A Review of the Corporate Insolvency Framework response form

The consultation response form is available electronically on the consultation page: https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework (until the consultation closes).

The closing date for this consultation is 06/07/2016.

The form can be submitted online/by email or by letter to:

Policy Unit
The Insolvency Service
4 Abbey Orchard Street
London
SW1P 2HT

Tel: 0207 291 6879
Email: Policy.Unit@insolvency.gsi.gov.uk

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

Information provided in response to this consultation, including personal information, may
be subject to publication or release to other parties or to disclosure in accordance with the
access to information regimes. Please see page 9 for further information.

If you want information, including personal data, that you provide to be treated in confidence, please explain to us what information you would like to be treated as confidential and why you regard the information as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

I want my response to be treated as confidential □

Comments:

Questions

Name:

Organisation (if applicable): **Insolvency Practitioners Association**

Address: **Valiant House, 4-10 Heneage Lane,**

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	Respondent type
X	Business representative organisation/trade body
	Central Government
	Charity or social enterprise
	Individual
	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
X	Other (please describe) Recognised Professional Body for the authorisation and regulation of Insolvency Practitioners

An Impact Assessment is also available online. In addition to responses to the questions below, we would welcome comments and further recommendations for change with supporting evidence, referencing the evidence provided in the Impact Assessment.

Please identify any unintended consequences or other implications of the proposals and provide comment on the analysis of costs and benefits. Are there any alternatives to the changes and regulations proposed?

Practical observations

In principle, we are in favour of any proposals which will enhance the tools available to promote company rescue. However, while widening access to the CVA moratorium and rescue finance may have a part to play in encouraging rescue, we believe that the current proposals fail to balance these objectives with adequate safeguards for creditors.

The availability of processes by which a business may be restructured and the availability of finance to do so are not, in themselves, enough to ensure the viability of a business and/or prevent its ultimate failure in the longer term. In our experience, which is supported by research, businesses do not fail because of the lack of an appropriate process; they fail because there are fundamental deficiencies in the business model and/or the competence of its management.

Restructuring a business requires analysis of why the business has failed or is failing, in addition to affording it protection whilst this process is undertaken. Too often directors fail to act quickly enough in obtaining ***specialist*** advice when their businesses are struggling. We suggest that any proposals for reform must encourage business owners to seek advice from specialists at an early stage.

Additionally, we would suggest that giving directors protection from liability in the moratorium period may have unintended consequences in that it may encourage abuse of the process, particularly in the absence of adequate professional oversight. Models used in Germany and France motivate desired conduct on the part of company directors with both incentives to seek protection and effective deterrents by way of punitive sanctions for failing to do so.

If the activities of a company are loss-making, it is difficult to see how they will become profit making simply by virtue of a stay on creditor action. Where the root cause of an otherwise profitable company's difficulties is a temporary cash-flow issue, this can typically be resolved through traditional means; where the cause is not a simple cash-flow scenario, it does not seem unreasonable to assume that trading losses will continue to be incurred during any moratorium period. For this reason, we believe that any moratorium period should be as short as possible and that 3 months presents an unacceptable risk to creditors of a further diminution in the funds that will ultimately become available to them. Furthermore, the current proposals do not address how any losses would be met.

It is clear that the proposed changes would lead to greater involvement of the courts, particularly in dealing with challenges from aggrieved stakeholders. It would be necessary for the courts to be adequately resourced so that they could deal with such cases quickly. At present, unlike the United States, we do not have dedicated insolvency courts. Furthermore, the cost burden of initiating a challenge is (unfairly, in our view) placed upon stakeholders, without sufficient oversight that the process itself is appropriate at the point of initiation.

On the subject of super-priority, we are deeply concerned that in providing this protection for funders, the ordinary costs of borrowing for UK business will necessarily increase to reflect the increased risk borne by lenders who can no longer be assured of their priority in recovery. The impact assessment does not monetise this likely consequence and we consider, therefore, that it may not present an accurate picture of the real costs to the economy of these proposals.

Our final observation is that it is not clear whether any new legislation would be retrospective. Borrowers and lenders will have entered into contracts on the basis of the current order of priorities and lenders will have priced their risk on the basis that they cannot be crammed down. We suggest that if the order of priority is to be changed it should only affect security created on or after the date on which the new legislation comes into force.

Regulatory observations

The current proposals provide for a moratorium supervisor to be drawn from a broader base of regulated professionals than the insolvency profession.

However, it should be noted that the regulatory infrastructures for accountants and solicitors are markedly different from those applied to Insolvency Practitioners. The framework for the regulation of IPs has been tailored over the last 30 years to apply appropriate levels of oversight to those conducting insolvency and restructuring work. It would be highly undesirable to create a situation of regulatory arbitrage, and we would expect all professionals acting in the capacity of moratorium supervisor to be regulated to the same high standards. It would also seem only appropriate for those acting in that capacity to be fully conversant with the insolvency options that may be required to be utilised by way of exit to such a moratorium.

The only way to ensure consistency is through the application of common standard setting processes and inter-regulator cooperation. These processes and fora are already in place in respect of the insolvency profession and largely function effectively under the oversight of the Insolvency Service.

The impact assessment does not monetise the costs of creating a similar system for ensuring regulatory consistency in the event that the role of moratorium supervisor were opened up to other professionals. There is also little commentary or explanation as to why it would be desirable to create a parallel profession to that of insolvency practitioners.

We understand the desire to avoid unnecessary barriers to entry to the role of moratorium supervisor. The recent changes to insolvency licensing mean that practitioners may now specialise exclusively in corporate insolvency, by sitting appropriate examinations and demonstrating sufficient experience, without having to qualify to act in personal insolvency proceedings. In our view, those wishing to act in the capacity of moratorium supervisor should avail themselves of this entry route to the profession, thereby averting the need to establish another regulatory infrastructure and ensuring all those seeking to act in this pivotal role are appropriately qualified and monitored.

The Introduction of a Moratorium

1) Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?

Not as currently formulated. In most instances, by the time of distress it will be too late to meet the conditions of the moratorium that trading is conducted on a breakeven basis. As explained above, it seems likely that a distressed business will necessarily continue to incur trading losses, which will ultimately be suffered by creditors who have not been consulted.

There needs to be additional clarity around what are considered to be “trading costs”; how they are funded and who meets any losses accrued. Additionally, it is not clear how the rights afforded to employees are to be affected (for example, consultation) and how any arrears of wages are to be treated.

Finally, no information is provided about how the conduct of the moratorium supervisor is to be assessed and regulated and how abuse of the process is to be prevented.

2) Does the process of filing to court represent the most efficient means for gaining relief for a business and for creditors to seek to dissolve the moratorium if their interests aren’t protected?

The efficacy of a court-based system will depend largely upon there being sufficient capacity and expertise within the court system. Experience within the US system would suggest that court-based processes are usually more expensive than those conducted out of court. Requiring creditors to act to bring the moratorium to an end will effectively shift the cost and burdens to them.

3) Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

No. We do not consider there are sufficient safeguards contained in the current proposals as the filing appears to be made by directors prior to an independent professional having considered whether the qualifying criteria have been met.

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

No. The proposals as currently formulated provide too much potential for abuse. There is a lack of early oversight and a potential lack of scrutiny of the moratorium supervisor.

Dissatisfied creditors will have to expend significant sums of money to challenge a moratorium in the court and there appears to be a lack of punitive sanctions for abuse of the process.

We would suggest that directors should be required to make a declaration of eligibility and that it should be an offence to knowingly make a false declaration (similar to the process of a declaration of solvency in a solvent liquidation).

It is proposed that directors are afforded protection in respect of losses in the moratorium period, whilst the process appears to ignore their pre-moratorium conduct. The company’s current circumstances may have been directly impacted by poor pre-moratorium corporate governance and the process does not provide of any scrutiny of that conduct. This contrasts with directors’ obligations when proposing a CVA under Rule 1.3(2)(c)(iii) of the Insolvency Rules 1986, whereby they are required to explain whether there are any circumstances which could amount to challengeable transactions (where the company to enter into liquidation) and the penalties imposed by s 6A of the Insolvency Act 1986 in the event that a director makes a false representation in this connection.

Generally, we consider that appropriate behaviours should be encouraged with both incentives and deterrent sanctions.

5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

No. For the majority of companies, we consider that the initial 3 month period is too long, particularly as filing appears to be without prior professional oversight. This could lead to unnecessary creditor detriment. We would suggest an initial period of 21 days, extendable to 42 days would be more appropriate.

In respect of larger businesses, experience in the US would suggest that more complex restructuring plans are often agreed within 3 months. Schemes of arrangement typically take 6-9 months to establish and would not be ready to go to creditors at such an early stage.

We would suggest that a shorter initial period, combined with the ability for the moratorium supervisor to extend the period by application to the court would be more workable and would reflect the considerable difference in the needs of the entities utilising the process.

6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?

In part. We are content with the suggested powers, however do not consider the qualification requirements to be sufficient or appropriate (for the reasons amplified upon above within our Regulatory Observations).

We consider that all moratorium supervisors should be subject to the same professional standards and code of ethical conduct, as applies to insolvency practitioners. In essence, we believe that the moratorium supervisor should be a licensed insolvency practitioner, albeit, potentially one licensed exclusively to conduct corporate insolvency.

Any risk of “conflict of interest” occasioned by confining the role to insolvency practitioners is mitigated by the provisions that a moratorium supervisor may not then act as insolvency office holder (although it should be recognised that this safeguard will, in itself, create some duplication of effort and cost).

Additionally, we consider that the moratorium supervisor should be required to provide some form of opinion, at the point of filing, as to the company’s eligibility and the suitability of the existing management to continue to be in control of the company’s affairs, as a protection against abuse of process by the unscrupulous. Protection could be afforded along similar lines to that provided in a CVA by the filing of a Nominee’s report under Rules 1.7 or 1.38 of the Insolvency Rules 1986.

More generally, we would comment that any process which is largely based upon Court proceeding is likely to ultimately be more expensive than an out of Court alternative, as has been seen in relation to Chapter 11 proceedings. Such proceedings are not deliberately designed to be expensive; the high levels of costs merely reflect the natural consequence of basing the process upon potentially contested proceeding.

7) Do you agree with the proposals for how to treat the costs of the moratorium?

Yes – but the costs of the moratorium need to be subject to appropriate oversight. The recently introduced regulatory objectives apply such oversight to insolvency professionals. This protection would not be afforded in the event the role is capable of being undertaken more widely.

8) Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

Given the role of the moratorium supervisor is largely passive (with the directors retaining control over the company and its affairs), the supervisor may not be in possession of the information, nor necessarily have ready access to it. Therefore, we consider that the directors should be obligated to respond to requests for information, rather than the supervisor. Any such obligation will need to be subject to some limitation in respect of commercial considerations and issues of confidentiality, costs and reasonableness.

With regard to requests for additional information in insolvency proceedings, there already exists statutory provision for this to be provided in respect of fees and expenses and we are unconvinced that these provisions require further extension. Practitioners are required to act transparently in accordance with the Ethics Code and may be subject to disciplinary action if they fail to respond to a reasonable request or communicate in an appropriate manner.

Any extension of rights to information must include safeguards against excessive or potentially vexatious requests, or requests which could prejudice the outcome of the moratorium or rescue process. It should also allow practitioners to weigh the benefits of providing the information as against the risks and costs of doing so. However, we would suggest the current system achieves that already and any additional requirement is, therefore, unnecessary.

Helping Businesses Keep Trading through the Restructuring Process

9) Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?

We believe that a mechanism for affording protection from withdrawal of essential contracts may assist the restructuring process.

However, consideration needs to be given to why supplies are withdrawn: typically illustrative of a lack of trust and confidence in the existing management or business or the likelihood of being paid. In addition, there may be cases where the supplier is unable to continue to supply as a result of its own financial difficulties or, importantly, the withdrawal of credit insurance.

We would suggest that the current proposals go too far in limiting the rights of suppliers and may result in innocent parties having to defend their position in costly legal proceedings. We believe that under current proposals, the burden of proof is effectively the wrong way round.

It would be fairer and give better protection against abuse to extend the existing statutory provisions to those suppliers assessed by the office holder (rather than the directors) as being "essential" to the recovery plan.

10) Do you consider that the Court's role in the process and a supplier's ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We consider that there is too much emphasis on court-based challenge having to be mounted by the affected party. Court proceedings are invariably costly and the proposals effectively shift the burden of instigating them to the innocent party.

We believe that it would be preferable to apply independent oversight at the outset and implement a process that adopts a more consensual approach to continued supply. Consideration also needs to be given to providing a level playing field in how to enforce continued supply both in the UK and overseas.

Developing a Flexible Restructuring Plan

11) Would a restructuring plan including these provisions work better as a standalone procedure or as an extension of an existing procedure, such as a CVA?

The existing moratorium framework is well known, if little used. We believe that it would be preferable to extend that process, subject to appropriate safeguards, rather than to create a new process.

With regard to CVAs under the current framework, our experience suggests that those that fail do so as a consequence of the underlying viability of the business, rather than as a result of defects in the process.

Furthermore, we would urge caution that the basic premise for secured lending is not unduly impacted by such changes. If secured lenders feel there is a risk of their rights being adversely affected, it may restrict the availability of lending and it may incentivise their precipitative appointment of administrators. It may also serve to drive up the costs of borrowing for all businesses, which would be counter-productive to the stated objectives of the proposals. We do not believe these factors have been fully costed into the impact assessment.

12) Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?

Yes – in theory. We would comment, however, that whilst this is superficially attractive, it may impact on broader UK lending practices.

13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

We broadly agree that the Court is probably the appropriate body to consider challenges. However, we would suggest that this is largely a question for banks and creditor groups. We note with some concern that only one such organisation is represented in the list of consultees and we would suggest broader consultation with the financial sector.

It is not immediately clear from the proposals whether the intention is to make all Schemes of Arrangement a variety of CVA, and suggest that this should be clarified.

14) Do you agree that there should be a minimum liquidation valuation basis included in the test for determining the fairness of a plan which is being crammed down onto dissenting classes?

A minimum liquidation valuation will not always be the appropriate point of comparison and we consider that the basis of valuation should depend on circumstances and potential alternatives available to that entity, at that time.

Whilst we support the concept of cram down, thought should be given to who is benefitting from it, particularly if the ultimate outcome of the process is better than originally anticipated. We consider that whilst the voting rights of “out of money” creditors might reasonably be crammed down, their right to participate in any benefits to which they would otherwise have been entitled should not be compromised.

Rescue Finance

15) Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. To do so could adversely affect the availability of start-up finance and would be likely to increase the costs of finance to reflect the additional risk. We also understand that such proposals may cause the banking sector some difficulty in fulfilling their Basel III obligations, and suggest that this should be explored further with them.

We do consider that a removal of negative pledges would be of assistance in securing funding on any available headroom. Our members’ experience suggests that where there is a viable business, existing funders will lend, if there is sufficient headroom, and where they decline to do so, it is a reflection of their view of the company’s longer term viability.

Administrators are effectively already at liberty to borrow on a super-priority basis, if they negotiate with existing lenders. We do not consider that encouraging the further emergence of DIP Financing, to the detriment of existing lenders and unsecured creditors, would be in the long term benefit of UK business as the costs will ultimately be borne in increased lending rates to the solvent majority and a diminution in the returns to unsecured creditors of the insolvent minority.

16) How should charged property be valued to ensure protection for existing charge holders?

N/A. We do not consider that super-priority over fixed charge holders should be afforded to rescue finance providers, as to do so would adversely impact on lending more generally.

17) Which categories of payments should qualify for super-priority as 'rescue finance'?

N/A

Impact on SMEs

18) Are there any other specific measures for promoting SME recovery that should be considered?

In our members' experience, SME's are the most difficult to restructure. The costs can be prohibitive and formal insolvency, perhaps with a sale of the business assets, may be a less costly and quicker solution.

Why SME's fail in the first place is highly variable, but a key and consistent factors are a lack of education on the part of the business management, delays in accessing professional advice and failure to acting swiftly to address financial distress at an early enough stage for restructuring to be a viable option.

We believe that company directors should be incentivised to act more quickly; not solely through providing them with additional protections, but also through more effective punishment when they fail to act.

Owner/manager personal guarantee liabilities will subsist, even where creditors are crammed down, to the effect that the impact of these proposals on the SME sector is likely to be minimal.

The proposals fail to recognise the inherent tension between encouraging entrepreneurial activity by facilitating re-starting without debt and the suggested broader benefits of restructuring as an alternative to liquidating, whilst under the burden of existing debt. It is arguable that the debt-free business is ultimately more likely to succeed, in the event that any underlying deficiencies in the business model and/or the management competencies have been addressed.

Do you have any other comments that might aid the consultation process as a whole? Comments on the layout of this consultation would also be welcomed.

The impact assessment is not persuasive of the economic benefits of necessarily restructuring a failing business, particularly in the SME sector, when countered against the broader risks of adversely impacting the availability of business finance presented by these proposals.

Further, it seems improbable that an increased reliance on Court proceedings will act to reduce costs and efficiency, given the example provided by the US system.

When previously consulted upon in 2009, it was noted that there was scepticism amongst consultees about the benefits of importing new measures drawn from the experience of other countries with very difference histories and systems; and that there was wide support for the suggestion that changes should not artificially prolong the life of companies which were not fundamentally viable and which did not have competent management.

We do not believe that these propositions have fundamentally changed.

Given the potentially serious impact on the availability of business finance that a shift towards an US style system could have, we would suggest that this area should be considered by a Royal Commission formed for that purpose, rather than a brief period of consultation with a small number of selected parties.

About the IPA

The Insolvency Practitioners Association is a membership body recognised in statute for the purposes of authorising Insolvency Practitioners under the Insolvency Act 1986 and Insolvency (Northern Ireland) Order 1989. It is the only recognised professional body to be solely involved in insolvency and for over fifty years the IPA is proud to have been at the forefront of development and reform within the profession.

The IPA has approximately 2,000 members, of whom 577 are currently Licensed Insolvency Practitioners (479 of whom are authorised to take insolvency appointments).

The IPA currently licenses approximately one third of all UK insolvency appointment takers, who are subject to a robust regulatory regime, applied by the IPA's dedicated regulation teams carrying out complaints handling, monitoring and inspection functions. The IPA also undertakes monitoring visit work for the Royal Institution of Chartered Surveyors under a joint voluntary regulation scheme for registered property receivers.

The IPA has a longstanding and continuing commitment to improving standards in all areas of insolvency (and related) work. It was the first of the recognised bodies to introduce insolvency-specific ethics guidance for IPs, and the IPA continues to be a leading voice on insolvency matters such as the development of professional standards, widening access to insolvency knowledge and understanding, and encouraging those involved in insolvency case administration and insolvency-related work to acquire and maintain appropriate levels of competence and skills.

The comments and opinions expressed below represent the views of the IPA's Corporate Consultation Committee, a committee comprised of practitioners with a specialism and particular expertise in the area of corporate insolvency and restructuring, and are not intended to reflect the opinion of each individual and firm member of the Association (who remain at liberty to express their own views within their responses to this consultation).