectiveness, or anything else. The accountancy and law trade associations might issue ethical rules, but the public has no way of knowing whether these have been complied with¹⁴.

With only 1,270 'active' practitioners (out of 1,834), inevitably trainees do most of the insolvency work. It is not unusual for the firms to charge-out their trainees at £80-£250 per hour and senior managers and partners at £300-£500 an hour. These exorbitant rates push up the fees, even for the most straightforward of cases. For example, during Parliamentary debates, one MP drew attention to the plight of his constituent (Hansard, 28 March 1993, cols. 837-839) who put his company into a voluntary liquidation. The assets of the company were sold for £180,000, but the insolvency practitioner charged a fee of £50,000 for winding up the company. Despite lodging complaints with the ICAEW over a three year period, no regulatory action has been taken.

Some evidence about the fees was secured in 1993 by the Social Security Committee (1993) investigating the conduct and progress of the Maxwell insolvency. In their defence, the insolvency practitioners admitted to making average charges (based upon charge-out rates for trainees, seniors, partners, etc.) of £191 per hour. This enabled them to secure fees of £50 million and their final fees are likely to exceed £100 million.

¹⁴ A recent report by the US Securities and Exchange Commission (SEC) noted that over a two year period, partners of PricewaterhouseCoopers (PwC) violated the profession's ethical rules more than 8000 times and the report concluded that the firm has "structural and cultural problems" (Securities and Exchange Commission, 2000).

FEES CHARGED ON MAXWELL INSOLVENCY

FIRMS	£MILLION FEES	RATE PER HOUR (£)
Robson Rhodes/Stephenson Harwood	6.1	111/174
Arthur Andersen/Allen & Overy ¹⁵	19.7	90/153
Price Waterhouse/Norton Rose & Others	24.7	120/191

Source: Social Security Committee, 1993.

The Social Security Committee also said that it was “very concerned at the cost of the process and the slow rate of progress” (page vii). The report was critical of the fees charged by the receivers. The essence of its criticism was that the receivers had greatly overstated the size of recoveries which they expected to be able to make for the estate and that this had been done in order to “make the task of acting as receivers more significant than it actually was, which in turn has enabled Buchler Phillips [one of the receivers] to maximise its fee income and to garner more publicity opportunities” (cited by Mr. Justice Ferris in *Mirror Group Newspapers plc v Maxwell and Others* [1998] BCC 343).

For its investigation, the Select Committee invited the Maxwell receivers to explain their conduct. The firm partners were asked to submit information and give evidence. This they did. But, subsequently, they also sought to charge fees for the time spent on defending their own conduct. The Committee’s conclusions persuaded the Insolvency Practitioners Association (IPA) to investigate the allegations, yet it soon claimed that it could not find any evidence to justify disciplinary action against anyone.

The court case of *Mirror Group Newspapers plc v Maxwell and Others* [1998] BCC 324 provided new insights into insolvency fees. The case centred on the fees charged by the receivers appointed to pursue just some of the Maxwell assets. The court noted that the insolvency practitioners charged fees of £1.63 million for realising assets of £1.67 million, leaving only £44,000 for the victims of Maxwell frauds.

¹⁵ Partners in law firms, such as Allen and Overy, are reputed to be earning more than £1 million a year (The Times, 27 June 2000, p. 4).

**THE FEES CHARGED BY MAXWELL RECEIVERS
AN EXAMPLE**

	£	%
Net assets realised (estimated)	1,672,500	100.00
Costs:		
Fees charged by Nabarro Nathanson	705,823	
Fees charged by Buchler Phillips	744,289	
Other disbursements	<u>179,000</u>	<u>97.40</u>
Available to stakeholders	<u>43,928</u>	<u>2.60</u>

Source: *Mirror Group Newspapers plc v Maxwell and Others [1998] BCC 324.*

The scale of the fees prompted the following comments from Mr. Justice Ferris.

..... the amounts [i.e. the receiver's fees] involved are very substantial indeed, both in absolute terms and in relation to the value of the assets got in as part of the estate. I cannot escape saying that I find them **profoundly shocking**. If the amounts claimed are allowed in full this receivership will have produced substantial rewards for the receivers and their lawyers and nothing at all for creditors of the estate. I find it **shameful** [our emphasis]

Source: *Mirror Group Newspapers plc v Maxwell and Others [1998] BCC 324.*

The matter of fees paid to Buchler Philips was also referred to the Chief Taxing Master (*Mirror Group of Newspapers n Maxwell & Others [1999] BCC 684*). The Taxing Master noted that the firm charged up to £265 per hour for its work. However, he felt that the firm had carried out "painstaking investigation" [and that "the receivership was carried out with a high degree of skill and efficiency. While the recovery of assets appeared disappointing when set against the total remuneration and disbursement claimed, the figures were far more acceptable and understandable when seen against the total asset recovery on behalf of the estate"(*Mirror Group of Newspapers n Maxwell & Others [1999] BCC 685*). The Chief Taxing Master permitted the firm to keep its fees.

In 1998, Mr. Justice Ferris published a report (Lord Chancellor, 1998)

recommending that fees must no longer be based on timesheets prepared by practitioners, but should take into account other factors, such as success in recovering assets. The report also called for changes that should lead to a system for fixing remuneration that is "both predictable and transparent". Yet this advice does not form part of any legislation.

Mr. Mitchell: To ask the Secretary of State for Trade and Industry what action his Department has taken over the report issued by Mr. Justice Ferris and his proposals for setting the fees of insolvency practitioners.

Dr. Howells: Following receipt of the first report by Mr. Justice Ferris, The Association of Business Recovery Professionals (formerly the Society of Practitioners of Insolvency) issued preliminary guidance to its members on the possible format of application for fee approval. Further guidance is awaiting publication of the final report of the Ferris Working Party and the issue of a revised Statement of Insolvency Practice on remuneration of officeholders. My Department is represented on the Working Party and is continuing to monitor the position.

Source: Hansard, House of Commons Debates, 20 June 2000, col. 139.

DISCUSSION

This chapter has drawn attention to the regulatory framework governing the insolvency industry. Unlike the financial, food, hygiene, health and safety and other sectors, the insolvency industry does not have an independent regulator¹⁶. Instead, the accountancy and law trade associations function as regulators. In their trade association role, they are the promoters, protectors and defenders of accountants and lawyers. They do not have the requisite independence to regulate the insolvency industry. In any regulatory system, there is always the likelihood that the regulators will be 'captured' by those to be regulated. However, in the case of insolvency, that is the starting point. The entire regulatory system is under the control of the insolvency practitioners.

Currently, the regulatory bodies owe no 'duty of care' to stakeholders. Their officers are not openly elected. There is no parliamentary scrutiny (e.g. a Select Committee) of the insolvency industry. There is no public record of the details of complaints lodged against insolvency practitioners and no independent system of investigating complaints. All complaints need to be lodged with the RPBs, who are effectively the promoters and defenders of the insolvency industry. They filter the complaints and decide whether any will be pursued.

¹⁶ For a discussion of some models of regulation, see Finch, 1998.

The complaints procedure is weighted against the complainant. The RPBs can drag a complaint on for years. There is no fixed time frame horizon for resolving complaints.

The Department of Trade and Industry (DTI) has the final responsibility for regulating the insolvency industry, but it rarely inquires into the progress of any insolvency. The Social Security Select Committee's report (Social Security Committee, 1993) on the Maxwell insolvency practitioners recommended that a system for monitoring the progress of all insolvencies over a certain value should be implemented but nothing has been done.

Mr. Mitchell: To ask the Secretary of State for Trade and Industry if he will list the receiverships and liquidations begun more than 20 years ago and still not finalised.

Dr. Howells: This information could be provided only at disproportionate cost¹⁷.

Mr. Mitchell: To ask the Secretary of State for Trade and Industry what inquiries his Department has made into (a) receiverships and (b) liquidations started more than 10 years ago but still not finalised; and how many liquidators come into this category.

Dr. Howells: This information could be provided only at disproportionate cost.

Source: Hansard, House of Commons Debates, 20 June 2000, col. 139.

The DTI has too many conflicting roles. For example, it acts as the promoter, defender, protector, prosecutor and final arbiter of the insolvency industry. Ministers and senior civil servants are more likely to have meetings with the representatives of the insolvency industry rather than with the victims of insolvency practices. Successive Ministers have been only too willing to pass the buck to the RPBs and have done little for the long-suffering stakeholders. In this vacuum, the insolvency practitioners can take as long as they wish to finalise an insolvency. The longer time they take, the more the fees. Not surprisingly, receiverships such as Polly Peck, Maxwell, Coloroll, BCCI, J.S. Bass, Exchange Travel, Helene and Stone Platt are still generating fees for the corporate undertakers. Ordinary stakeholders receive little from collapsed businesses. Insolvency practitioners can charge exorbitant fees, but ordinary people can do nothing about it.

¹⁷ The RPBs should routinely ask practitioners for a list of the long standing receiverships and liquidations. They clearly do not.

CHAPTER 3

THE DEAD HAND OF SELF-REGULATION

The insolvency regulators routinely seek to disarm critics, journalists, politicians and interested parties by appealing to notions of ethics and disciplinary arrangements. They also shield the insolvency industry from critical public gaze by claiming that insolvency practices are boring, technical, grey and complex. Such rhetoric is designed to silence the public, journalists and legislators. The charade of ethics and discipline is sustained so long as no effective challenge is mounted that disputes or scrutinises its basis.

The ethical guidelines issued by the accountancy trade associations claim that

"In accepting or continuing a professional assignment or occupation a member should always have regard to any factors which might reflect adversely upon his integrity and objectivity in relation to that assignment or occupation".

"A member in practice should be, and be seen to be, free in each professional assignment he undertakes of any interest which might detract from objectivity"

"..... a firm should not accept or continue an engagement in which there is likely to be a significant conflict of interests between the firm and the client. The test is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the judgement of the firm Where the acceptance or continuation of an engagement would, even with safeguards materially prejudice the interests of any client the appointment should not be accepted or continued. All reasonable steps should be taken to ascertain whether any conflicts of interests exists Relationships with clients and former clients should be reviewed before accepting a new appointment".

Sources: ICAEW, 1979.

The accountancy trade associations urge "Full and frank explanations" where there is a potential conflict of interests (ICAEW, 1979). The ICAEW promises to discipline its members for misconduct, incompetence and inefficiency which "bring discredit to himself, the Institute or the profession of accountancy" (bye-law 76 of the ICAEW). The specific purpose of the disciplinary procedures is to investigate and hear criticisms and complaints about a member's conduct. In enforcing the standards of conduct, the insolvency trade associations promise to mete out a range of punishments to the guilty parties. These range from

suspension from membership and fines to withdrawal of practising certificates (see Appendix to the ICAEW Royal Charter). The next section shows that the realities of regulation rarely match the rhetoric.

THE POLLY PECK AFFAIR¹⁸

With pre-tax profits of £161.4 million, net assets of £845 million and 17,227 employees, the Polly Peck group was one of Britain's top one hundred quoted companies. In October 1990, it collapsed. Accountants from Coopers & Lybrand (now part of PricewaterhouseCoopers) together with Touche Ross (now part of Deloitte & Touche) were appointed joint administrators of the company. By June 1991, the firms had received £2.56 and £5.8 million respectively in fees. Before accepting the position of administrator, Coopers did not reveal its extensive links with Polly Peck and its chairman Asil Nadir.

Coopers & Lybrand acted as joint reporting accountants when Polly Peck originally went public (Accountancy Age, 23rd April 1992, page 11).

Cooper's Channel Islands practice had acted as auditor of Restro Investments through which Asil Nadir held his (at one time majority) stake in Polly Peck. Coopers had also been involved with the Polly Peck group through consultancy assignments (Accountancy Age, 20th June 1991, page 1).

Three of the firm's partners were reported to be shareholders and acted as directors of Vemak (Jersey), a company that ran Asil Nadir's (stately) home and other property investments. Coopers also acted as personal tax adviser to Asil Nadir (Accountancy Age, 6th December 1990, page 1).

A recommendation from Coopers led to the appointment of Polly Peck's finance director (Accountancy Age, 19th March 1992, page 3).

Coopers' special work income from the Polly Peck group is estimated to have been £1.5 million from 1985 to 1989. The firm received £262,000 from auditing Polly Peck's far East operations (Accountancy Age, 27th February 1992, page 1).

It should be recalled that the ethical guidelines issued by the ICAEW urge its members to avoid conflicts of interest and to make full and frank disclosures. Yet in the absence of such disclosures by Coopers & Lybrand, the ICAEW did nothing. The matter was raised with the DTI, which has the ultimate responsibility for regulating the accountancy business. The DTI's routine line of action is to refer anything to do with accountancy firms to the ICAEW, but in this

¹⁸ For Further details see Mitchell et al, 1994.

case the ICAEW's inaction was the issue. The DTI has two potentially conflicting functions. It has to regulate the conduct of business and has to promote the British business interest. These functions can conflict when the businesses it is encouraging are the ones that have to be constrained. In this case the DTI was trapped by this conflict of roles. Wishing to better understand the dynamics of the regulation process, we sought to investigate the system.

Our correspondence with the Minister for Corporate Affairs began on 22nd March 1991. His attention was drawn to ostensible conflicts of interest and also to the ICAEW's failure to secure disclosures even though the matter had received prominent news coverage in the trade press since October/November of the previous year. The Minister replied stating that

"An insolvency practitioner should be satisfied before accepting an appointment as an office holder that there is no conflict of interest and if there is doubt as to whether he can act he should seek clarification from the parent body which authorises him to act as an insolvency practitioner".

Source: Letter from the Minister for Corporate affairs, 12 April 1991.

On the matter of investigation and enforcement of the ethical guidelines, the Minister argued that the matter was for the ICAEW to consider. Of course, if the ICAEW had any intention of doing anything, it would already have done so. Meanwhile, the correspondence was passed by the DTI to the ICAEW who wrote on 26th April, promising to give a fuller reply soon. But a letter dated 25th April was also received which noted that "The position is that the Institute has sought and obtained the comments of Mr. Jordan and his co-administrator, Mr. R.A. Stone. These are now being studied and a report will be made to the Institute's Investigations Committee at its next meeting on 7th May".

A reminder was sent on 19th June and at the same time the Minister was informed of the ICAEW's lack of response. A letter from the ICAEW, dated 3rd July, stated that "The Institute is still considering the appointment as administrators of Polly Peck plc of Messrs Michael Jordan and Richard Stone. I will let you know when it has arrived at a decision". The Minister (letter dated 11th July) added that "The ICAEW assures me that the matter is still very much under active consideration; it is hoping to conclude its examination shortly". Once again, the ICAEW fell silent. Therefore, on 30th August a reminder was sent. It added, "Would you please inform me why the wheels of an organisation which can move with lightning speed to lobby government departments, move so slowly when major firms are the subject. Can you give me a date by which you will be able to

pronounce on the matter?". In a letter dated 6th September, more than four months after the promise of a fuller reply, the ICAEW replied, "..... the matter is still under consideration and until a decision is arrived at there is no information I can properly give you. I am unable to give any firm date when a decision will be reached or any announcement made concerning it".

Based upon information received from an 'insider', the ICAEW's and the Ministers attention was drawn (9th October 1991) to the possibility that some cosmetic gestures, such as setting-up further working parties, were being considered as a way of dealing with the problems. The ICAEW Director of Professional Conduct responded (15th October) by stating that the "..... Investigation Committee is still considering the matter I regret that I cannot disclose the content of our enquiries".

On 21st October, the Minister asked us to give the ICAEW more time. On 11th November, we reminded the Minister that still no announcement had been made by the ICAEW. In his reply of 25th November, the Minister defended the ICAEW's procedures. On 18th December, the Minister was asked to make a statement stating what he and the ICAEW already knew. On 19th December, the ICAEW was also asked to make a statement. The Minister replied (12th January 1992) by referring the matter back to the ICAEW but added that "since Christmas, [the ICAEW] has received a substantial quantity of fresh evidence". But the ICAEW (19th December 1991) stated that the information was confidential and could not be disclosed.

Meanwhile creditors of Polly Peck were also getting worried that any public revelations might jeopardise a fairly well advanced administration of the companies, and Coopers were concerned that they might have to forego their fees. An emergency meeting between Coopers and Polly Peck's creditors took place where "conflict" was the only listed topic for discussion (Daily Telegraph, 18th December 1991, page 20). Subsequently, in the interests of creditors, the High Court ratified Coopers appointment as administrators (Accountancy Age, 19th March 1992, page 17). The firm admitted its oversights in a forty page dossier sent to the ICAEW and stated that the courts had not been informed of the firm's links with Polly Peck in the three years prior to the administration (The Mail on Sunday, 22nd March 1992, page 74).

The disciplinary hearings were finally to be held on May 21st and 22nd (Accountancy Age 23rd April 1992, page 1). They were then adjourned even before they began (Accountancy Age, 21st May 1992, page 10). One reported reason for the postponement was that the partners involved argued that they did

not have sufficient time to prepare their defence even though the matter had been in the news since October 1990. The partners wanted to argue that they should be exonerated, as the courts in re-confirming their appointment as administrators had effectively cleared them of unethical behaviour. But Mr. Justice Millet in a written statement stated that he "did not form any view whether there was a breach of professional ethics" (Accountancy Age, 23rd April 1992, page 1).

The hearings finally opened on 27th July (Financial Times, 28th July 1992, page 7). We had urged the ICAEW to hold its hearing in the 'open' (letter dated 28th April 1992). But this was not accepted. Despite the very public concerns, the ICAEW excluded the public from the disciplinary hearings (Financial Times, 2nd July 1992, page 9). After four days, the matter was once again deferred (Financial Times, 31st July 1992, page 5). A press release by the ICAEW (dated 31 July 1992) simply stated that "No further information will be released until the conclusion of the case".

The hearing finally began on 12th October and concluded on 15th October. Coopers & Lybrand partners were found guilty of breaching the ethical guidelines (Financial Times, 16th October 1992, page 10). The ICAEW did not issue a statement until 30th November as it wished to negotiate the wording with Coopers, even though its own Council members were unhappy about such unprecedented arrangements (Accountancy Age, 26th November 1992, page 1; Financial Times 1st December 1992, page 6). The eventual statement noted that

"in seeking or accepting appointment as administrator(s) to Polly Peck International [the partners] failed without good reason to follow the guidance in Statement 20 of the Guide to Professional Ethics". There has, in our opinion, been no satisfactory explanation for the information which you put before the court on 25th October [1990] being so inadequate..... conflicts would have been apparent to you at an early stage had you taken proper steps to consider the position".

Michael Jordan and Richard Stone were fined £1,000 each (then the maximum possible) and ordered to pay costs of £1,000 each. No report on the affair, which might have explained the delay, was published. No one explained why the maximum fine was set at £1,000 and more importantly, why the DTI accepted such a low figure. The fines were not used to compensate any injured stakeholder. Instead, the fines merely provided more resources for the ICAEW to undertake its propaganda wars. No other penalties were imposed on the partners or the firm, as the ICAEW argued that its rules did not enable it to take any action against the firm. There was no investigation of the overall standards of the firm.

The firm has probably made more than £30 million from the Polly Peck receivership. The partners must have quaked in their boots, all the way to the bank.

DISCUSSION

The Polly Peck affair was not highlighted by any insolvency practitioner or accountancy firm. It was not highlighted by any of the insolvency regulators. Indeed, their response was to ignore the mounting evidence. It took them two years to do anything. The ICAEW faced no public pressure from the DTI. Indeed, our experience is that the DTI continues to indulge accountants. It does not exert any pressure upon the accountancy bodies, rather the other way round. When faced with any challenge, it routinely considers it to be a matter for someone else (for further evidence see, Mitchell et al, 1998). The accountancy bodies are hardly in a position to take any action against any major accountancy firm, since the firms are able to muster considerable economic and political muscle both within and outside the insolvency industry. The major firms provide officeholders, disciplinary panel members and members of major committees. They are hardly likely to establish benchmarks which could be used to question their conduct or prevent them from exploiting profitable opportunities similar to the Polly Peck receivership.

In a perfect world, it might be hoped that individually and collectively, accountants would act ethically. However, we do not live in that perfect world, but in a world dominated by market pressures in which accountants, just like other sellers of labour, are competing for business and are accountable for their contribution to the performance of the firms for which they work. The pre-occupation with the advancement of 'private interests' demands that an independent regulator to protect and defend the wider public interest be created, but the insolvency industry does not want such constraints and opposes such independent structures. In any system of regulation, there is a constant concern that the regulators will be 'captured' by those who are to be regulated, but in the case of the present structure of insolvency regulation this is the starting point. The system of self-regulation effectively means no regulation.

The Polly Peck case study has given an indication of how the accountancy trade associations react to allegations of real/alleged misconduct by insolvency practitioners. Further episodes cited in subsequent pages will show that the regulators and the DTI continue to turn a blind eye to cases involving malpractice, which result in loss of jobs, homes, businesses and economic infrastructure.

CHAPTER 4 THE UNDEAD

In Parliamentary debates Ministers have argued that one of the aims of the Insolvency Act 1986 was to combat the

“Phoenix syndrome” or the “the ease with which a person can allow a limited liability company to become insolvent, form a new company and then carry on trading much as before, leaving behind him a trail of unpaid creditors and in the worst cases repeating the process several times”

Source: Hansard, House of Lords’ Debates, 15 January 1985, col. 898.

The Insolvency Act 1986 seeks to curb such practices and expects insolvency practitioners to root-out rogue directors and help to disqualify them by preparing reports on their conduct. The Act also introduced the concept of “wrongful trading” and directors could be made personally liable for a company’s debts. The Act, however, did not contain any provisions for dealing with insolvency practitioners who might be facilitating the “phoenix syndrome”.

In this chapter we seek to do two things. Firstly, we explain the consequences of the “phoenix” by referring to a real court case. Secondly, we show that “phoenixing” is facilitated by insolvency practitioners who make considerable financial gains from it at the expense of various stakeholders. More importantly, we show that neither the regulators nor the Department of Trade and Industry (DTI) have shown any willingness to tackle the return of the “phoenix”.

THE PHOENIX

The details and impact of “phoenixing” is vividly captured by the court case known as *Re Ipcon Fashions Limited (1989) 5 BCC 773*. The case was brought by the DTI and centred around the activities of a Mr. Hava who traded through a succession of companies during a fifteen year period leaving a trail of unpaid creditors behind him. The first company that he traded through was called Quoshi Limited. Nothing is known about its trading activities except that it went into liquidation in 1977. Thereafter, Mr. Hava commenced trading through Ainsley Woods Limited and it went into liquidation in December 1980 with an estimated deficiency of £43,000. Immediately after the failure of

Ainsley Woods Limited Mr. Hava commenced trading through Lorenzo Fashions Limited which went into liquidation in May 1985 with an estimated deficiency of £120,000. The company's debts included £10,000 owing in respect of PAYE and National Insurance contributions and £15,000 in respect of VAT. Lorenzo fashions was followed by Ipcon Fashions Limited, which in May 1985 commenced trading from the same premises under the same trading name ("Lorenzo"). This company was compulsorily wound up in October 1986 with an estimated deficiency of £41,000 which included £3,000 in respect of VAT and £12,000 for PAYE and National Insurance contributions. Ipcon Fashions was followed by Lorenzo London Limited which started trading from the same premises in July 1986. The judge noted that Mr. Hava does not appear to have introduced any capital into his successive ventures. He traded at the risk to his suppliers, bankers and the Crown.

The court took particular interest in the 15-month trading life of Ipcon Fashions. It overlapped with Lorenzo Fashions for a few weeks: the resolution to wind up the latter was passed on 14 May 1985 while Ipcon had already begun trading on 19 April 1985. In its early life Ipcon traded, but trading soon ceased. One supplier was unable to recover £12,047. The National Insurance contributions, Pay-As-You Earn (PAYE) and Value Added Tax (VAT) was not paid. The proprietor's conduct was described by the judge as "particularly reprehensible contrary to commercial morality reckless disregard of the interests of all creditors including in particular the Crown" (*Re Ipcon Fashions Limited (1989) 5 BCC 775*). Mr. Hava was disqualified from acting as a director for a period of five years.

In the above case the prosecution was brought by the DTI. The next episode focuses upon the involvement of insolvency practitioners in facilitating a "phoenix". It should be noted that despite the very public revelation, neither the DTI, nor any insolvency regulator has taken any action.

THE RETURN OF THE PHOENIX

Corporate Communications Plc

Corporate Communications was the darling of the 1980s, a rising media and PR company with plush offices in London rented at a cost of around one million pounds a year¹⁹ (also see Sikka, 1996b). Corporate Communications was run by two well known entrepreneurs who received a salary and expenses package of around £450,000 per annum. The company was audited by Price Waterhouse (now part of PricewaterhouseCoopers) who also acted as advisers. An

¹⁹ BBC Radio 4 'File on Four' programme, 21 June and 25 June 1994.

unqualified audit opinion was given on the 1990 accounts, but it was subsequently learnt that the affairs of a subsidiary had been omitted from the accounts altogether. Before the 1991 accounts could be finalised, it appeared that the company would break its financial covenants to the bank. Price Waterhouse were asked to prepare a restructuring package. For this the firm's fees came to more than a million pounds. On 23rd July 1992, the company was told that its restructuring proposals were not acceptable and on 30th July, the company was placed into receivership as its bankers, the Royal Bank of Scotland, were unwilling to restructure its finances. Within hours, the receivers sold the main part of the business back to the directors (PR Week, 6 August 1992, p. 1). Only a month before, the business with debts of £32 million, had been valued at £11 million (PR Week, 22 October 1992, p. 1). Now the directors paid around half that figure to buy the very same assets. Corporate Communications' bankers had got their money back, but the main casualties were the unsecured creditors, estimated to be losing some £16 million (PR Week, 15 October 1992). Some three months after the rise of the "phoenix", some unsecured creditors were finally able to call the receivers, Coopers & Lybrand, to account. The meeting proceeded in the usual manner. The receivers explained that the assets had been sold off and that no money was available for unsecured creditors.

Midnight receiverships and quick sales to management do not occur without planning, negotiations and prior contacts. Some leaked documents (secured by the BBC Radio for its File on Four programmes broadcast on 21 June and 25 June 1994) showed that, at least a month before the receivers were called in, the group's management and bankers were considering a plan to transfer all the group's assets to brand new companies, leaving the main creditor, its landlord, high and dry. Another document showed that just three days (i.e. 27 July 1992) before the date they were appointed, the receivers took part in discussions about how to sell the main assets back to the management. A letter from the company's US based lawyers stated that "The proposed receivership for Corporate Communications plc, the senior management, and the Bank of Scotland, are discussing the following transaction to be offered after the receivership of Corporate Communications". The letter then went on to detail a complex mechanism for "phoenixing" the company in a way that "accommodates all of our respective concerns". The concerns of the people who would lose their money were not mentioned. No one other than the directors was given enough time to bid for the company's assets. No creditor was told of the prior connection between the receivers and the company management.

What about the much vaunted ethical guidelines which are supposed to govern insolvency practitioners? The ethical guidelines issued by the ICAEW stated that “where there has been a material professional relationship with a company, no principal or employees of the practice should hold appointment as a receiver in relation to that company”.

In this case Coopers had been doing work for the company and its management before their appointment as receivers. For example, they had valued the company and prepared detailed plans for restructuring the company. Ian Bradberry, President of the Insolvency Practitioners Association (IPA) explained that the “rationale behind the ethical guideline is in order to maintain independence and objectivity in any insolvency related function that a member is asked to perform or appointed to”. So what is material relationship? Bradberry explained, “Certainly, where a practice has previously acted as auditor or taxation advisers to the subject company”. But what if someone had been paid to carry out work on the long term future plans of the company or to advise on the financial restructuring, would that count as a material relationship? Bradberry commented, “I suggest that it would if you had been involved in acting for the company in any form of reconstruction or rearrangement, yes, bearing in mind the questions of independence and objectivity, it would be advisable for the firm that had been involved in that situation not to accept an insolvency appointment”. So there appeared to be a strong case of conflict of interests and breach of what the insolvency industry promotes as its ‘ethical guidelines’. Would the formal regulatory system do anything?

We lodged a formal complaint (letters dated 19 and 21 January 1993) with the DTI, urging it to investigate the matters. The Minister for Corporate Affairs rejected the call for an independent investigation and added:

“If the creditors of the company consider that they have been disadvantaged by the sale, it is open to them to seek legal advice as to the remedies which might be available to them.”

Source: Letter from the Minister for Corporate Affairs, dated 3 February 1993

The Minister suggested that the matter should be referred to the ICAEW. A formal complaint had already been lodged with the ICAEW on 21st January 1993. After a routine acknowledgement nothing further was heard. Following a reminder, an ICAEW spokesperson assured us (letter dated 22 July 1993) that the matter is receiving attention. A deathly silence fell upon the ICAEW and

nothing more was heard for nearly a year. A complaint to the DTI (20 June 1994) drew the response that “officials are writing to the Institute to seek a report as to progress in relation to the handling of this case” (letter from the Minister for Corporate Affairs, 9 July 1994). A letter sent the same day to the ICAEW elicited the reply that

“The Investigation Committee concluded its enquiries into this matter at its meeting on 6th June 1994 and did not find that any professional misconduct had occurred.The Investigation Committee does not give reasons for its decisions.

Source: Letter from the ICAEW Chief Executive, dated 29 June 1994

The details of the above case were broadcast on the BBC’s Radio Four, ‘File on Four’ programme (21 June 1994 and 25 June 1994). and the resulting tape recording was sent to the DTI on 18 July 1994. The Minister would not consider an independent investigation and argued that the matter is for the ICAEW to investigate (letter dated 18 July 1994). But the ICAEW response (30 September 1994) was simply to reaffirm the previous decision. The ICAEW report, if it exists, into the matters relating to the receivership of Corporate Communications remains unpublished. We do not know the nature of evidence which the Investigation Committee considered or ignored. We do not know how any evidence was weighted, the questions that were asked, replies sought, files examined, written/oral evidence taken or anything else. The ICAEW was only too keen to sweep things under its cover-up carpets.

DISCUSSION

This chapter has drawn attention to two contrasting ways of engineering a “phoenix”. In the *Ipcan* case, the regulators (the DTI) dealt with the matters by investigating it and bringing a prosecution. They brought the court case under Section 6 of the Company Directors Disqualification Act 1986. In contrast, there was no independent investigation into the matters relating to Corporate Communications and no action whatsoever has been taken by any regulator, or the DTI. Both cases resulted in losses to unsecured creditors. Both cases involved “phoenixing”. Insolvency practitioners are not dealt with by the legislative equivalent of the Company Directors Disqualification Act 1986. Instead, the government relies upon puny accountancy trade associations to regulate the conduct of giant multinational accountancy firms. Without ever inviting any evidence from the general public, unsecured creditors or any other stakeholder affected by the midnight sale of the company to its directors, the

ICAEW acted as judge and jury and claimed that no professional misconduct had occurred, even though the senior officials of the insolvency industry acknowledged that the ethical guidelines had been violated. The ICAEW report remains unpublished and there is no way of verifying its claims.

CHAPTER 5 GOING FOR BROKE

Conflicts of interests are rampant in the insolvency industry. At the heart of it are the insolvency practitioners whose main aim, like other businesses, is to maximise their fees and income. To remain in business, they need a constant supply of new clients. In big accountancy firms, managers are set targets for generating fees and income. Their salaries and promotion are linked to their performance (Hanlon, 1994). There is always a temptation to meet targets and generate income by putting healthy businesses into receivership and by prolonging the receiverships.

The small business community has argued that a large number of them are unnecessarily placed into receivership. In common with many other businesses they rely upon bank loans and overdrafts to finance their working capital. When, due to recession and/or seasonality of cash flows, they fall behind in repayments, the banks usually appoint a reporting accountant to compile a report. If the reporting accountants conclude that the business does not have deep financial problems, they only receive a one-off fee payment. On the other hand, if the reporting accountants take a pessimistic view and recommend receivership, they can collect fees for many years.

"Nine times out of ten, that report will say your business is not viable, because, to start with, the accountants are mindful of the consequences to themselves if they say you are viable and then go under. Also they are likely to be appointed receivers anyway, and will receive a fee. There are rich pickings for insolvency departments".

Source: Mallinson (2000).

Like other businesses, insolvency practitioners need ever increasing fees and profits. They need a constant supply of new clients to meet their financial targets.

During the parliamentary passage of the Insolvency Act 1986, the government was asked to clarify the matters relating to the conflicts of interest, but it dodged the issues.

Mr. Nicholas Lyell: Will a chartered accountant who is placed by a bank with a debenture in a position of company doctor to advise the company on its financial affairs be capable thereafter of acting as a receiver if the company is subsequently put into receivership or wound up?

Mr. Fletcher: That is a good question, and it is the sort of point we are currently considering. We must discuss where we should draw the line with regard to the conflict of interest. I cannot give my hon. Friend the precise answer, because this is the sort of point that the Department wishes to consider further before introducing proposals in the House.

Source: Hansard, House of Commons Debates, 30 April 1985, col. 143-144.

The DTI failed to put any proposals to Parliament. Subsequently, in relation to the case studies highlighted below, the DTI was invited to (re)consider the impact of the insolvency practitioners' conflicts of interests on loss of jobs, homes and investments. The Ministers ignored the facts and said,

I do not think the Government should intervene; for example a different receiver would have to become acquainted with the business thus increasing costs to creditors and a prohibition might mean that fewer investigations were commissioned and insolvency procedures were resorted to earlier”.

Source: Letter from the Minister for Corporate Affairs, dated 9 November 1993.

Seemingly, the Ministers are unwilling or unable to see the issues from the prospective of the employees, local communities, creditors, entrepreneurs or from any principle of fairness.

The insolvency industry does not have an independent regulator, ombudsman, complaints system or a compensation system. Complaints have to be lodged with the accountancy and the law trade associations that were formed to advance the economic interests of their members. These trade associations do not owe a 'duty of care' to the stakeholders. Consequently, there is little check on the abuses and little protection for those affected by questionable practices. The remainder of this chapter provides some case studies.

Chris and Claire

Chris and his wife Claire ran a thriving restaurant business and employed 15 people. Following a proposal put forward by the company's accountants to its bank, the Natwest Bank insisted that Arthur Andersen should undertake a review of the company's financial position. Arthur Andersen reported to the bank, but the company had to pay the accountants' fee of £3,000 plus VAT, an amount which resulted in a further increase in the company's overdraft. A few days later, the report from Arthur Andersen recommended that the company be placed into receivership. Arthur Andersen now returned as receivers. Chris and Claire were initially retained as restaurant managers, but were soon sacked by the receiver. The receivers brought in a management company to run the restaurants, but they were unable to match the previous high quality of food and service delivered by its owners. The business's reputation and financial position declined. At one stage, the local Environmental and Health Officers threatened to close the restaurant on account of lack of cleanliness and rubbish strewn floors. After just 12 weeks, a business developed over a 12 year period was liquidated. Despite various legal battles, Chris and Claire have lost their home and savings. They cannot appeal to any independent ombudsman to review the conduct of their insolvency.

Derek

Derek was a successful trader in jewellery. One day, whilst at lunch, he was contacted by an employee informing him that a couple of people from the bank, accompanied by an accountant, had suddenly arrived (McQueen, 1992, p.24). Within two hours, the reporting accountants concluded that the business needed to close down. The accountants became the receiver. In a subsequent report, they claimed that it took them two days to reach their conclusion, but they were on the premises for only two hours and informed Derek of the conclusion immediately afterwards. Derek said that he would consider re-financing the business, especially as he had an almost full order book. But this was not encouraged and the insolvency practitioner (an accountant) was not keen on it. Once a liquidator was appointed, Derek was not consulted for the running of the business. The liquidator had no knowledge of the jewellery business, but placed a valuation of £50,000 on the contents of the strongroom. Within a week, a sale was organised. The liquidator had no idea of the worth of the tools. Items previously valued at £35,000 were sold for just £3,000. Many sets of jewellery were separated and sold as separate items, thus decimating their value. The rubbish piled on the floor included pearls and gemstones. Valuable solutions used in the jewellery business were given away for no charge.

Ed & Mike

In the late 1980s, Ed and Mike started a small business specialising in the removal of asbestos (McQueen, 1992, p. 10). From little acorns big oaks started to grow. The business expanded. It became the main contractor for the local authority. It also generated overseas business and was highly profitable. By the third year, the business employed 40 people. It had a full order book and was on track to generate a turnover of a million pounds. The business had a good relationship with its bank and continued to expand its overdraft facilities in line with its trading growth. Then one day, out of the blue, the bank manager phoned. He wanted an accountant from an accountancy firm to look over the company's financial position. Within one hour of the telephone call, the accountant phoned saying that he wanted to come immediately. This visit from the neighbourhood beancounter was just the beginning of Ed and Mike's troubles²⁰.

The accountant visited the premises two days later. He spent just six hours on the job. Despite a full order book, healthy profits, no history of bad debts and no overdue creditors, he painted a very gloomy picture of the financial position. He drastically reduced the value of all assets and inventory. He reduced the debtors figure by 75%. Within a few days of his report, the bank appointed an administrative receiver. The accountant who acted as the investigating accountant for the bank now returned as a receiver. Rather than receiving a one-off fee for acting as an investigating accountant, he now stood to receive fees for the whole period of the receivership. Within a few weeks the receiver/accountant sold assets, contracts, goodwill, fixtures and stock at knockdown prices. The result was a shortfall in the amounts due to creditors. As Ed and Mike had provided personal guarantees for their business, their homes and personal belongings also went under the hammer.

Euroscan

Euroscan Reproductions Limited, a Nottingham based printing company, was placed into receivership by a bank. A local businessman, David Freeman, sought to buy it from the receivers, Grant Thornton. Freeman explained that he "spent a great deal of time and my own money investigating the business. It seemed like a sound company, I obviously took professional advice on it and it seemed to me basically a sound business that one could manage back to a

²⁰ The Bankruptcy Association of Great Britain and Northern Ireland has been trying to nurse the victims of the insolvency industry. It has catalogued a horrific pattern of insolvent abuse.

profitable business” (BBC Radio ‘File on Four’, 21 June 1994). Freeman offered £320,000 for the business, but the bid was rejected by Bill Hutchinson, the receiver, as being an inadequate offer (Sikka, 1996b).

Freeman tried to negotiate a new deal. Months went by. The bank got impatient. Eventually, it said that if Grant Thornton could not sell Euroscan, it would put Euroscan into liquidation and break the company up. But things were going on behind the scene. Rather than contracting, like many companies in receivership, Euroscan seemed to be expanding. It even built new facilities and Bill Hutchinson (the receiver) entered into a contract to buy new plant and machinery valued at £700,000. All of this worried the company’s directors as, in the event of the company failing to pay the banks and secured creditors, they may have been personally required to meet the obligations.

Mr. Hutchinson was wearing two hats. As a receiver, he was helping to dispose of Euroscan’s business. But as an entrepreneur, he was making plans to buy it, and had set up a company for that purpose. A few Euroscan employees took shares, but Mr. Hutchinson was the major shareholder, chairman, company secretary and, when the deal went through, the managing director. The price paid was rather less than Mr. Freeman’s offer five months earlier.

Grant Thornton claimed that the sale of Euroscan was conducted “at arm’s length”. But this raised questions such as, how could Grant Thornton sell a business to a consortium led by their own employee at “arm’s length”. Grant Thornton issued a statement stating that, “We are completely satisfied that this particular case was handled in a totally correct and proper manner” (BBC File on Four, 21 June 1994). Responding to this case, Jack Maurice of the ICAEW stated²¹, “There is very clear guidance in the ethical guidance which says that an insolvency practitioner shouldn’t allow himself, anyone in his firm, or any employee to acquire the assets of the insolvent company”. A formal complaint was lodged with the IPA who expressed satisfaction with the practices of the accountancy firm. No regulatory action was taken.

Josephina

The government, the regulators, the industry and the banks may be able to ignore the consequences of various practices, but their impact is real enough. Mrs. Josephina Askew held leases to two pubs (Morning Star and Ye Olde Crowne) in Lincoln city centre, a bungalow in a nearby village, a property in Skegness and an apartment in Venice. These assets were estimated to be worth some £550,000. Mrs. Askew (50) looked forward to a comfortable retirement

²¹ BBC Radio 4 ‘File on Four’ programme.

after spending some 28 years in the trade. Then a chain of events began which was to shatter Mrs. Askew's life (Sikka, 1996b).

In 1992, Mrs. Askew fell ill (subsequently diagnosed as a thyroid problem) and the paperwork became neglected. Wine merchants Peter Dominic took action to recover a debt of £4,430.63. Mrs. Askew was unable to attend the court, but the judge signed the legal documents declaring Mrs. Askew bankrupt²². Unfortunately, the judgement was obtained (in Lincoln County Court) against a Mr. Askew (her manager) and not Mrs. Askew. Before proceeding further, it is appropriate to clear up the confusion regarding Mr. Askew. The chronological list of events is as follows.

On 5th August 1991, a writ naming a Mr. Jack Askew as the sole defendant was issued in the Northampton District Registry by Peter Dominic, a wine merchant, claiming a debt of just £4,145. On 14th October 1991, a judgement was entered against Mr. Askew in default in the sum of £5,056.96 and on 8th July 1992, a statutory demand was served on Mr. J. Askew for the judgement debt. Subsequently, on 13th October 1992, a bankruptcy petition was presented against Mr. Askew. On 4th February 1993, the petition was adjourned for procedural defects and on 16 March 1993, Mr. Askew was granted leave to amend the Petition, but the bankruptcy order was made against him. On 8th June the bankruptcy order against Mr. Askew was set aside and on 9th July 1993, the court judgement against Mr. Askew was set aside.

The events relating to Mrs. J. Askew are as follows. On 8th July 1992, a statutory demand for the overdue debt was served on her. On 31st December 1992, a substituted Bankruptcy Petition was served on her. On 4th February 1993, a Bankruptcy Order was made against Mrs. Askew. Followed by the appointment (on 22 February 1993) of a Trustee in Bankruptcy. Subsequently, Mrs. Askew made a number of unsuccessful attempts to have the Bankruptcy Order against her annulled on the grounds that the original was incorrectly drawn up. However, the courts rejected her application on the grounds that any change would prejudice the interests of her creditors.

On 4th February 1993, Mrs. Askew's balance sheet showed net assets of £377,148. The legal documents relating to bankruptcy were served on her in the hospital where she was recuperating. The locks on her pubs were changed and the Trustee also proceeded to take charge of the assets in Venice. The very act of appointing a trustee alerted creditors and negatively affected the business. Under the terms of the leases for pubs, the brewery company insisted that a

²² For some details see, *The Licensee and Morning Advertiser*, 26 February 1995.

bankrupt would not be allowed to run the business and the brewery seized possession of the pubs.

To mitigate the effect of bankruptcy, Mrs. Askew was advised to go into an Individual Voluntary arrangement (or an IVA), and the same Trustee now became an administrator. The Trustee alleges that Mrs. Askew's full co-operation was not forthcoming. Mrs. Askew alleges that the Trustee has not been forthcoming with full information and indeed has met him only once. Another insolvency practitioner commenting on the Trusteeship noted, "If the leases have been surrendered, forfeited or still retained, the Trustee should be invited to provide copies of correspondence/documentation showing the appropriate professional advice taken at the time. It appears strange too that the Trustee does not appear to have consulted or notified Mrs. Askew about any decisions concerning the two business leases. Again he should be required to provide copies of all correspondence with Mrs. Askew" (letter dated 19 January 1994).

Mrs. Askew's estate has been depleted by some £120,000, all to settle a debt of just £4,430.63. A complaint to the DTI (on 24th May 1996) drew the response that it is a matter for the Institute of Chartered Accountants in England & Wales (ICAEW) and the Minister then added that the "Institute sought detailed information from [the Trustee] but were unable to substantiate the claims which had been made by Mrs. Askew". The ICAEW has not issued any report. The nature of its inquiries and evidence, if any has been collected, is not known. Mrs. Askew has not been given any sight of any information collected by the ICAEW or asked to corroborate any statements made by the Trustee. Some eight years later (2000), the Trustee is still collecting fees. Mrs. Askew cannot appeal to any independent ombudsman because there isn't any.

J.S. Bass Group of Companies

The Manchester based J S Bass & Co Ltd Group of companies was owned by the Chapman family. It employed 130 people and consisted of J S Bass & Co Limited, Southern & Darwent Limited, James Mann (Newhey) Limited and T. Ashcroft & Son Limited. The Group dealt in timber and barrier foil products, manufacture of timber mouldings and packing cases and also ran a garage. The parent company, J S Bass, was 150 years old, and the Group had banked with Barclays Bank for 80 years (Christer, 1992).

The J.S. Bass Group had a history of successful trading. The name of Southern & Darwent was known, in the Northwest of England, as the specialist centre for

timber mouldings and in 1988 was trading at record levels of activity. James Mann (Newhey) Ltd had always been profitable. The pioneering Barrier Foil packaging business of J S Bass & Co was growing by over 50% each year for five consecutive years, and was now exporting to over a dozen countries. The timber packaging activity of Bass was being downsized at the cost of 13 redundancies. Its key property in Manchester was surplus to needs and was to be sold. T. Ashcroft was a small garage servicing company. The general level of profitability is indicated by the following audited pre-tax profits.

Profit (£000)		1984	1985	1986	1987
Southern & Darwent		56.3	40.2	55.6	108.5
James Mann		68.5	41.7	109.0	44.3
J S Bass/T Ashcroft		(41.4)	132.7	(149.9)	(151.5)
Group	Profit(Loss)	83.4	214.6	(14.7)	
(1.3)					

In September 1988, Barclays Bank asked Bass directors to appoint consultants from Ernst & Whinney (now part of Ernst & Young) to undertake a study of the Group to advise the Bank on the Group's viability. The directors agreed and the next day two representatives of Ernst & Young arrived. They allegedly spent a total of one hour within the company with access to Directors and Members. Within the next 48 hours, their report was ready and circulated. The report, allegedly, contained adjustments, all of which were negatively inclined towards the Group. Chapman also queried the weight given to the possibility of re-financing the Group, or comment on the Group's future viability, which some consider to be the major objective of preparing a reporting accountants' report. The report recommended that the business be placed into administration.

On 13 October 1988, Mr N. Hamilton²³ and Mr J. Warren of Ernst & Young wrote to Mr R B Chapman, the current Group Chairman and Managing Director of J S Bass & Co Ltd informing him that upon the petition of Barclays Bank they had been (the previous day) appointed Administrators by the High Court (no particular court stated). The letter was accompanied by a copy of an Administration order for J S Bass & Co made out to Manchester District Registry and stamped by Leeds High Court. Mr. N. Hamilton and Mr J. Warren of Ernst & Young assumed the position of Administrators of the entire Bass

²³ In June 2000, Nigel Hamilton (liquidator of Barlow Clowes, Stone Platt and others) retired from Ernst & Young to devote more time to being the chairman of the Financial Services and Compensation Scheme Board at the Financial Services Authority (The Times, 24 February 2000, p.33).

Group. They sacked all the directors and some staff and proceeded to sell the assets of the Group over the next few months. The Administrators appointed Ernst & Young as liquidators for J.S. Bass & Co.; Ernst & Young and Grant Thornton as joint liquidators for Southern & Darwent and James Mann (Newhey) Ltd. Grant Thornton were also appointed liquidators for T. Ashcroft.

The information filed by the Administrators at Companies House shows that at 15th May 1989, the Bass Group had creditors of £1,397,540.

Creditors	Amounts
Preferential	£ 122,926
Non-Preferential	£ 926,614
Bank Overdraft	<u>£ 348,000</u>
	<u>£1,397,540</u>

The fees taken by the Administrators over the period 12 October 1988 to the date of Liquidation (approximately 5 months) are as follows

Company	Professional Fees	Date of Liquidation
J S Bass & Co Ltd	£222, 094	May/June 1989
Southern & Darwent Ltd	£157, 363	April 1989
J Mann (Newhey) Ltd	<u>£ 79, 212</u>	March 1989
	<u>£458, 669</u>	

At the same time, the sale of assets (excluding properties in Cyprus) produced £2,752,319. As of 26 May 1989, £1,219,192 of creditors had been paid, as shown in the Administrator's statements filed at Companies House, leaving a surplus of £1,532,127 to pay the remaining creditors of £178,348. By December 1995, the liquidator ran up fees of £555,233. As late as 1998, the information sent by the liquidators to Companies House (S192 reports) indicates that some creditors have still not been paid in full.

Barry Chapman was unhappy with the administration and liquidation of the Group. He objected to the numerous unexplained adjustments made to his accounts by Ernst & Young. The adjustments depleted the trading accounts and resulted in lower profit and asset figures. He also felt that Ernst & Young's original report failed to adequately discuss the future viability of the Group, as itemised in the letter of instructions. Since Chapman ceased to be a director of

the companies, he did not have any legal entitlement to see the books, to enable him to ask further searching questions.

Ernst & Young argued that they did not owe a 'duty of care' to the company, or members, or directors of Bass. In a court hearing²⁴ at the High Court, (*R B Chapman v Ernst & Young*), His Honour Judge Gower QC in his judgement of 11 July 1995, stated, "That having regard to all the relevant circumstances the defendants owed the plaintiff a duty to use reasonable care and skill in the preparation of the report. That they failed to discharge it in that they founded the report's recommendations upon inaccurate information as to the company's financial position whereas with the exercise of reasonable care and skill they would have discovered the true facts".

Almost ten years into the administration/liquidation process, Barry Chapman discovered that the Administration Order given to him in 13th October 1988 may have been problematical. For an Administration Order to be made, first a petitioner petitions the Court requesting an Administration Order and proposing Administrators. This petition is given a number by the receiving court, which becomes the Administration Order if the court subsequently grants the order. In the Bass case, Barclays Bank were the petitioners, and N. Hamilton and J. Warren of Ernst & Young their designated Administrators.

The court records appear to be incomplete and invite further scrutiny. To clarify this point further, it would be helpful to briefly explain the six Court record keeping procedures for Administration Orders.

²⁴Barry Chapman was represented by Mr. Anthony Scrivener QC.

Court Records and Recording Procedures

(1) *The Court File*: A court file is opened for every case and is an accountable and independently audited document. All court documents and records relating to a case reside within the court file.

(2) *The Court Record Book* (also called Court Fee Book): This is a book in which every court event and interaction within a court is recorded. This is an accountable and independently audited document.

(3) *The Administration Book*. All cases in which an Administration petition are received by a Court are logged within the Court's Administration Book and numbered sequentially. If an Administration Order is granted, the Order is assigned the number of the petition. It is noted that if the petition is transferred to another court, on transfer it would be given a different number dependent upon its position within the new Court's Administration Book. In addition, the letter 'A' would be added after the petition number by the receiving court to denote it had been transferred. Thus, a petition No. 5, say, first lodged in Manchester and subsequently transferred to Leeds, would be assigned a number 3A by the Leeds Court, but only if the last petition lodged at Leeds was numbered 2. Manchester, as an original court in which a petition was lodged, would not number a petition with an 'A' designation.

(4) *The Court Clerk's Notes*: This is a record of court cases and judgements as recorded by the court clerk. It is not an accountable document, and is not checked or audited. For entries within this document to have any authority and standing, it must be checked and validated against the Court Book and File

(5) *Vice-Chancellor's Notes*: A presiding V.C's will usually make his/her own case notes within his notebook. -

(6) *Vice-Chancellor Clerk's Notes*: Each V-C has his/her own personal clerk who takes his own case notes.

Note: Of the above six sources, the Court Record and Court File are the main source documents within a court, and are audited to prevent abuse

Further inquiries by Barry Chapman have failed to find any court files at Leeds relating to J S Bass & Co Ltd, Southern & Darwent Ltd, or James Mann (Newhey) Ltd. There is no recording within the Court Record Book at Leeds

relating to J S Bass & Co Ltd, Southern & Darwent Ltd, or James Mann (Newhey) Ltd. The number of the J S Bass Administration Order sent by Ernst & Young to Mr Chapman on 13 October 1988 was 5A Petition No 5 of Leeds District Registry. It relates to a debtor company called Forlines Ltd, which was dismissed on 11 October 1988. Barry Chapman has been unable to find an entry within the Administration Book at Leeds or Manchester for either J S Bass & Co Ltd, Southern & Darwent Ltd, or James Mann (Newhey) Ltd.

An entry exists within the Court Clerk's Note Book recording that at 3.30 p.m., an urgent application for an Administration Order was heard by the V.C. on 12 October 1988. It also records that an Administration Order was granted for J S Bass and its two subsidiaries within the Director's consent. This document has no standing or legal status without confirmation from the Court Record and Court File. No such confirmation has been forthcoming. It should also be noted that, (i) the requirement for the clerk's notes to be validated against the audited Court Record and Court File is a mechanism to prevent malpractice. (ii) Blank spaces within the clerk's notes are not unusual. As a consequence, such space provides the opportunity for subsequent additions in text. (iii) In the case of the J S Bass & Co entry in the Court Clerk's Notes, the first two lines are written in Black, consistent with most of the Notes, but the subsequent seven lines reporting the Administration Orders are written in blue, possibly suggesting a later entry. (iv) The handwriting of the Clerk's Notes is the same as that which appears on the alleged Court Notes indicating an Administration Order was granted as drafted, and numbered 5A. (v) Unusually, the entry for the Bass Group does not appear to contain any Court number.

Enquiries by the Court Services have failed to find an entry within the VC's Notebook relating to J S Bass & Co Ltd, to Southern & Darwent, or to James Mann (Newhey) Ltd. The Vice-Chancellor's Clerk has been contacted by Court Services, and has been unable to find records of any hearing concerning J S Bass & Co Ltd, Southern & Darwent Ltd and James Mann (Newhey) Ltd.

The Insolvency Act 1986 requires that if a court makes an Administration Order then it shall give notice of that to the Administrator and the Registrar of Companies. Ernst & Young claim that they do not have any papers relating to proceedings 5 of 1988 at Leeds. After making inquiries, Barry Chapman

claims that no statutory notice of appointment for the Administrators of any of the Bass Group of companies appears within the Court, and that no such notice is found upon discovery to be within the possession of Ernst & Young. At the same time, the records of the Registrar of Companies show that no notification of the Administration Order has been lodged with them.

When an Administration Order is granted by the Leeds Court (or any Court), the petition for the discharge of the Order would first have to be filed at the Leeds (or granting) Court. No record exists within the Court Record or the Court File at Leeds relating to any such petition re J S Bass & Co, Southern & Darwent Ltd or James Mann (Newhey) Ltd.

On 19th May 1989, the Administrators of the Bass Group petitioned the High court in Manchester to have J. Warren appointed as compulsory liquidator of the parent company J.S. Bass Limited. A Court Order, number 731 of 1989, was duly presented and J. Warren was appointed liquidator. Barry Chapman has been unable to find a record within the Manchester or Leeds court confirming a petition to dissolve the Administration, or seek liquidation. The quoted court order number 731 of 1989 seems to refer to another case which has no connection with the Bass Group.

From the outset Barry Chapman was unhappy with the conduct of the Administration, unexplained adjustments to his accounts, excessive fees and disposal of assets, which he considered to be at values below the market prices and without proper advertising and professional advice²⁵. In December 1988, Barry Chapman lodged a complaint with ICAEW. A long period of silence resulted in reminders and requests for action. In October 1992, a spokesperson for the ICAEW stated that he hoped to reach a conclusion before too long. In July 1993, the spokesperson for the ICAEW stated that Mr J Warren had recently retired on health grounds, and following discussions with Ernst & Young, he did not see how the complaint could be pursued any further. It would be recalled that fees were paid to Ernst & Young. This attempt to shelve the complaint led to some press publicity (for example, the Independent on Sunday 12 September 1993). After exposure on a radio programme (BBC File on Four, 21 June 1994), the ICAEW was pursued and in January 1995, it claimed that the complaint was being actively progressed. In September 1996,

²⁵ The court judgement in *Medforth v Blake and Others* [1999] 3 All ER 97 established that the receiver who sold charged assets but failed to take reasonable care to obtain a proper price may be liable notwithstanding the absence of fraud or *mala fides*. A receiver managing mortgaged property also owes duties to both the mortgagor and anyone else with an interest in the equity of the redemption (also reported in The Times, 22 June 1999).

some 8 years after the initial complaint, the ICAEW changed the person handling the complaint, who was again changed in October 1997. On 12 October 1997, the 9th anniversary of the collapse of the Bass Group and aided by BBC TV's 'Here and Now' TV Programme, a birthday cake was presented to the Office of the ICAEW to commemorate their nine years of "investigative inactivity". This publicity prompted a reaction from the ICAEW and it claimed that "there was no prima face case to answer".

In keeping with the ICAEW procedures, no reason or justification for this view was given. Barry Chapman referred the matter to the ICAEW's Reviewer of Complaints (selected, appointed and remunerated by the ICAEW), a Mr. Anthony Surtees. For ten months nothing was heard from him. A revised complaint submitted to the ICAEW Reviewer on 13 January 1999 included a considerable volume of fresh supporting evidence, including for the first time questions about the inconsistencies in the court records. In April 1999, after 15 months of silence, the ICAEW Reviewer, Mr Surtees was replaced by a Mr S J C Randall. This Reviewer eventually reported in early 2000 saying that he could see no problems with the conduct of the administration and liquidation. However, the Reviewer's files, correspondence and evidence are not available for scrutiny.

Barry Chapman has made numerous attempts to raise his case with the ICAEW and the DTI. His case has been raised during radio and television programmes and in the House of Commons debates (Hansard, House of Commons Debates, 15 July 1997). Despite voluminous correspondence, Barry Chapman has been unable to persuade the regulators to investigate his case. The DTI and the ICAEW are adept at passing the buck. The ICAEW's Reviewer of Complaints can find no fault with the ICAEW or any of the accountancy firms. The DTI has refused to launch an independent investigation. Barry Chapman cannot refer the matter to an independent ombudsman because there isn't any. He has been unable to get legal aid to have his concerns aired in the courts.

Nevern Dairies

Nevern Dairies owner Andrew Thriepland ran a multi-million pound farming business in Pembrokeshire, employing 30 people. As the price of cheese fluctuated in the international market, Thriepland became concerned about the value of his stock and sought advice from his bank. The bank appointed Peat Marwick (now part of KPMG) to report on the business affairs. As Thriepland recalled, a young man aged about 24, totally inexperienced in farming, came to his premises to prepare a report. "He spent most of the day looking through our

books which I think were in reasonably good order, then spent a few minutes walking around the cheese store. He took a look at our stocks which were worth £800,000 on my knowledge and calculation. He said they were worth only half that, and he had as far as I know absolutely no advice on that and he had no experience to be able to value the cheese”²⁶.

The one day visit and report by the accountancy firm resulted in a fee of £3,000 which Thriepland had to pay. The resulting report was sent straight to the bank. Based on what it said, the bank manager decided to appoint a receiver. The same Big-Five firm now became the receiver. The accountancy firm was estimated to be charging at an average rate of £250 an hour for attending meetings aimed at closing the business. But receivers had difficulties. Thriepland knew the farming business and the insolvency practitioner did not. The receiver could hardly milk 200 cows and keep the animals in good health for ultimate sale. Through threats of non-co-operation and the nature of his business, Thriepland gained the upper hand in the dispute. He also obtained alternative valuations for his stock which were far nearer the original figure. Based upon the revised stock valuation, the bank granted an overdraft facility of one million pounds. Though the cheese business was sold, Thriepland was able to rescue the rest and save thirty jobs. The unsecured creditors stood to lose one million pounds from the receivership but were eventually paid in full. Thriepland sued the Big-Five firm for negligence, but was unsuccessful because the receiver only owes a ‘duty of care’ to the party appointing him/her, in this case the bank.

Alan Preen

During the late 1980s Mr. and Mrs. Preen built up a reasonably successful business from leased premises with an annual turnover of £250,000 (Hansard, 23 October 1996, cols. 112-120.. In the course of their business, a dispute arose with the landlord over the repairs, dilapidations and structural refurbishment covenants in the lease. In December 1992, the landlord issued an invoice of £12,000, subsequently withdrawn, to levy charges. Indeed, on 18th December 1992, the bailiffs arrived demanding immediate payment of £12,000.

The dispute was complex. Mr. and Mrs. Preen were advised that they could either sue the landlord with all the risks involved in that, or place their business into administration i.e. place it under the protection of the courts. On 21st December 1992, they approached a Luton based firm of chartered accountants and a Mr. A.G. Aiyer was appointed as an administrator. At this point the business had a bank balance of £7,475.83. The only creditor was the landlord

²⁶ BBC Radio ‘File on Four’, 21 June 1994.

for £7,000. Mr. and Mrs. Preen's business was considered to be worth £130,000, representing their life savings and investment in the business. The Preens asked the insolvency practitioner for an indication of his likely fees, but received no definitive answer. Mr. and Mrs. Preen understood that they would continue to work in the business and save it, but the insolvency practitioner soon sacked them. The insolvency practitioner took complete control of the business, but the Creditors' Committee considered his conduct to be lacking in efficiency and competence. A genuine approach from the assistant manager of the business to buy the business was turned down. Subsequently, the assistant manager was also sacked by the insolvency practitioner.

In summer 1993, the insolvency practitioner had appointed a new manager. It was thought that he would buy the business, but an early bid did not materialise. By the late summer of 1993, the insolvency practitioner decided to close down the business. He had already sacked employees and removed some of the fixtures and fittings of the business and placed them into storage with another company. This company raised invoices for the storage fees which the Preens considered to be inflated. The insolvency practitioner then intended to secure the transfer of the company in its entirety to yet another company. Around the same time he sent forms to Companies House purporting to be the resignations of Mr. and Mrs. Preen as directors of the company. Eventually, the assets of the business were sold at knock-down prices. Most of the original staff lost their jobs. The unsecured creditors did not receive even 1p in the pound. Mr. and Mrs. Preen lost their life savings.

On 13th July 1993, Mr. and Mrs. Preen reported the conduct of the insolvency practitioner to the Institute of Chartered Accountants in England & Wales (ICAEW). One might have expected the ICAEW to act swiftly, especially since as recently as October 1992, it had found the same insolvency practitioner guilty of professional misconduct in that he had passed client's monies through his own bank account. The practitioner's past misconduct was not communicated to the Preens at the time of his appointment. Rather than acting decisively, the ICAEW only sent a routine note acknowledging receipt of their letter. In December 1993, Peter Butler MP took up the Preen's case. But still no reply or action came from the ICAEW. The Institute finally responded in February 1994 to say that it was looking into the matter. On 22 June 1994, the ICAEW Director of Professional Regulation stated that the matter is "under active consideration, but I regret I am unable to predict with confidence when a decision will be reached". Despite further letters, no more information could be secured. Finally, Peter Butler MP secured a reply from the ICAEW (letter dated 18 August 1994).

In September 1994, an Industrial Tribunal concluded that the insolvency practitioner had breached Section 53 of the Employment Protection (Consolidation) Act 1978 by unfairly dismissing staff. He was ordered to pay costs of £381.30. In Autumn 1994, it was learnt that Mr Aiyer had pleaded guilty at the Luton Magistrates Court for breaching Section 389 of the Insolvency Act 1986. Between December 1986 and March 1993, he practised as an insolvency practitioner whilst not qualified to do so. He was given a conditional discharge for two years. Did the ICAEW not check whether the complaint was against someone who might have been acting as an insolvency practitioner whilst not qualified to do so? Perhaps it did not really care much about complaints from one of the little people. After all, the ICAEW does not owe a 'duty of care' to anyone.

By November 1994, still nothing further had been heard from the ICAEW. After further letters, the ICAEW officials stated that

“the investigation committee decided not to prefer a formal complaint to the Disciplinary Committee. Mr. Aiyer has, however, had his licence withdrawn. That was done last autumn administratively not by disciplinary action. Arrangements have been put in hand for him to be given assistance in dismantling that part of his practise, and, of course, for the procedures to be monitored”

Source: Letter from the ICAEW to Mr. Preen, dated 22 February 1995.

Subsequently, Mr. Preen was informed that

“You were not told of the withdrawal of Mr. Aiyer’s licence at the time because our practice is not to make such information publicly available until after the decision has taken final effect”

Source: Letter from the ICAEW to Mr. Preen, dated 17 March 1995.

On 15 July 1996, bankruptcy proceedings were launched against Mr Aiyer in Luton County Court. The Luton & Dunstable Herald and Post reported (29 August 1996) that Mr. Aiyer was bankrupted by litigation claims of around £150,000 against him.

So the ICAEW has no mechanisms for quickly responding to stakeholder

concerns. It does not have systems for knowing whether its' members are authorised to conduct insolvency work. How does the ICAEW monitor the work of insolvency practitioners? In response to a Parliamentary debate, the Minister for Corporate Affairs acknowledged that

“the manner in which [Mr. and Mrs. Preen’s] complaints were dealt with by the Institute of Chartered Accountants was not all that it should have been. There were delays in the investigation into the complaint, and delays in communicating its progress and its outcome to Mr. and Mrs. Preen”

Source: Hansard, House of Commons Debates, 23 October 1996, col. 118.

Despite such statements, the ICAEW has not been obliged to compensate the Preens for any of the losses that they might have suffered because of the shortcomings in its administrative procedures. Mr. and Mrs. Preen lost assets estimated to be around £130,000. There is no independent ombudsman to examine their case. The best the DTI could advise was that

“the position remains that the government has no power to make the ICAEW compensate him. However it is open to Mr. Preen to take legal advice as to whether any remedies under law are available to him and to proceed on the basis of that advice”.

Source: Letter from the Minister for Competition and Consumer Affairs to Austin Mitchell MP, dated 31 July 1998.

In common with many other victims of insolvent abuse, Mr. and Mrs. Preen do not have the financial resources to seek legal advice. They cannot ask an ombudsman to adjudicate their dispute because there isn't any.

Heritage Plc

Heritage Plc was a thriving business. It employed more than 100 people, many of whom were disabled (London Evening Standard, 25 November 1999). Its 1994 consolidated accounts, audited by KPMG, showed a turnover of £12,650,000 and operating profit of £425,000 (for further details see Hansard, House of Commons Debates, 7th May 1999, cols. 1266-1272). Like many other businesses it relied upon bank overdrafts to finance its working capital. The position became acute as the company became embroiled in a dispute with one of its major customers. The finance director was dismissed. Then in July 1995,

Lloyds Bank asked Grant Thornton to comment on the company's financial affairs. Grant Thornton had already been doing some tax work for the company. Who were Grant Thornton to serve: the bank or the company? The company feared 'conflicts of interests' and was not too keen for Grant Thornton to act for the bank. The Grant Thornton report issued in July/August 1995 was not too complimentary, but felt that the overdraft could be brought under control and reduced to almost zero by April 1996.

Auditors KPMG continued to have considerable doubts about the debtors figures. After heavy bad debts provisions the 1995 accounts showed a loss of £919,000. During the same period, the company introduced a computer system, but it did not function properly and caused considerable administrative problems. The finance director was struggling to get to grips with the problems. In March 1996, the bank again asked Grant Thornton to report on the company's financial affairs. Soon afterwards, the bank rejected the cheques issued by the company's subsidiaries and in July 1996 Grant Thornton were appointed administrative receivers. The company objected to the appointment of Grant Thornton on the grounds of 'conflicts of interests', but to no avail. A Grant Thornton partner argued that "After full consideration of the facts at the time (before accepting the brief from the Bank), I did not consider that the existing relationship was material and it did not constitute a conflict for GT. the relationship on the tax work was not material" (letter from Grant Thornton to Mr. J. Lampert, dated 20 March 1997).

To avoid liquidation, the company sought a merger/take-over with another company, but the receiver would not entertain it. Grant Thornton collected initial fees of £400,000 from the receivership. A complaint to the ICAEW was rejected (letter from the ICAEW, 8 April 1998) and Heritage directors cannot appeal against the decision. The matter was referred to the DTI, but it merely passed the correspondence to the ICAEW. The whole process can induce dizzying effects. The directors of Heritage Plc could not call upon any independent ombudsman to adjudicate on their concerns. This case has been the subject of an Adjournment Debate in the House of Commons (Hansard, House of Commons Debates, 7th May 1999, cols. 1266-1272). To date, neither the RPBs nor the DTI have done anything.

James²⁷

A builder bankrupted seven years ago, despite going to court with the cash to pay his debts, has subsequently been advised that the sequestration was wrong in law and should never have happened. Mr. James Ward, of Blantyre, was at

²⁷ This case has also been reported in the Glasgow Herald, 28th June 1999, p. 8.

the time owed £85,000 by Edinburgh Woollen Mills (EWM) and had two witnesses to him being at Hamilton Sheriff Court with the cash in his pocket on October 19, 1992, only to be told by the Sheriff it was “too late for that now”.

Seven years later, after asking at least 20 firms of solicitors in Glasgow and Edinburgh to examine his case, Mr. Ward has been told that he should have appealed immediately and would have had the sequestration lifted. The past seven years have seen Mr. Ward, who cares at home for a sister with cerebral palsy, powerless to stop further debts of £20,000 being run up by a bankruptcy trustee, who owns his house, and to his former lawyers Wilson Chalmers & Hendry who it now emerges failed to advise him that he could have had the sequestration lifted within 10 weeks, back in 1992.

As long as the trustee has power over his assets, Mr. Ward is unable to conclude his case against Edinburgh Woollen Mills, which has already paid £75,000 into court in admission of its liability for the unpaid bill. Now the Scottish Legal Aid Board is refusing to grant Mr. Ward aid to return to court to have his sequestration lifted, despite having conceded that it was wrong in law.

Mr. Ward’s case mirrors that of Edinburgh florist Ian Cross whose sequestration was lifted by Lord Osborne two years ago in an unprecedented judgement, but who has been refused legal aid to fight for compensation. Mr. Ward’s £85,000 bill was run up for building work at Edinburgh Woollen Mills’ Antartex factory at Alexandria in 1988. When EWM disputed the bill, an independent quantity surveyor reported that the job had actually been underpriced. When a desperate Mr. Ward asked Hamilton solicitors J & Y Robertson to recover money from his own building suppliers, the only outcome was that Robertson petitioned for Mr. Ward’s sequestration.

When Edinburgh legal firm Connell & Connell took on the case earlier this year it applied for legal aid for a case to have the sequestration “reduced” – enabling Mr. Ward to escape from his trustee and put his affairs back where they were seven years ago. He is ready to pay off all his trade creditors from the proceeds of the commercial case which could then, at last, proceed to a settlement.

In February 1998, the Scottish Legal Aid Board (SLAB) said that “There is no support for the claim that he offered to pay the entire debt at the sequestration ... the remedy of recall was open to him”. When presented with evidence from accountant Henry Mitchell and quantity surveyor Tony Murray that Mr. Ward was at court with the money, and offered to hand it over, the SLAB changed

tack. In June 1998, it responded by claiming that “different reasons for refusal have emerged”.

It claimed that reducing the sequestration would not affect Mr. Ward’s debts to his trustee as he was discharged, and suggested that he should pursue his former solicitors Wilson Chalmers & Hendry for professional negligence. Connell & Connell says that WC & H “failed to advise” Mr. Ward that he could and should have asked for the sequestration to be recalled within 10 weeks, but more importantly it was “not open to the sheriff to award sequestration”. Mr. Ward said: “My trustee has full powers over me and my house, yet none of this should have happened. What about justice”?

Ms Fiona Munday at Connell & Connell said: “It is clearly a case where there was an absolute foul-up by the courts. He should never have been put in that position”. James cannot ask an independent Ombudsman to look at his case because there isn't any.

Roche

In 1990, Mr. M invested in a new company, Roche, involved in the manufacture and installation of UPVC and aluminium windows and roller shutters. He mortgaged his house to provide a building and plant and machinery for the business, as the company did not have the funds available to pay for the assets. He also provided a loan of £180,000 as working capital. In return, the company issued a debenture for the sum of £399,000 in favour of Mr. M. The intention was that the company would pay for the assets and repay the loan over a period of time from the profits of the business. Mr. M became the company’s chairman, but was not involved in the day-to-day running of the business.

In 1997, the company suffered heavy trading losses. These were compounded through the liquidations of three major customers, whose combined debt amounted to £100,000. The company incurred significant costs in fruitless efforts to recover the debts owed to them by these companies. Some key staff members found it too difficult to work within the bounds of the very tight credit control methods that were imposed following the aforementioned bad debts and left the company.

During 1998 there was no evidence of any improvement in the trading position. Roche’s accountant advised Mr. M that the company had negative assets and he was advised to liquidate it. At the end of July 1998, in line with the covenants contained in the debenture trust deed, Mr. M decided to place the company into

a creditors' voluntary liquidation. A medium-size accountancy firm was appointed as the liquidator. The choice of the liquidator was influenced by a number of factors, such as the personal recommendation by a friend. More significantly, the accountancy firm assured Mr. M that the liquidation was a very straightforward matter and the cost would be in the region of £2,500. Mr. M also told the firm of the size of his loan and the fact that he held a mortgage debenture over the assets of the company and a copy of this document was made available to the firm. He also told the firm that the company had no money, that he would pay the liquidator's fee, the preferential creditors and the bank. Mr. M did not want the liquidator to realise the assets of the company, as they were the subject of his mortgage debenture

Although the trading position of the company was precarious, its books and records were properly maintained and audited accounts up to 31st December 1997 were available. The liquidation should have been a relatively quick and straightforward process. The trade creditors amounted to less than £10,000. The preferential creditors were estimated at £6,500. Mr. M was prepared to pay the bank, the preferential creditors and the quoted cost of the liquidation of £2,500. The accountancy firm fixed a meeting of members and creditors for 28th August 1998, a date when Mr M was away on holiday. Mr. M, a major secured creditor, was told that he did not have to attend the meeting.

However, two years later the liquidation has still not been finalised and the liquidator is requesting a fee of £26,000. After the creditors meeting, the liquidator appointed a team of agents to value the building and the assets. The agents, who were based in Leeds, were sent to the factory in Oswestry to carry out this exercise at a total cost of £6,000. A local agent would have carried out this work for less than £1,000. The liquidator took out insurance cover on the premises at a cost of £3,737. Cover was already in place with a local agent at a cost of £1,496. The local agent was prepared to maintain this cover and made several attempts to contact the liquidator in order to arrange this. However, his phone calls were not returned and he was unable to speak to the liquidator.

Early in 1999, the liquidator left the accountancy firm and set up his own practice. Without any notice to creditors and members, he took the case of Roche with him. This only came to light after Mr. M lodged a complaint with the ICAEW in August 1999.

The liquidator did not finalise the position of the preferential creditors until August 1999, but he did not ask Mr. M to pay any of these. The Inland Revenue experienced considerable difficulties in getting responses from the liquidator,

so Mr. M actually completed the necessary documentation for them.

In desperation, Mr. M wrote to the ICAEW. It suggested that Mr. M may not have been given proper advice by the liquidator in respect of the method of liquidation. He told them that he had received no advice at all. In a reply to the ICAEW, the liquidator referred to an alleged telephone conversation with Mr. M., and produced a hand-written file note as evidence of this conversation. In his letter he stated that the telephone conversation had taken place in July 1998 – the file note was dated July 1999. Good practice is to formally communicate the details of telephone conversations to clients, but the liquidator had not done so.

Mr. M's solicitor queried the liquidator's fee demand of £26,000. He was advised that a resolution had been passed at the meeting of creditors agreeing the fee basis. In evidence, the liquidator produced hand-written (not typed) minutes of the meeting which had been signed by him. Only two creditors, whose cumulative debt was very minor, attended the meeting. Neither recalls the resolution being proposed or passed. The Chairman of the creditors' meeting, a director of the company, also states that the liquidator's fee was not discussed at the meeting and confirms that she was neither shown nor asked to sign any minutes in respect of the meeting.

Apart from the instances stated above, the Statement of Affairs shows a realisable value of £36,000 in respect of the floating assets, whereas the valuation provided by the agents employed by the liquidator and the amount shown in the Annual Report is £16,000. The timesheets submitted by the liquidator are incomplete. The liquidator had opportunities to sell the assets to settle the debts, but turned down four such opportunities. With the passing of time, the value of plant and machinery has declined. Meanwhile, the fees due to the liquidator continue to increase. The liquidator's report states that "The company had created a mortgage debenture and this debenture included a fixed charge on the company's debts, goodwill and property and a floating charge over the company's other assets. No distribution has been made by the liquidator to the secured creditor at this stage pending realisation of the other outstanding assets".

In May 1999, Mr. M complained to the DTI who promptly referred him to the ICAEW. After seven months of correspondence, the ICAEW have been unable to refer him to any guideline which urges insolvency practitioners to complete the liquidation efficiently and effectively, or to any requirement to finalise the liquidation within a reasonable period. To date, no regulatory action has been

taken by the ICAEW or the DTI. Mr. M can't refer the matter to an independent ombudsman because there isn't any.

DISCUSSION

This chapter has drawn attention to some of the abuses by the insolvency industry. We are aware of numerous similar cases. In each case, the victims presumed that by referring the matter to the RPB, the DTI, their MP or someone else, they would get some justice. But MPs are powerless. Most of the victims of insolvent abuse cannot muster sufficient financial resources to mount a legal challenge against the insolvency practitioners or the RPBs. The RPBs are in no position to call major accountancy firms to account and don't even try. The DTI Ministers simply wring their hands. In fact, the DTI has become a willing accomplice in insolvent abuse.

Prior to the Insolvency Act 1986, all malpractices were blamed on the absence of a professional culture. But with all the trappings of a formal profession (e.g. ethical codes, disciplinary procedures), most of the issues still remain. In response, the insolvency industry argues that it is determined to clean up its act and deal with all offenders. However, the inability to deal with major firms who are often implicated in questionable episodes does not inspire any public confidence. Disciplinary proceedings are also a way of deflecting attention away from the deeper issues. They individualise the issues and rarely tackle systemic problems which give rise to the abuses.

The RPBs increasingly operate what may be called a 'private system of law'. Under this they hold discussions with the firms, but are not obliged to issue any reports. Stakeholders may complain, but the RPBs do not say what information they have secured from the firms. The RPBs function as quasi-courts and tribunals, but the complainant is not given sight of any information, files, papers or letters which the RPBs may have collected. There is no opportunity for the complainants to comment on the evidence considered, check its completeness, test its accuracy, or otherwise. The disciplined insolvency practitioner can appeal against the decision of the RPB, but the complainants have no right of appeal. The RPBs collect fines but use them to fill their own coffers rather than compensate the victims of malpractices. For example, for 1999, the ICAEW and the ICAS made a surplus of £3,025,000 and £386,000 respectively, out of the fines collected for malpractices²⁸.

²⁸ These figures are from the accounts of the Joint Disciplinary Scheme (JDS), an arm of the accountancy trade associations, with responsibility for investigating major disciplinary cases.

Those dissatisfied with the actions of an RPB cannot complain to an independent ombudsman either. For public relations purposes, the ICAEW claims to have a 'Reviewer of Complaints'. But s/he has no independence. The selection, appointment and the financial rewards of the Reviewer are dependent upon the ICAEW. No doubt, the Reviewer acts in an honest and objective manner, but like everyone else his/her worldview is bound to be coloured by their business and financial concerns. S/he is not in a position to bite the hand that feeds them. In terms of his duties, the Reviewer states, "I don't think I have a formal duty of care under legislation or statutory rules but I believe I have a duty of care at common law both to the complainant and the member complained about" (Letter to Austin Mitchell MP, dated 17 July 1994). A member of the public dissatisfied about the rigour of investigation cannot sue the Reviewer either, though there may be a potential to refer the matter to the Courts for a judicial review, assuming that the injured stakeholder can afford the considerable costs.

The vast majority of insolvency practitioners themselves, believe that "most people involved in insolvency, whether it be the IPs [the insolvency practitioners] themselves, the debtors or the creditors, would be far better served by one regulator" (IPA News, November 1997, p.2). But the officials of the accountancy and law trade associations are keen to hang on to their powers and perks. They support the need to have eight separate regulators to deal with just over 1,800 practitioners on the grounds that a single regulator "would increase costs and cause disciplinary problems" (Accountancy, June 1998, p. 23)!!

The spokespersons for the insolvency industry claim that less than one-third of the reports prepared by investigating accountants recommend receiverships (Bradberry, 1994; also see Insolvency Practitioner, Winter 1995, p. 27). However, this is no consolation to those suffering from ineffective regulation. The accountants' conflict of interests has caused untold misery to families and damaged the economic fabric of the UK. The British Chamber of Commerce has urged the government to investigate the role of reporting accountants in placing businesses into receivership (Financial Times, 2 March 1994, page 9).

With deafening silence from the government, the insolvency trade associations and the banks, some have taken matters into their own hands. Accountancy firm Morley & Scott has announced that it will no longer accept receivership appointments where it has already acted as an investigating accountant for the same company (Accountancy, December 1994, page 14). The Royal Bank of Scotland (RBS) has declared that it will not award receiverships to any

accountant who previously acted as a reporting accountants for the client in question. In addition, RBS has instituted a policy of seeking competitive tenders for the award of any insolvency work. In its evidence to the Social Security Committee, the Bank stated that “if an investigating accountant recommends receivership, we usually appoint a different firm as receiver. This reassures the customer when an investigation is initially requested, and avoids any conflicts of interest for the accountancy firm. In every case two or three firms will be invited to quote for the business and supplied with information on the customer in question in order that they can prepare their tender.” (part of a letter dated 9th September 1993). As a result, RBS Director Derek Sach explained, “In 1992 Royal Bank appointed 418 receivers, compared to 152 in 1993, which is considerably less than the average for the UK (letter dated 1st July 1994). Overall, RBS claims that it has placed 60% fewer businesses in receivership and that the cost of placing businesses in receivership has also shown a dramatic reduction, in some cases by as much as 40% (Newton, 1994; also see Hansard, House of Lords Debates, 26 January 1999, cols. 936-951).

The DTI primarily sees itself as the defender of the insolvency industry. It is unable/unwilling to take steps to safeguard the welfare of the stakeholders. It could encourage banks to adopt the best practice, as exemplified by the Royal Bank of Scotland, but the Ministers remain silent.

CHAPTER 6

WHAT'S TO BE DONE

This monograph has drawn attention to the shortcomings of the insolvency industry and to real-life cases which highlight the abuses. Many of the problems relate to the position of reporting accountants. They have a vested economic interest in recommending receivership. They charge exorbitant fees and are not accountable to all stakeholders. The RPBs have no independence from the insolvency industry and have been unable to check the abuses, especially those relating to major accountancy firms. The DTI sees its role primarily as the defender, promoter and protector of the insolvency industry. It has become adept at passing the buck to the RPBs, who in turn have become very efficient at sweeping things under their carpets.

Following the principles applied by the House of Lords (January 1999) to the Pinochet judgement (*In re Pinochet*), the accountancy and law trade associations should not remain in control of disciplinary hearings. In this case, the Law Lords ruled that the presence on the Appeals Panel of Lord Hoffman, who had connections with Amnesty International, had the capacity to give the impression of bias. The Law Lords argued that this was unacceptable and set aside the original decision relating to the extradition of General/Senator Pinochet.

The same principles should also apply to disciplinary hearings. It is evident that the accountancy and law trade associations have a direct interest in the outcome of the disciplinary hearings. Partners from the firms with direct interest in selling insolvency services preside on the disciplinary hearings. At any one time, given the number of insolvency practitioners and the number of complaints, it is likely that the partners from firms whose own conduct is subject to scrutiny, are simultaneously presiding on hearings relating to other firms and their partners. They have a direct interest in ensuring that precedents which might apply to their own firms and partners are not allowed to develop. The disciplinary hearings held by the accountancy and law trade associations seem to violate the principles established by the *Pinochet* judgement.

The regulatory system is also unfair in that those affected by the shortcomings of the insolvency industry and its regulators cannot appeal to an independent body. With the profit motive paramount, it is inevitable that the insolvency practitioners will seek to prioritise their private concerns over and above the public concerns about business rescues.

Insolvent abuse is the outcome of the overwhelming business ethos dominating the conduct of banks and insolvency practitioners. No bank manager or loan officer wants to be associated with bad loans, losses or poor profit opportunities. Their salary, promotion, bonus and status depend upon it. So 'reporting accountants' are periodically asked to review the cash flows and viability of business clients. At the slightest sign of difficulties, the financial plug is pulled. The banks are only interested in recovering what is owed to them. The welfare of other stakeholders and the local economy does not form part of their business objectives. The same business ethos also applies to insolvency practitioners. They need a constant supply of new and profitable clients to increase their fees. In major accountancy firms, partners and senior staff are set targets for generating income and profits. Their career, status, promotion, salary and bonuses depend upon them. So the pressures to place businesses into liquidation unnecessarily are always there. The 'reporting accountant' could conclude that the business being reported upon is doing well, and receive a one-off fee. The accountants could recommend receivership and/or liquidation, and then urge the bank to appoint them as receivers and liquidators. In this case, the firm will collect fees for many years. Insolvent abuse is clearly institutionalised in the structures and processes of market economies.

Insolvent abuse could be checked by ensuring that reporting accountants are not permitted to become receivers and liquidators. Yet successive governments have looked the other way. It could be checked by ensuring that all stakeholders had a meaningful say in insolvency matters. However, company directors, shareholders, employees, unsecured creditors and other stakeholders usually have little say in the conduct of the insolvency. The legal fiction is that insolvency practitioners are supervised by a Committee representing the creditors of the insolvency business, but none of the stakeholders have access to the files and working papers of the insolvency practitioners. Deprived of income, homes, savings, security and money, many stakeholders are rarely in a position to call the insolvency practitioners to account, or adequately supervise their conduct. Many unsecured creditors are too busy looking for alternative sources of trade and cash and have little time to take any part in the running of the Creditors Committee, so the Committee is effectively controlled by the insolvency practitioner and the bank that initiated his/her appointment.

Equality, democracy, fairness and accountability are the guiding principles of our times. Yet they are not applied to the insolvency industry. There is no independent check on the fees charged by insolvency practitioners unless

someone seeks a costly judicial review. There is no routine independent audit of the insolvency practitioner's accounts, bills or costs. They are under no obligation to finalise the insolvency efficiently and expeditiously. The stakeholders are not made aware of the best bids received for a distressed business's assets. It is not uncommon for the receivers to reject good bids and then eventually sell the assets at knockdown prices to companies that they themselves have formed. With the absence of any information about performance, efficiency and effectiveness, no stakeholder can make any informed assessment about the desirability of appointing any firm as receiver, liquidator, administrator or trustee in bankruptcy. The absence of a 'duty of care' to all stakeholders provides no strong economic incentives for the practitioners to operate in any socially responsible way.

Mr. Mitchell: To ask the Secretary of State for Trade and Industry if he will introduce legislation under which the receivers and liquidators will be required to owe a duty of care to all the stakeholders affected by their decisions.

Dr. Howells: I have no plans to do so.

Source: Hansard, House of Commons Debates, 20 Jun 2000, col. 140.

There is no independent regulator to safeguard the interests of stakeholders. There is no independent ombudsman to investigate complaints and adjudicate on disputes.

APPEASING AND DEFENDING THE INSOLVENCY INDUSTRY

The large numbers of complaints against insolvency practitioners are an indication of the public's concerns. Despite the presence of some lay members²⁹, the values, vocabularies and agendas of the insolvency industry dominate the disciplinary proceedings. Disciplinary action against any major firm, or its partners, is rare.

²⁹ As regards the presence of laypersons on disciplinary panels, one has to ask how are they selected? How many are hired because of their unease about the insolvency industry? They are hired and remunerated by the insolvency trade associations. The financial dependency soon encourages a certain kind of conformity and deference.

COMPLAINTS AGAINST INSOLVENCY PRACTITIONERS
1 January 1992 to 31 December 1999

Year	Number
1992	391
1993	532
1994	587
1995	567
1996	540
1997 to 1999	1,339

Sources: Hansard, House of Commons Debates, 2 March 1998, col. 458; 20 Jun 2000, col. 139.

Neither the RPBs nor the DTI respond to any public revelations. For example, on 19th June 1996, Channel 4 ‘*Dispatches*’ programme broadcast a documentary highlighting the questionable practices and regulatory inaction in the insolvency industry. Through undercover filming, the programme showed that insolvency practitioners were willingly offering questionable services. Posing as businessmen, the *Dispatches* team asked one of insolvency practitioners to help prevent a fraud from being discovered at their company. They also asked whether they will be able to get their assets back by placing the company into receivership and by effectively depriving the creditors of their monies. The insolvency practitioner(s) indicated that this was not a problem and went on to explain how the task could be accomplished. When later on confronted with the reality of the set-up, the practitioner(s) had a bout of amnesia. Commenting upon the documentary, a journalist concluded that

“the *Dispatches* team seemed to have made a pretty strong case for a professional investigation into the services on offer cases appeared to warrant an investigation on the face of what was broadcast.

Source: Insolvency Practitioner, August 1996, p. 21.

When asked to take decisive regulatory action against the insolvency practitioners exposed on the *Dispatches* programme, the Minister for Corporate Affairs said, “I am not persuaded that any action is called for from me at this stage although my officials remain in close touch with the bodies” (Letter

from the Minister for Company Affairs, dated 11 July 1996). Some four years later, when further details were sought, the Minister said the following:

Austin Mitchell: To ask the Secretary of State for Trade and Industry, what action (a) he and (b) the recognised professional bodies have taken against the insolvency practitioners whose malpractices were highlighted in Channel 4's Dispatches programme broadcast on 19th June 1996.

Dr. Kim Howells: The relevant Recognised Professional bodies were made aware of the programme at the time and I have no reason to doubt that any matters arising which related to the conduct of authorised insolvency practitioners would have been fully and thoroughly investigated by the bodies concerned

Source: Hansard, House of Commons Debates, 20 June 2000.

We are not aware of any regulatory action against any of the insolvency practitioners whose questionable practices featured on the TV programme. We have been unable to secure any report showing that any of the RPBs took any action. The public gloss on the failures of the regulatory system is that

“We have, in Britain, one of the best ways of regulating the insolvency profession, but there are grounds for improvement”

Source: The Minister for Competition and Consumer Affairs, Hansard, House of Commons Debates, 15 Jul 1997, col. 306.

Against the above background, a Working Party, the Insolvency Regulation Working Party (IRWP), was formed to examine the regulation of the insolvency industry (IRWP, 1997). The IRWP consisted entirely of the representatives of the insolvency industry. It had no representation from any consumer or stakeholder group. The IRWP met behind closed doors and its minutes are not publicly available. It did not hold any ‘open’ hearings. Thus its beliefs and value systems could not be challenged. It invited public submissions, but only five were received from what the IRWP describes as the “Public”. Most came from the insolvency industry and its representatives. In any case the submissions probably enabled the IRWP to legitimise its views by dressing them up in the garb of public consultation. In the final analysis, they probably made little difference to the December 1997 interim report (IRWP, 1997).

The report claims to scrutinise the first ten years of regulation. In fact, it is

remarkable for a whole series of omissions (Sikka, 1998). The IRWP claims that the present mode of regulation works well. But no evidence is provided. There are no statistics about the number of insolvency practitioners and the domination of the industry by major accountancy firms. There are no statistics about the number and nature of complaints, or the time taken to investigate and how the complaints have been resolved. There is no information about the penalties that might have been imposed upon those disciplined, whether working for small, medium or large firms. There is no information about the performance of the insolvency industry e.g. the number of jobs that might have been saved or lost. There are no case studies of any large or small insolvencies to show the kind of problems which the regulatory processes manage. Inevitably, its final report (IRWP, 1999) was a whitewash and protected the privileges of the insolvency industry.

The IRWP's wanted to retain the present regulatory structures and opposed the need for a single independent regulator to replace the eight overlapping regulators for 1,800 insolvency practitioners (see Sikka, 1999 for further details). In addition, the IRWP recommended the formation of yet another self-regulatory quango. Its proposals included the formation of an umbrella body, the Insolvency Practices Council (IPC), to oversee the eight regulatory bodies. The IPC will consist of six lay members and three insolvency practitioners. It will, however, be a toothless tiger unable to intervene in any specific or live case. It will be able to make general observations and recommendations, but “will have no regulatory responsibilities” (Letter from the Minister for Corporate and Consumer Affairs, dated 21 October 1999). The present regulatory bodies (the RPBs) will retain all their licensing and monitoring powers, pretending that they can combine their trade associations and regulatory functions. The financing for the IPC will come from a newly formed “Foundation”, which will raise money from City interests. Big business is not in the habit of giving away money without some strings. Interestingly, the IRWP does not recommend ‘sunshine’ for the IPC or the Recognised Professional Bodies (RPBs). What will flourish behind closed doors?

The IRWP rejected the call for the creation of an ‘independent stakeholder body’ for regulation of the industry by describing it as “impractical” and something which would “obscure ministerial accountability” (IRWP, 1999, page 50). Little analysis or argument is provided. On the contrary, the Ministerial accountability is confused in the current system of regulation. Ministers play pass-the-parcel rather than accept responsibility. In theory, the insolvency processes and the activities of the insolvency practitioners can be the subjects of judicial reviews. But in practice, millions of individuals are unable to get any access to courts and legal aid. They certainly cannot afford to

pursue insolvency practitioners through the courts. They need an alternative means of securing reviews, justice and redress. The situation is crying out for an independent ombudsman. However, the IRWP opposed the need for an 'independent ombudsman', an 'independent complaints' system or a compensation scheme.

The Labour Party's business manifesto for the 1997 general election promised to introduce 'independent regulation' for the insolvency industry. However, the government has since negated this by accepting all the proposals made by the IRWP.

Austin Mitchell (Great Grimsby): To ask the Secretary of State for Trade and Industry, what proposals he has to replace the present regulators of the insolvency business with a single independent regulator.

Dr. Kim Howells: I have no such proposals

Source: Hansard, House of Commons Debates, 28 April 1999, col. 199.

Thus, unlike the water, railways, food, electricity, gas, telecommunications, financial services and other sectors, the insolvency industry is not to have an independent regulator, ombudsman compensation scheme or a complaints system. The RPBs, the IPC and the insolvency practitioners will not owe a 'duty of care' to the individuals directly affected by their conduct.

In a previous incarnation at the Treasury, Stephen Byers, the Secretary of State for Trade & Industry announced that

“The Financial Services and Markets Bill will, by creating a single regulator with a single authorisation process, a single compensation scheme, a single ombudsman, and a single appeals tribunal, reduce the amount of regulation whilst at the same time provide for greater accountability”

Source: Treasury Press Release, dated 26 November 1998

The same principles should be applicable to the insolvency industry.

REFORMS

- The insolvency industry needs urgent reform. The ideal position would be to

delegate the whole conduct of the insolvency processes to an independent non-profit making organisation. The profit motive is responsible for a large number of abuses by insolvency practitioners, but such solutions are likely to be opposed by some on ideological grounds. Therefore, second-best solutions need to be considered.

- At the very least, all aspects of the insolvency industry need to be regulated by a regulator, an Insolvency Commission, that is independent of the insolvency industry and its trade associations. The membership of the Commission shall represent a plurality of interests. It shall not be under the control of the insolvency industry or its trade associations.
- The membership of the Commission can be nominated by the Secretary of State for Trade & Industry. The criteria for making such appointments should be publicly announced. All appointments would need to be ratified by the House of Commons' Trade & Industry Select Committee.
- An independent complaints investigation system and an independent ombudsman with powers to hear and investigate complaints should also accompany the Insolvency Commission. Of course, the parties affected could still seek judicial reviews should they so wish.
- The Insolvency Commission should also have powers³⁰ to appoint public limited company (PLC) administrators, receivers and liquidators. It should monitor their performance, value for money, assess reasonableness of fees and develop protocols for major international receiverships.
- The Insolvency Commission should have no responsibility for promoting and advancing the interests of the insolvency industry. All its meetings shall be open to the public.
- The Insolvency Commission should advance and defend stakeholder interests. It would be responsible for drawing up and revising insolvency regulations by establishing committees to undertake this work. Its members could be seconded from diverse constituencies (including insolvency practitioners) to undertake this work. The formulation of all rules and regulations shall be preceded by full consultation, inter alia discussion documents, draft documents, public hearings etc.

³⁰ For further details see Mitchell, A. and Sikka, P., *Corporate Governance Matters*, London, Fabian Society, 1996.

- The Insolvency Commission should be responsible for monitoring all licensees. It will have powers to publicly name and shame persons/firms with a poor record. Any practitioner criticised will be required to publicly state the steps that s/he is taking to remedy the problems highlighted by the regulator.
- The Commission should have full powers and resources to investigate the overall standards of any licensed person/firm to enable it to determine whether the person/firm is 'fit and proper' to undertake insolvency work.
- The regulator would have the right to expand the supply of insolvency practitioners by inviting, subject to suitable safeguards, additional players to enter the insolvency jurisdiction.
- The Commission should be able to suspend/withdraw licences and levy unlimited fines for non-compliance with its rules. It can also mount civil and criminal proceedings where necessary.
- It should have a statutory right of access to any document, record and notes held by insolvency practitioners to enable it to determine whether the licensee is a fit and proper person. It shall also have a statutory right of information and explanation from any person involved with the conduct of the insolvency under investigation. Anyone who knowingly or recklessly misleads the regulator shall be deemed to have committed a civil and/or criminal offence.
- The Insolvency Commission should fully co-operate with other regulators (e.g. the Inland Revenue, the Financial Services Authority) and exchange information in its possession. It will also develop policies and procedures that will give nominees of stakeholders a statutory right to examine the relevant files and papers of the insolvency practitioner.
- All insolvency practitioners should owe a 'duty of care' to individual stakeholders. To help insolvency practitioners to resolve insolvencies quickly, the Commission would need powers to secure files held by external auditors so that corporate structures and asset/liability details can be quickly learnt, thus speeding up the delays in tracing assets and corporate structures.
- All licensees would be required to publish meaningful information about their affairs. This could include matters such as fee income, the time taken

to complete receiverships, details of competitive tenders received for the sale of assets and businesses in receivership, what percentage of assets realised were swallowed up in fees and the number of jobs lost/rescued.

- The US style Chapter 11 legislation has much to commend it. The troubled company, under the protection of the courts, should have some 90 days³¹ to restructure itself before any receiver or liquidator is appointed.
- Steps should be taken to prevent banks from easily pulling the financial plug. In return for nursing a company through troubled times, they should be persuaded to accept equity. As all wealth generation is dependent upon the co-operation of various providers of finance and human and social capital, there is little reason why the banks should continue to enjoy a priority charge on business assets.
- Reporting accountants should not be allowed to act as receivers for a business where they have acted as reporting accountants. No doubt, some would object to this separation on economic grounds, but there are also costs associated with not separating these tasks.
- The Insolvency Commission would be financed through a number of ways. Rather than the licensing fees being disbursed over eight regulatory bodies and their numerous overlapping structures, the fees would go solely to the Insolvency Commission. The sale of literature (e.g. insolvency regulation), donations, and contributions from general taxation and levies could supplement this. For example, the cost of registering businesses and filing the annual accounts and returns for major companies could be increased.

The above proposals may not eliminate all the abuses prevalent in the insolvency industry, but they do provide a framework for creating a proper institutional structures that are concerned with advancing and defending the interests of the stakeholders.

THE ACTION TO TAKE

We also urge the stakeholders to exercise their democratic rights and take the following action.

³¹ The Draft Insolvency Bill is proposing a 28 day moratorium, (extendible to two months if creditors agree) for small companies wanting to implement a Creditors' Voluntary Arrangement (CVA).

- Refer all insolvency abuses to your local Member of Parliament and insist that the MP refers the matter to the DTI and the RPBs. In addition, urge your MP to call an Adjournment Debate in the House of Commons. This way, the abuses of the insolvency industry can be given higher visibility.
- At general elections, ask the candidates to publicly support the need for 'independent regulation' for the insolvency industry. Only vote for the candidates supporting independent regulation. If they are elected, ask them to honour their pledges.
- Write to Ministers, including the Prime Minister, urging an end to the present state of affairs. Tell them how the insolvency practices, insolvency practitioners and the role of the banks has affected you, your family and your community.
- Form pressure groups and organise campaigns to promote stakeholder protection. Exchange views via newsletters and web sites.
- Organise campaigns to highlight insolvent abuse by insolvency practitioners. Brief newspaper journalists, television and radio programmers to expose insolvent abuse. Demonstrate outside the offices of insolvency practitioners, insolvency regulators and the DTI to give visibility to your concerns.

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