AUDIT & STANDARDS COMMITTEE	Agenda Item 50 Brighton & Hove City Council

Subject:		**Cash Collection - Company Administration Update**		
Date of Meeting:		**8 January 2019**		
Report of:		**Executive Director, Finance & Resources**		
Contact Officer:	**Name:**	**Nigel Manvell**	**Tel:**	**29-3104**
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Ward(s) affected:		**All**		

FOR GENERAL RELEASE

1 SUMMARY AND POLICY CONTEXT:

1.1 Previous reports regarding the insolvency of the council's former security carrier provider, Coin Co International Plc (CCI), advised that updates would be given to the Audit & Standards Committee regarding the progress of the Company Administration process as appropriate. CCI went into administration in November 2014 and this report provides a further update following the ending of the company administration process and publication of the Administrators' final report. It also covers the next stage of the process and the council's options.

2 RECOMMENDATIONS:

2.1 That the Audit & Standards Committee note the report.

3 CONTEXT/BACKGROUND INFORMATION

Brief Synopsis (as previously reported):

3.1 In 2014, the council's contractor for providing cash collection services, Coin Co International Plc ('CCI'), entered into administration owing the council £3.243m. The company, locally based in Burgess Hill, had been in operation for over 30 years and had been the council's security carrier provider for over 5 years from 2008. CCI's contract required payment-over of cash and coin collected from many council establishments and parking machines within 10 banking days.

3.2 A number of delays in payments over to the council were experienced in 2012/13 and CCI were accordingly requested to improve performance. CCI notified the council that they had changed banks and were experiencing processing difficulties with a new system. However, delays lengthened to an unacceptable level in early 2014 and the council again took steps with the contractor to improve performance.

3.3 Requested improvements included clearing payment backlogs quickly and demanding payment over of all sums owing to the council within an agreed period. Backlog payments were made and received on arrangement for a short period but then performance and payment delays again became unacceptable. CCI advised that these delays were related to short term cash flow issues caused by continuing banking issues, a dispute with a creditor, and a substantial outstanding VAT claim. These were not accepted by the council and, following formal legal exchanges, CCI were given notice with the contract terminating in August 2014.

3.4 The council continued to seek recovery of all sums owing at the point of termination but CCI subsequently went into administration in November 2014 owing the council £3.243m and a total of over £10m to all creditors. It is now clear that during 2014 other smaller creditors had also given notice, presumably due to similar performance concerns, and this ultimately resulted in the company's insolvency.

3.5 During the period of performance concerns there were constant communications between officers and the company's directors, including site visits. Following termination of the contract, the council (and other major creditors) instructed CCI to provide them with independent reports concerning its financial health and its processing operations and seeking assurances over the recovery of sums owing. The report provided to the council gave a negative outlook and very shortly afterward, CCI went into administration.

3.6 The provider was collecting between £200,000 and £300,000 per week and therefore sums collected built up quickly and the security carrier would therefore legitimately be holding between £400,000 and £600,000, under the terms of the contract, before payment over to the council. Security Carrier contractors operate in this way because they are handling cash for many organisations and can negotiate very favourable banking terms as well as providing trained and accredited security staff, appropriately modified vehicles and secure bullion facilities and premises (in CCI's case, based in Burgess Hill). The terms of the contract with CCI were therefore in common with most security carrier contracts for large public or private sector clients.

3.7 Following insolvency, insolvency practitioners from Baker Tilley Restructuring & Recovery LLP were appointed Administrators (now renamed RSM Restructuring Advisory LLP) and their initial report into the CCI insolvency (June 2015) did not provide unsecured creditors with any assurance that significant sums would be realisable on their behalf. The implications of CCI's insolvency were therefore reported to Policy & Resources Committee in June 2015 (TBM Provisional Outturn 2014/15, Agenda Item 8) and the committee were advised that under the council's approved accounting policies, full provision for the potential loss would need to be made in the 2014/15 accounts. This was a one-off provision of £3.243m which the council was able to meet through prudential financial management without any direct impact on council services or earmarked reserves.

End of Company Administration – Final Report:

3.8 The company administration process was extended many times by the courts upon application from the Administrators. This was to allow them to continue attempted recoveries abroad, particularly Australia and Tunisia, and to take legal action against the directors. Having concluded these actions as far as possible, no further extension has been applied for and the company administration process concluded on 25 November 2018. The Administrators filed their final report on 15 November 2018.

3.9 Incorporating all previous updates, the overall summary of actions taken and recoveries made by the Administrators over the 4-year period 27 November 2014 to 15 November 2018 were as follows:

i) In accordance with their statutory obligations, the Administrators filed the appropriate documentation with the Department for Business, Energy and Industrial Strategy ("the Department") in relation to the conduct of the directors of CCI. The Secretary of State duly accepted disqualification

undertakings from John Francis Baker, Doreen May Baker, Sean Douglas Baker and Joanne Samantha Baker for periods of 8 years each. This disqualified them from being directors of companies as of 3 May 2018.

ii) The Administrators also took up legal proceedings for breach of duty against the Directors of the company and achieved a settlement of £0.550m. The detailed grounds for this legal action are not known and are not disclosable.

iii) The Administrators made a number of recoveries of stocks and cash as well as selling CCI's premises. These realised a total of £2.080m.

iv) However, after taking into account the cost of bringing about the actions and realisations above, including legal fees, settlement of VAT and other liabilities and the Administrator's costs, there remained insufficient net realisations to meet the sums owing to the secured creditor, Santander UK Plc. The secured creditor was owed £1.628million but has received £1.296m in settlement to date.

v) The Administrators undertook a number of investigations relating to CCI's accounts and operations. Although the information provided in their reports is limited, in summary they found evidence that the company appeared to have utilised clients' cash to manage the cash flows of the business enabling it to continuing trading while making losses. Having analysed their accounts and bank statements, the Administrators' evidence indicates that CCI's business model (contract pricing) was flawed and that this is the principle reason, rather than any detected fraud, as to why it eventually became insolvent and was probably trading at a loss for some time prior to entering into administration.

3.10 The Administrators' final report confirms, as they have throughout, that it is uncertain that there will be sufficient asset realisations (after the costs of the administration) to enable a distribution to unsecured creditors of which the council is the largest among many others. In particular, it should be noted that the Secured Creditor is still owed £0.333m and the Administrators have unpaid costs of at least £0.270m.

Company Voluntary Liquidation

3.11 With the ending of the administration period, the Company was placed into Creditors Voluntary Liquidation on 30 November 2018, with the current Administrators being appointed Liquidators (by default). Prior to this, the Administrators had indicated that their intention was to convene a meeting of creditors so that the creditors could consider a replacement liquidator.

4 ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 Administration and Company Voluntary Liquidation (CVL) are both legal processes covered by the Insolvency Act 1986. A CVL is used to bring a business to an end by appointing a liquidator (who must be a licensed insolvency practitioner) to liquidate the company's assets (if any) and distribute them between the company's creditors following set rules. The Administrators' reports show that all the Company's assets which are likely to be realisable have now been realised. This process has taken an unusually long time due to legal complexities and recoveries being attempted from other countries, with the Administration period having been extended to cover a period of 4 years in total.

4.2 However, there are potential options for liquidators to consider, if desired, in terms of pursuing claims against the directors and/or attempting other potential

recoveries as part of company liquidation but none are without considerable risk. In this respect, at its meeting on 24 July 2018 the committee approved the following recommendation: 'That the Committee support bringing a claim by the council against the Directors of CCI for wrongful trading, and/or their auditors once due consideration of the legal and financial risks have been considered by officers.' These options and others are considered and evaluated below.

4.3 Appointment of Alternative Liquidators

The Authority holds over 10% of the unsecured debt by value. The option is open to the Authority to summon a meeting of creditors to seek the appointment of a replacement or alternative liquidator to take up further potential investigations or claims. This would also of course be dependent on any liquidator being willing to take up the case based on the likely success of any claims or recoveries and therefore the likelihood of covering their costs and fees. Potential claims that liquidators could consider are discussed later.

Evaluation: There is a risk that replacing the current liquidators would result in a significant loss of knowledge and understanding of how the Company's business operated and the steps taken to attempt recoveries while the Company was in administration. Funding is also an issue as an incoming liquidator will be aware of the former Administrators' outstanding fees and would be unlikely to take the appointment as Liquidator unless they were confident their fees would be covered. They will be aware of the settlement and other costs already recovered and incurred by the Directors and the impact this is likely to have on further settlement, and as licensed practitioners will be fully aware of concerns about the viability of bringing a successful wrongful trading claim in the courts (see below). In short, no liquidator will take up the appointment without the unsecured creditors underwriting their costs. It is unlikely that the council would be able to secure support from other creditors in this regard (none have requested a creditors meeting to date) and the council may therefore end up carrying all of the risk.

4.4 Claim for Wrongful Trading against the Directors

The Administrators' investigations and evidence indicated that there may be grounds for a claim of wrongful trading to be brought against the directors now the Company is in liquidation. Their reports provided evidence that the Company may have been trading insolvent in 2011 and possibly earlier and suggests that their business model and pricing strategy were flawed. The re-procurement of the contract following CCI's collapse provided some evidence that CCI's pricing was out of step with the market with the re-procured contract coming in at approximately double the price.

Evaluation: There are serious concerns about the chances of success of such a claim. As noted above, the Administrators brought a claim for breach of duty against the former directors which, significantly, may also preclude bringing a claim for wrongful trading. Officers have also been advised that recent decisions in wrongful trading cases have not favoured office holders (i.e. liquidators). As a minimum, this will require counsel's opinion to determine whether or not a claim could even be brought in the first instance. In addition, even if a claim for wrongful trading against the former directors could be successfully brought to bear, there are concerns that they would not have any remaining assets or resources to meet any settlement agreement or judgment. The former directors have already paid £0.550m to the Administrators to settle a breach of duty claim and are understood to have arranged repayment of a loan to a related company in the sum of £0.211m. They are also understood to have defended Disqualification proceedings

against them for a lengthy period which is likely to have resulted in them incurring significant legal costs.

4.5 Claims against the Company's Banker

The Administrators' investigations highlighted that CCI appeared to be misusing clients' cash and using this to supplement business cash flows. Their report identified that in breach of customer contracts one of their bank accounts (the UKCS1 account) that was used to hold customers' cash was depleted by regular transfers from this account into other bank accounts to fund and support the Company's trading activities. This raises the question of whether or not there is a case to be answered by the Company's bankers, Santander UK Plc, regarding the manner in which the Company's bank accounts were allowed to be operated.

Evaluation: It is unclear whether a claim against the Company's bankers relating to the manner in which the Company's office and client bank accounts were operated could be brought. There is also minimal information available to creditors from which to assess the merits of such a claim. Any investigation by an alternate or replacement liquidator would be highly speculative and require considerable funding from the Authority to cover the cost of specialist personnel such as forensic accountants and advice from a leading QC with no obvious prospects of success at this stage. Bringing claims against well-resourced and conversant defendants would carry very significant risks to the Authority and could result in extensive legal costs being incurred reaching well into six figures. Bringing such claims cannot also rule out the possibility of counter-litigation against the council.

4.6 Claims against the Administrators

Similarly, for not pursuing the above line of investigation into the Company's banker, the view may be taken that a claim could be made against the Administrators for loss of opportunity.

Evaluation: The same arguments apply as for 0 above. The Administrators are a large firm of legal and insolvency professionals who will be capable of mounting a strong legal defence even if a claim could be brought.

4.7 Claims against the Company's Auditors

The Administrators' investigations also appeared to identify that amounts owing to creditors were understated in the last published accounts as at 31 December 2012 although they were unable to fully reconcile this. This therefore raises the question of whether or not there may be a claim against the Company's auditors for failing in their duty of care to third parties, in particular, creditors.

Evaluation: To bring a claim against auditors it is necessary to demonstrate that they held a duty of care to the claimant and that they were in breach of their responsibilities and did not exercise professional competence and/or independence with due care. In the case of CCI's accounts, the auditors made the following disclaimer in the Company's December 2012 financial statements:

> *'This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in a Report of the Auditors and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, of for the opinions we have formed.'*

While there is a general audit duty to take reasonable care in carrying out the audit of a company's accounts, the duty is owed to the company in the interests of shareholders as a whole, not to individual shareholders or creditors. It is possible for a special duty of care to exist between an auditor and a third party, such as the council, but it is exceptional. There is recent case law in which it was decided that a clear disclaimer, which met the reasonableness requirements of legislation on unfair contract terms, and the absence of a letter of engagement or fee paid between auditors and the third party (in this case a bank), which had relied on the contents of non-statutory audit reports when lending money to a company, meant that the auditor did not owe a duty of care to the bank. It is therefore very unlikely that the Authority would be able to establish a claim against the company's auditors.

4.8 In all options funding is also an issue for the office holders; the current appointees are carrying a significant level of unpaid fees incurred whilst acting as Administrators and may not have the resources or inclination to incur further costs investigating and pursuing potential avenues of recovery. In addition, they do not have the full support of creditors. Similar considerations will apply to potential replacement liquidators.

4.9 These options have been evaluated with external legal input which mirrors officers concerns about the difficulties of obtaining evidence to evaluate whether there is the basis for a successful claim. The critical issue is the high level of financial risk the council would be required to underwrite in obtaining expert legal opinion and advice and in securing the services of a liquidator in order to pursue very uncertain outcomes. Based on this analysis and the likelihood of losses being compounded, officers could not recommend pursuing further legal action or alternative investigation.

4.10 Members are advised that summary advice has been provided in this Part One report to ensure that Members and the public are aware of all of the options that have been explored and tested. However, further discussion of the legal risks and options is likely to require moving into a Part Two session as further information may not only compromise the council's position but, more importantly, may also compromise other creditors who may be considering their own options.

5 COMMUNITY ENGAGEMENT & CONSULTATION

5.1 No specific consultation has been undertaken in relation to this report.

6 CONCLUSION

6.1 Latest information from the appointed Administrators confirms, as previously, that it remains uncertain that there will be sufficient realisations (after the costs of administration) to enable a distribution to unsecured creditors including the council. This position is not different to the Administrators' previous progress reports and is the position assumed by the council (in 2014/15) for accounting purposes.

6.2 The corollary of the Administrators' findings is that the Company was losing money for a period of years due to a flawed business model and pricing structure. It was able to mask this position for a longer period than normal because it was collecting and dealing in UK and foreign cash and coin from a wide range of clients and was able to utilise this money across its bank accounts to support business cash flows.

6.3 Reports from the Administrators provide evidence that the Company appeared to have been trading while insolvent and that a liquidator could therefore consider

pursuing claims against the directors for wrongful trading. The Authority could also consider bringing claims against the Administrators, the Company's banker or its auditors. In summary, none of these options can be recommended because:

i) The Directors have already paid a settlement of £0.550million and are understood to have repaid a loan and incurred substantial legal costs in defending disqualification. Further recovery of assets from the Directors may therefore be very uncertain.

ii) As a result, the current liquidators, who also have unpaid fees outstanding, are unlikely to invest further resources in pursuing uncertain outcomes.

iii) Similarly, attracting an alternative liquidator is unlikely to be successful without the council substantially underwriting costs due to the uncertainty of recovering their fees.

iv) Bringing claims against the former Administrators and/or the Company's banker is evaluated as very high risk. The ability to bring claims is very uncertain and would need external legal advice. In addition, both are large, well-resourced organisations who would therefore be able to mount strong legal defences. The legal costs to challenge either would be very substantial and therefore present a very high financial risk to the Authority.

v) Bringing claims against the Company's auditors is similarly uncertain and not considered viable.

vi) As an added risk to bringing any claim, the risk of counter-litigation cannot be ruled out.

6.4 In conclusion, as none of the potential actions can be safely recommended, the council should continue to monitor the process of liquidation until the Company is wound up. However, in common with the majority of insolvencies, this is unlikely to result in a dividend for unsecured creditors.

7 FINANCIAL AND OTHER IMPLICATIONS

Financial Implications:

7.1 There are no direct financial implications relating to the report. The financial impact of the CCI insolvency was fully dealt with in 2014/15 as summarised in paragraph 3.7 above.

7.2 As the report highlights, any dividend to unsecured creditors is highly uncertain. The only dividend currently identified relates to the legally defined 'prescribed part' which the Administrators currently estimate to be £58,575. The council would be entitled to receive approximately one third of this.

Finance Officer Consulted: Peter Francis Date: 10/12/18

Legal Implications:

7.3 The limited information currently available to unsecured creditors makes the causes of action referred to above highly speculative at best, bearing considerable risk to the Authority which could result in significant legal costs being incurred.

Lawyer Consulted: Simon Court Date: 11th December 2018

Equalities Implications:

7.4 There are no direct equalities implications arising from this report.

Sustainability Implications:

7.5 There are no direct sustainability implications arising from this report. As noted above, the one-off loss incurred through the insolvency of the Company was accommodated in 2014/15 without recourse to earmarked resources and without impacting directly on the provision of services.

SUPPORTING DOCUMENTATION

Appendices:
None.

Documents in Members' Rooms:
None.

Background Documents
Reports of the Administrators, RSM Restructuring Advisory LLP.