clarke willmott solicitors

Disruptive Asset Finance

Summer 2021

Fast cars, fancy watches and emergency finance

The challenges presented by CBIL's fraud Coronavirus Business Interruption Loan Scheme.

2020 was reportedly the best year for expensive watch sales. Similarly the demand for luxury high end cars also rose dramatically. Why would extravagant purchases of this nature being made in the middle of the pandemic and during an economic crisis? Where has this liquidity come from? Could it result from the abuse of "CBILS"?

CBILS stand for the Coronavirus Business Interruption Loan Scheme. This was a government scheme introduced by the UK Chancellor in March 2020. It led to £20 billion being lent across 80,000 separate facilities. CBILS closed for new applications on 31 March 2021.

CBILS loans may be of varying duration but important characteristics of a CBIL are that the first year of the loan is interest free and the fees for arranging a loan are paid for by the government. An attraction to a CBILS loan was that the banks could not seek any form of security for the first £250,000 lent. Further, a government guarantee is in place for up to 80% of the sums lent (or £50,000 depending on which sum is the greatest).

A common misconception is that CBILS are grants – they are not. A CBIL is a debt which needs to be treated as such by the business. A second misconception is that it is government money when, in fact, it is money advanced by the bank. Government involvement is limited to the payment of the charges and interest due on the loan for the first 12 months and the guarantee. However, the guarantee is only engaged where the loan was advanced under certain conditions and where certain conditions have been complied with regard to any enforcement action if the loan goes into default.

This inevitably leads to a number of very serious problems. There was widespread abuse of the CBILS. CBILS were intended to replace lost turnover with borrowing. The notion was that once a company is back up and trading it ought to be able to pay its borrowing back. While in lockdown the CBILS loan could be used to pay fixed costs a business could do nothing about. It was a way of preventing companies going immediately into insolvency.

However, a number of CBILS loans were used for other things such as the acquisition of property, with the acquisition of plant and machinery running a close second. Given the lending condition not to seek security, the attraction for businesses was that the debt would not then attach to the asset.

A further serious problem with CBILS is fraud committed by a significant minority of borrowers. If a business is not trading and it suddenly receives a large sum of money that effectively sits on the top line of the balance sheet.

Continued on page 2

Welcome

to the Summer edition of Disruptive Asset Finance

The long term impact of the pandemic is not yet known. Well over a year has now passed since the first lock down restrictions and COVID-19 has certainly had a significant impact on litigation. Clarke Willmott has certainly adapted to the 'new normal' and continues to support businesses and individuals finding their way during this period of uncertainty.

In this edition of Disruptive Asset Finance I have considered whether a mock cross examination of witnesses is permissible and what can be done by a witness to ensure they are ready for trial. Peter Brewer, Ken MacLennan and Philip Roberts consider the future impact of the Coronavirus Business Interruption Loan Scheme. Sarah O'Grady and Ellen Yeates consider the human side to settlement at mediation and finally, Louise Goodwin and Alex Megaw consider whether COVID Killed the Search and Seizure Order.

John Flint

Fast cars, fancy watches and emergency finance - continued

Dishonest and misfeasant directors may simply withdraw that money straight out of the company and then use it to purchase personal items – such as luxury watches and cars. When businesses default on loans in such circumstances we can expect to see a significant amount of insolvency litigation as the banks and insolvency practitioners pursue misfeasant directors.

One of the causes of the above problems was that the loans were based on very limited due diligence by the banks. Huge volumes of businesses sought lending and large amounts of money were being lent but lockdown restrictions meant due diligence on borrowers was extremely limited or completely restricted. No doubt as banks attempt to unwind their CBILS lending we will see a significant, possibly overwhelming, amount of litigation for banks. At Clarke Willmott our insolvency lawyers, recovery specialists and expert banking litigators are ready to assist with the unravelling of some of these facilities in a time which may otherwise be overwhelming.

Peter Brewer
Partner
0345 209 1718
peter.brewer@clarkewillmott.com

Ken MacLennan
Partner
0345 209 1325
ken.maclennan@clarkewillmott.com

Philip Roberts
Partner
0345 209 1778
philip.roberts@clarkewillmott.com

The psychology of mediation

Lawyers will often provide their clients with much practical information about what a mediation looks like and how the day will be run.

Doubts can often exist as to whether the day will have any worthwhile purpose and some adversaries cannot stand the sight of each other but rarely will a client be briefed on the psychological dynamics of the day. Emotion is important, even for those settling disputes on behalf of large businesses who may consider the decision-making process to be devoid of feeling. We are not automatons so what are some important factors to keep in mind mentally at mediation?

1. The offers

Parties come to mediation expecting to negotiate and expecting the other party to reciprocate. It usually takes around 3 offers each in a mediation to reach a mutually acceptable settlement figure. With that in mind it might be tempting to skip this and cut to your best and final position. However, just making one 'final offer' is contrary to the expectation of negotiation and will disrupt what is known in psychology as the 'rule of reciprocity'. It is expected that there will be an opportunity for movement in a reciprocal manner and for counteroffers to be exchanged. Similarly, if a party does not respond to an offer but simply asks for a 'better' offer that also can be counterproductive to the flow of the negotiations - often no better offer will be forthcoming.

The 'rule of reciprocity' can be used to a party's advantage. While some see making the first offer as a sign of weakness, where that first offer is in the realms of what could be considered reasonable, it can bring great strength to the negotiations because the 'rule of reciprocity' means like will tend to respond with like. A generous offer met by a stingy offer will break this unwritten code of conduct and a mediator may well ask such a party to consider modifying an unproductive offer.

2. Fairness

Each party in a dispute tends to believe that they are fairer and more reasonable than the other party. Parties in a mediation sometimes turn down an offer 'on principle' and this may be due to an innate sense of fairness. Strangely, offers may be turned down by a party even though they would be better off accepting the offer than facing the alternatives (such as trial). This is done even though by turning down the offer they are punishing themselves. This trait of fairness is not uniquely human and is even shared with animals such as monkeys and dogs (try rewarding one animal with a tasty treat and one with a lesser prize and watch the latter quit). Parties should be mindful at mediation that fairness is subjective and what one party regards as fair will be interpreted quite differently by the other party.

3. Understanding risk

Where a certain loss (here being the settlement sum that is to be paid) is compared to a potential larger loss (being an uncertain judgment sum) the willingness to take risks is heightened. Defendants may therefore prefer to take the risks associated with trial rather than suffer the psychological pain of paying a settlement sum!

Unsurprisingly, attitudes to risk are linked to probability. However, the assessment is not symmetrical. If a party believes it has a 50% chance of success it will not equate a fair settlement with 50% of the damages. Research shows that where a claimant has a 5% chance of success it would want more than 5% of its claim to settle. However, a claimant who has a 95% chance of success would accept less than 95% as a settlement.

Thus, depending on the probabilities involved in a case a party's position can change from risk seeking behaviour to risk adverse behaviour. It is suggested this is because the possible loss of an almost certain win has greater psychological influence then the pain of giving up the value of the case. The same principle is also said to be true for defendants. The problem of course is the fact that the parties will seldom agree on the prospects of success!

4. Priming

Priming can be demonstrated with a simple puzzle. Can you fill in the missing letter? a) bread, butter, cheese, so*p? b) towel, bathroom, shampoo, so*p? Most people will fill in these blanks with soup and then soap. Priming is a stimulus that influences a response. Many different types of priming can be experienced throughout a mediation day. Words commonly used at mediation such as 'fair', 'open mindedness' and 'reasonable' do seek to influence the parties but this should not be seen as manipulative. Rather it can help dislodge negative thoughts about the process and encourage the behaviours that foster resolution.

The psychology of mediation - continued

5. Heightened awareness

Be aware that high stakes mediations carry increased emotional activity. This can have a great impact on communication. However, a heightened awareness can be positive as it can also enable the parties to see new perspectives to otherwise entrenched points of view. It is important to think about how key issues are framed.

6. Retelling the story

There is no shame in recognising that all people misremember events and this is often worsened as the story is told time and time again. Further, memories and recollections are selective. We all have filters that stifle particular memories. In litigation stories may be told, for example, in pleadings, witness statements and correspondence. The more the story is told the more entrenched the story becomes in this documentation. Remember that those stories never tell the whole detail and are subjective to the storyteller.

This is important because the success of mediation can often hinge on someone feeling that they have been wrongly accused. A boundary to settlement can be all the parties insisting that their recollection is right. It is important to remember that the other party may genuinely hold different recollections. Differing recollections and perceptions are normal and not necessarily fabrication or deception. At mediation the focus is the future rather than agreeing who is precisely correct in respect of elements of a dispute.

Accept that it can take time for a party to acknowledge a different version of facts to those which have become engrained through its storytelling. During a mediation it can help when the mediator describes in a non-judgmental way the different viewpoints. This can open up new perspectives. Often mediations which aren't successful on the day still produce settlements shortly afterwards because the parties have had a chance to reflect and process the new information they have heard.

7. Therapy

Mediation is not psychotherapy but having the opportunity to be heard and having the feeling of being heard can be extremely important in achieving resolution. A party may be seeking from a mediation an apology and in some cases an acknowledgement of hurt caused or that something was wrong opens up the gateway to settlement. While supressing emotion is counterproductive to settlement it does need careful management as angrily venting can deepen the anger and anxiety of all the parties. Listen to the ground rules the mediator will set to navigate this difficult path.

8. Why are we here?

Although the ultimate aim of mediation is settlement, there are opportunities for mediation to be of a great benefit even where it fails to resolve the dispute. Mediation is an opportunity to better understand the other party's case, to ask questions and to reflect upon the strengths and weaknesses of your own case. Use the day as an information gathering exercise as well as seeking to achieve settlement.

Understanding some of the psychological aspects of mediation helps many clients appreciate why the mediation day can produce settlement where correspondence has failed. It also helps manage expectations about the day.

Sarah O'Grady
Senior Associate
0345 209 1525
sarah.ogrady@clarkewillmott.com

Ellen Yeates
Senior Associate
0345 209 1594
ellen.yeates@clarkewillmott.com

Be prepared: The witness

The way a witness performs at trial can have a huge impact on the case. Preparing a witness for trial is therefore a very important part of the litigation process.

However, the work that can be undertaken to prepare a witness is limited. Familiarisation with the *process* of giving evidence is permitted as this simply helps witnesses give their best evidence at trial but the process used must not risk contaminating the evidence and important safeguards to protect this are in place.

In any discussions lawyers have with witnesses regarding the process of giving evidence general guidance can be given about how to give evidence. For instance, lawyers may remind witnesses to speak up, speak slowly, answer the question, keep answers as short as possible and ask for clarification if the question is not understood. However, those conducting the familiarisation process must not do or say anything which could be interpreted as suggesting what the witness should say, or how the witness should express themselves in the witness box on any question or issue: This is impermissible coaching.

Witnesses often feel that practising with a mock cross examination before the day of the trial would be useful - but there can be no rehearsal of the evidence. While legal dramas we might see on television may suggest otherwise remember that these programmes are often based in the United States which has significant cultural and professional differences when it comes to witness preparation. The rules in the UK are stricter.

A mock examination is possible but its purpose should be to give the witness greater familiarity with and confidence in the process of giving oral evidence. It needs to be conducted in a way so there is no risk that it might influence the evidence of a witness. As such the exercise should not be based on facts which are the same (or similar) to those proceedings where the witness is likely to participate. Therefore, fictional case studies, far removed from the type of case coming to trial, are often used to demonstrate to a witness what to expect. In other words a witness can practice cross-examination but not on the evidence that is going to be given. While this is beneficial in many ways this type of preparation can take away from the groundwork the witness could otherwise be doing in readiness for the actual trial.

What should a witness do to prepare in advance? Certainly a witness should ensure that he/she has re-read his/her witness statement and any exhibits so the content is very familiar. A witness should also ensure that they are familiar with any of the documents relevant to the case which they have been provided with. Making their own notes may help a witness when they are reviewing their statement but a witness will not be able to refer to any such notes when giving evidence.

Arriving at the court early is strongly recommended - Usually a witness in a civil case will be allowed into the court room on their arrival at the court. This can give a witness the invaluable opportunity to see other witnesses give their evidence beforehand and a chance to see the court in action before they give their own evidence. There is nothing to stop a witness attending the court pre-trial to observe the court and the way evidence is given in a different case.

A witness who feels it would be desirable to have a practical session going over their evidence being directed in the types of question they will likely face will no doubt be disappointed to discover the limitations that are placed on this type of behaviour. Nevertheless, in many cases having a third-party help, using an unrelated fictional case study, can often ease a witnesses' apprehension and this should be carefully considered.

John Flint
Partner
0345 209 1079
john.flint@clarkewillmott.com

Has COVID killed the search and seizure order?

A search (and seizure) order is a powerful tool in the litigator's armoury where there are concerns in a dispute that crucial evidence will not be preserved.

It allows one party to enter the premises of the other party to search for, copy, and retain evidence. Search orders are typically granted without the other party having prior notice of their existence to prevent the hiding or destruction of evidence before the order takes effect. The recent case of *Ocado Group Plc v McKeeve [2021] EWCA Civ 145* is a cautionary tale where a solicitor was found to be in contempt of court after advising his client to *"burn all"* after getting wind of such an order.

Such orders are understandably not easy to obtain. The court needs to be satisfied that: (1) the party applying for the order has a strong case; (2) the destruction of the evidence would be serious; (3) the other party has incriminating items; (4) there is a real possibility that evidence would be destroyed if the other party had notice of the order; and (5) any harm caused by the order to the other party is proportionate to the purpose of the order.

COVID-19 has now created other potential hurdles to the effectiveness of search orders. Applicants must give full and frank disclosure when applying for an order (supported by a cross undertaking in damages). In the current climate this will necessitate bringing the court's attention to any COVID-19 related factors which could mitigate against an order being made. Such factors could include the other party's travel and medical history (could they be deemed a vulnerable person?) and the possibility that an order could lead to physical harm to the other party and others at their premises.

The party applying for the order must also satisfy themselves that an order will be compliant with the latest (and changing) coronavirus legislation which restrict gatherings and travel, including those specific to the locality of the premises. These restrictions do not immediately sit well with a search of indoor premises involving a team of numerous people (which would typically include solicitors for each party, anyone at the premises at the time, supervising solicitor(s), forensic experts and potentially the police).

Successful applicants, having likely incurred considerable time and expense to obtain theorder, could then face an opponent who refuses entry to the premises on coronavirus grounds on the basis that government guidelines to self-isolate are being followed or that someone is demonstrating coronavirus like symptoms. Such a response could render the order worthless because the other party will then know of the order and may start to hide or destroy evidence.

However, such hurdles are not insurmountable and recent decisions show that COVID-19 challenges can be successfully navigated. In *Koldyreva v Motylev [2020] EWHC 3084 (Ch)* the court recognised that "stringent precautions" were needed before a search could be considered but proceeded to grant an order based on a reduced size search team and site. Safeguards were put in place to protect the other party's son with a search to be conducted at a time when he was at school and excluding his personal electronic devices.

Similarly, in *Calor Gas Ltd v Chorley Bottle Gas Ltd [2020] EWHC 2426 (QB)* an order was granted subject to number of "COVID Undertakings" including the search team's required use of personal protective equipment and temperature checks and allowing potentially at risk individuals to contain themselves prior to a search taking place. Orders could build in similar coronavirus requirements from social distancing to sanitisation of premises. An unusually trusting party may also be satisfied with the immediate delivery up of items from the premises on the day of the search (known as a "doorstop delivery" order), without requiring the need for physical entry to the premises.

If entry is refused this carries significant legal risk to the party who is refusing entry. As search orders contain a penal notice refusing entry carries the risk of being in contempt of court which could result in imprisonment. A judge is also likely to draw obvious inferences as a result of a failure to comply. Such a decision should not therefore be taken lightly.

The "nuclear" option of a search and seizure order is therefore set to continue its crucial role. However, potential risks associated with such orders are also likely to encourage other creative options to disputes of this nature.

Louise Goodwin
Senior Associate
0345 209 1524
louise.goodwin@clarkewillmott.com

Alex Megaw
Consultant
0345 209 1361
alex.megaw@clarkewillmott.com

If you would like to receive future editions of **Disruptive Asset Finance** or if you have any comments or suggestions for the newsletter please contact: news@clarkewillmott.com