Business Rescue Case Studies

Featuring case studies from Mercer & Hole:

• Technology Company Rescue
• Insolvent Company Rescue
• Charity Rescue
• Cross Border Insolvency Rescue
• Rescuing businesses within a group
Technology Company Rescue – a case study

Two directors who sought timely advice ran a company with an exclusive licence to use a software package in the premium finance industry. Over a period of time, the company had invested a large amount of money in adapting and enhancing the software, to the extent that the only significant asset on its balance sheet was its intellectual property rights. The problem was a common one for startups: the company’s customer base had not grown sufficiently to support the operating costs and its investment funding was running out.

We were instructed several weeks before the company’s cash reserves were exhausted to assist the directors by advising them on the company’s solvency position and on their duties in the circumstances, whilst they continued in their efforts to find additional funding.

When it became apparent that none of their proposed funding deals would complete, we formulated an orderly wind down plan. This provided sufficient cash resources to allow the company to continue to trade under the protection of administration.

The purpose of the administration was to rescue the company as a going concern. Through reducing costs to a minimum we gave ourselves a year of continued trading, demonstrating the value of the company’s offering. We also avoided crystallisation of £millions of contingent liabilities by meeting the company’s contractual obligations. In due course an extensive global marketing strategy was implemented and a number of parties expressed an interest in the software. One of these developed into a firm commitment to acquire the business. We negotiated an offer providing an enhanced return to the company’s creditors, and also the prospect of a future return to the company’s existing shareholders. Once we had implemented a mechanism to safeguard their future interests and the shareholders had agreed to sell their individual shares, we were able to present a Company Voluntary Arrangement (CVA) proposal to the creditors, with a view to exiting the administration.

Approval of the CVA resulted in the sale of the company’s shares to the third party investor, a significant one off contribution into the CVA and the establishment of a trust so that creditors and existing shareholders could benefit from the profitability of the company going forward.

Dealing with companies that are running out of cash presents a variety of challenges, as illustrated in our case study.

The most important step to be taken is seeking specialist advice early. Directors should bear in mind their responsibilities and duties to employees, creditors and shareholders as well as their own personal positions.

If you would like us to provide you with any help, guidance or assistance in dealing with a company that is running out of cash, then please contact us on 020 7236 2601.
When a company has value that would be lost if it were wound up, preserving that value may be possible, even if a winding up petition has been presented.

A Company Voluntary Arrangement (CVA) or administration may be required, but these can both be temporary procedures. They can allow a company to emerge with value remaining in its business and assets. Crucially, agreement will need to be reached with creditors for this approach to work. If there is really no prospect of creditors supporting a proposal despite the loss of value that liquidation would entail, forced sale asset realisation and complete loss of shareholder value may be difficult to avoid.

A company that can be made profitable and cash generating when relieved of its debt burden may well benefit from a CVA. If creditor pressure is severe – but negotiable – the CVA may need to be preceded by administration. In such circumstances the purpose of the administration is to gain protection from individual creditor actions with a view to having the company continue as a going concern. The exit route from administration would be through the CVA.

If a winding up petition has already been presented, the administration may need to be opened by a secured creditor (if there is one with a qualifying floating charge) or by an application to court. Either way it may not be too late to save the company if the situation is addressed quickly.

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In this example, we successfully arranged an administration and a CVA for a company that a creditor was petitioning the court to wind up. The result was that the company survived and is now trading normally.

The directors of the FCA (previously the FSA) registered company had been trying to defend a winding up petition, but saw they could not put off the petitioning creditor any longer. When they contacted Mercer & Hole we identified that they should seek to use the moratorium provided by putting the company into administration to protect the value of the company’s business and assets.

The company had only very limited tangible assets, a few unlisted shares and some potential income under informal agreements. Its valuable asset was its FCA registration.

We established an administration strategy to rescue the company as a going concern through a CVA. One of the directors was interested in refinancing the company and anticipated being able to negotiate with sufficient creditors to persuade them to accept a CVA proposal. Given the apparent depth of the company’s insolvency, this appeared ambitious, but it was the only way to generate sensible realisations from the company’s assets. The FCA registration could not be transferred and would only have value to the company itself. Any exit mechanism from administration other than a CVA would lose the value of the principal asset.

In order to preserve the registration, it was necessary for the company’s registered activity to continue and, by using the directors’ knowledge and experience and by subcontracting operations to a related company, we were able to undertake sufficient activity to satisfy the FCA. Naturally, a good deal of work went into ensuring compliance with FCA regulations, but it did eventually pay off as the business generated a modest income and we were successful in retaining the FCA registration.

It became necessary to raise further funds by selling the company’s residual assets (again to the director’s related companies) and this was done with the specific agreement of the creditors’ committee. They recognised that any strategy other than seeking to maintain and extract value from the company’s FCA registration would lead to there being no return at all to creditors.

The negotiations to persuade creditors to accept the CVA proposals were protracted and the administration lasted almost two years. Finally, we paid a lump sum to those creditors who were not prepared to exchange their claims for equity.

The key to this successful rescue was the director’s ability to persuade a sufficient majority of creditors to accept a CVA proposal. This is the basis of any CVA, but in this case the negotiations were facilitated by the administration moratorium. It prevented certain initially aggrieved creditors from taking action against the company. Two years was a long breathing space during which the company was restructured financially, however the company has now concluded its CVA and is trading normally once again.

If you would like us to provide you with any help, guidance or assistance in dealing with a winding up petition, please contact us on 020 7236 2601.
Difficult financial conditions, less available sector funding and falling personal incomes mean that charities can expect more turbulent and challenging times ahead.

A survey carried out by the National Council for Voluntary Organisations suggested that the ‘perfect storm’ that has hit charities (falling income, higher costs, higher levels of demand from beneficiaries) is still a real issue. The majority of organisations have seen their financial position worsen and expect it to get even worse over the next year; and almost all still think the economic conditions facing charities will be negative for the next twelve months. Despite this, the survey found signs of some confidence in that charities expect to maintain or increase the services they provide despite decreasing or static expenditure.

Charities who have prepared for these ongoing tough economic conditions and have acted decisively may find themselves better placed to weather the storm. Unfortunately, however, despite cutting jobs and costs there will still be charities facing insolvency. In an insolvent situation it becomes the responsibility of the trustees to put the interests of creditors ahead of the charity itself and seek professional advice, most likely from an Insolvency Practitioner.

We give a recent example of an innovative solution utilised by the restructuring and insolvency team at Mercer & Hole to rescue a charity and avoid disruption for 300 vulnerable people.

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**Charity Rescue – a case study**

The charity was already being turned around.

A variety of issues had been addressed, not least those relating to financial information and cost management. There was even a fall-back plan, but the trustees were still concerned about the risks of insolvency. Rightly so as it happened.

Substantial ongoing losses on one major contract were the biggest threat: the charity had underpriced its services. Then the takeover bidder withdrew. Mercer & Hole’s first workstream, a solvency analysis for the board, established that without the takeover safety net there was no reasonable prospect of avoiding formal insolvency.

So far this is not an uncommon distressed business scenario, but let’s consider the specific and sometimes unusual features of the case. As a charity, the entity was not untypical in having a wholly non-executive board (the trustees), but both the CEO and the Finance Director worked part time. Also this was not a registered charity or a company registered under the Companies Act: it was an Industrial and Provident Society, giving a very different legal framework for restructuring and insolvency.

Critically, the Industrial and Provident Societies Act 1965 and related legislation makes no provision for the members to meet or act on short notice unless specifically allowed by the society’s rules, which in this case required a minimum of 14 clear days’ notice for a members’ resolution. Also, and most significantly, only those parts of the Insolvency Act relating to liquidation apply to an Industrial and Provident Society. So, there could be no CVA or administration rescue here¹, and there were no charges enabling the appointment of a receiver and manager.

Now for some statistics. The charity was turning over £11m p.a., employing almost 400 staff to provide care to over 300 vulnerable people in over 40 various residential settings in five local authority areas. Its net liabilities of £1m and the ongoing losses of £4m p.a. would be dwarfed by the contingent claims crystallising on abrupt cessation of activity.

A smooth – and swift – transition to alternative care provision for the vulnerable people being cared for, often 24/7, was vital. And, of course, the reputational risk attaching to all those involved in maintaining (or not) such care heightened anxiety. Fortunately, therein lay part of the solution. The care service was in essence an outsourced statutory responsibility of the local authorities. Not only did they share the reputational risk but, given the charity’s insolvency, they bore much of the financial risk in the event of its failure.

Against that backdrop we advised the trustees to implement a three-pronged strategy. Stakeholder management was central, both to maintain stability during the crisis and to bring together the participants who would at least avoid care disruption, if not save the charity. There also needed to be a mechanism for formal insolvency. And finally, we conceived a bold plan to go back into the market to seek to sell the society, as a whole entity, in the days before liquidation, failing which we would at least give ourselves a head start on liquidating the assets.

At this stage, our best guess as to outcome was some form of partial pre-pack liquidation, but let’s look at the three aspects of strategy separately.

The constitutional challenges outlined above, together with the urgency the situation demanded, meant that a Creditors’ Voluntary Liquidation (possibly using the accelerated Centrebind procedure) was not an option: we could not wait for the 14 clear days’ notice required before passing a members’ resolution. The board could however petition the court to wind up the charity compulsorily. We thought we should be able to persuade the court to appoint provisional liquidators immediately to effect an appropriate transaction, all with a view to maintaining care services through the charity or otherwise.
and thereby maximising the potential return to creditors. Fortunately, counsel agreed and the applications were prepared. Having identified a fairly abrupt insolvency mechanism, of which we were in control (not least because the provisional liquidators’ powers were likely to be – only – what we applied for), we were well placed to start dangling stakeholders over the insolvency precipice, in the nicest possible way. We just didn’t have time for protracted debate. People had to realise that there had to be a quick solution.

One particular challenge we faced was that the charity and the local authority with the loss-making contract had such a poor relationship that there was no meaningful high level communication between them. To break the impasse we used a PR house and had a journalist contact the authority, whilst the charity set out its position in writing, emailed and hand delivered to all the relevant councillors and local MPs, explaining what was required. It worked and within 48 hours we were meeting with the local authority’s Deputy Chief Executive, engaging in constructive planning and determining what the art of the possible was in the challenging circumstances they had to address.

The accelerated M&A play was attractive to the local authorities because it offered a glimpse of the solution that would involve them in least pain. They were very keen to introduce their other service providers, generating a total of 25 expressions of interest, that were narrowed down within a week to a handful of bids for all or part.

At this stage the stakeholder management proved its worth as we were able to persuade two of the major local authorities to be sufficiently concessionary to the final bidder to enable the risks inherent in the acquisition of an insolvent and loss-making entity to be mitigated sufficiently to meet the bidder’s strategic objectives.

The result was that within three weeks and with absolutely no disruption to the 300 vulnerable people and their carers, the charity’s shares were sold for £1 and it continues under new ownership and management. Formal insolvency proceedings were not necessary, although they were less than 48 hours away at one point. Managing the stakeholders was crucial, but so too was a well prepared insolvency plan and the ability to promote and execute an accelerated distressed M&A transaction.

1. If we’d been in Northern Ireland, the relevant secondary legislation has been introduced to allow administrations and CVA’s, but not yet elsewhere in the UK!
Cross border insolvency solutions

Financial distress can often be overcome, but the challenges it presents when a company operates in more than one country multiply rapidly. Although it is common for businesses to establish local companies to operate in other jurisdictions, there are many situations where companies operate abroad through branches.

The obvious restructuring issue is the interaction of different countries’ insolvency laws on the company. Although in principle most countries have an insolvency system designed to maximise returns to creditors from the value in the company, the detail of the way this is done varies hugely.

Within Europe there is a European Insolvency Regulation designed to facilitate co-operation between insolvency regimes in such circumstances. Using such European legislation in conjunction with local insolvency law and practice is one of Mercer & Hole’s particular skills.

Cross border insolvencies are not uncommon. Sometimes there is – as in any case of financial distress – an opportunity to rescue the company. Many jurisdictions have pre-insolvency procedures or practices to facilitate turnaround and rescue even when a company has run out of cash and has a balance sheet deficiency. As ever, the key is for such businesses to seek early professional advice.

However, not all restructuring and insolvency work involves rescue and sometimes we simply concentrate on achieving the best possible result for creditors in the circumstances. The case study on page 7 illustrates the interaction of European and local legislation and our role in protecting the interests of creditors, including local employees, using formal insolvency proceedings.
Acting in creditors’ interests – a case study

A German company, with branch operations in five other European countries including the UK, went into formal insolvency proceedings in Germany. There had been unsuccessful attempts to refinance and turn the company around and the situation faced by the German administrator was extremely difficult, with almost no cash available and few readily realisable assets to fund the proceedings.

We were contacted to deal with the English assets – a factory employing some 70 people, who had not been paid for 2 months and were not actually working as no raw materials were being supplied.

The German administrator saw a prospect of selling the international business as a whole and we were therefore appointed administrators both to facilitate a sale of the English operation as a “gone concern” if necessary and in particular to deal urgently with the employees. They were in limbo as the German management had not terminated their contracts although they were not working and were not being paid. Indeed, the employees’ situation was sufficiently dire to be the subject of parliamentary discussion and of interest to various MEPs.

The urgent and unusual application to the English court by the German administrator was something we were able to facilitate and within 24 hours the employees were able at least to apply for state benefits.

In the longer term we were able, through cooperation with administrators in other jurisdictions, to facilitate the employees’ preferential claims against the company being met in the parallel Italian proceedings.

There was in fact no serious interest in the acquisition of the company’s operations as a whole and although we negotiated a settlement with the secured creditor, realisations from the English assets were insufficient to permit any distribution to creditors. However, we were subsequently appointed as liquidators in order to agree the claims of English creditors so that, in due course, they would be able to receive a distribution from the other estates. The current situation is that there may well be distributions made by insolvency officeholders in some other jurisdictions, but the likely quantum remains uncertain.

Without using the provisions of the European Insolvency Regulation it would not have been possible quickly to address the desperately difficult position of the unpaid employees. What we were also able to achieve was to put the creditors (particularly the English creditors) into the best position possible to allow them to share in any distribution from the company’s insolvency in due course.

Specialist advice is essential if you are faced with cross border insolvency. Chris Laughton, who heads our international insolvency services, is a leading practitioner in this field and is a past president of INSOL Europe.

If you would like us to provide you with any help, guidance or assistance in dealing with a cross border insolvency please contact us on 020 7236 2601.
Rescuing businesses within a group – can be a challenge

Mercer & Hole were contacted for advice by the directors of a group of companies that provided various learning support, training and work experience services throughout the northern Home Counties. The group included two not-for-profit companies, two commercial companies (one of which was a joint venture with a third party), and a not-for-profit holding company.

The original company had been spun off from a local authority in 1995 and had initially traded successfully. In recent years it had suffered a number of setbacks, which had resulted in a significant restructuring exercise downsizing both staff and premises. Withdrawal of major contracts and subsidies had meant that cash reserves were depleted trying to get the company back on an even keel. The group development plan had included the acquisition of complementary commercial entities which could distribute their profits to the holding company in order to support the not-for-profit operations. This allowed continuing negotiation with the local authority in relation to an on-balance sheet pension liability which had been transferred out of the local authority with the employees in 1995 and resulted in the principal not-for-profit company and the group showing a seven figure balance sheet deficit. The directors had become increasingly concerned by the continued run on cash reserves, the under performance of the commercial entities and the inability to remove the pension deficit from the balance sheet and had been negotiating with a third party to purchase the company’s business to take it forward.

When no purchaser could be identified who could act quickly enough, the directors needed advice about insolvency and whether the company, or parts of the company, could be rescued. It was clear from the outset of our involvement that the company was extremely distressed and did not have sufficient funds to meet salary requirements at the end of the month. However, there were a number of workstreams that had the potential to be profitable if they could be extracted from the company and the group without significant investment. It also quickly became clear that balanced with the responsibility to the company’s creditors was a responsibility to other stakeholders that might not necessarily arise in a ‘for profit’ insolvency estate. Most notable was a group of vulnerable young adults to whom the company had provided learning support.

We quickly set to work to review the available financial and operational information, to split out the operations of the different entities, and to make sure that if the main not-for-profit company did go into an insolvency process the impact on the rest of the group could be minimised. During our review exercise the search for third party purchasers continued and significant interest was generated in the company. However, potential purchasers could not overcome, in the time available, the risk of the pension liability transferring with the purchase of the business.
With no cash and no realistic prospect of a sale, the directors were forced to make staff redundant and place the company into liquidation. The work we had undertaken to minimise the impact on the group meant that other group companies could continue to trade and support for the vulnerable young adults could be transferred to a third party. The interplay between ensuring support for such a stakeholder group and maximising realisations in the estate for creditors was a fine and complicated balance. While the young adults were supported and responsibility for provision of their learning needs was transferred to a third party, as liquidators, we could not simply give away the intellectual property developed by the company over many years of running the teaching programme. This balance can be challenging when dealing with companies in the not-for-profit sector and can even play on the emotions of the most thick skinned insolvency practitioner!

Further workstreams that could be separated were identified and, where possible, sold. In particular, the schools’ student work experience workstream was sold to a local authority following a negotiation which saw a final sale price some five times greater than the initial bid. As well as generating a significant return to the estate, the sale also meant that, despite some initial disruption, it would be possible for the schools to attain the work experience places they required. A further significant result of our strategy was the repayment of the secured creditor in full and generation of a surplus from the book debts which was paid into the liquidation estate.

An additional asset of the liquidated company was a debt due from the group’s parent company. The parent company’s only assets were its holdings in subsidiary companies, which themselves had been significantly affected by the group’s plight. The parent company was also liquidated and the disposal of the subsidiaries was assessed in order to try and preserve some value for the parent company’s insolvent estate. It was also important to separate the other subsidiaries from the group, in order to give them the opportunity to survive, continue to trade as a going concern, and therefore preserve both employment and the provision of services. The disposal of the subsidiaries has generated a return to the parent’s insolvent estate, which may allow a distribution to the parent’s unsecured creditors.

Advising and restructuring a non-performing group with a seven figure pension deficit, no cash and no material assets, through continued trading of three of the five group entities, whilst protecting the services for the most vulnerable group of stakeholders and restructuring the group’s businesses – using liquidation where appropriate - has proved both challenging and rewarding in equal measure.

The Restructuring & Insolvency team at Mercer & Hole has extensive experience in advising directors on their responsibilities and duties, particularly if there are concerns as regards the financial viability of the business.
Whether you are a business or charity, an individual or representing your family in seeking assistance, the Partners of Mercer & Hole can help you with much more than standard accountancy or tax compliance. We take the time to understand our clients’ current situations and their future aspirations, and we aim to provide a very personal service tailored to their specific requirements. We achieve the highest standards of technical excellence, but what we believe singles us out is our passion and determination to exceed our clients’ expectations.

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This newsletter will give you an insight into the firm and you can find out much more by visiting our website at www.mercerhole.co.uk. The site includes full details of the services we offer, and also provides visitors the opportunity to subscribe to our blogs, which offer regularly updated comments and solutions to topical issues facing organisations and individuals.

About Mercer & Hole

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