Collective Redundancy Consultation for Employers facing Insolvency

ICAEW welcomes the opportunity to comment on the call for evidence *Collective Redundancy Consultation for Employers facing Insolvency* published by the Insolvency Service on 23 March 2015, a copy of which is available from this link.

This response of 12 June 2015 reflects consultation with ICAEW's Insolvency Committee, which is a technical committee made up of Insolvency Practitioners working within large, medium and small practices. The Committee represents the views of ICAEW licence holders.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

ICAEW's regulation of its members and affiliates in insolvency is overseen by the Insolvency Service, and ICAEW is the largest of the Recognised Professional Bodies under the Insolvency Act, currently licensing around 700 practitioners.

MAJOR POINTS

1. We welcome this consultation in particular because flaws in the UK's legal regime present our licenced insolvency practitioners (**IPs**) with practical difficulties in performing their role.

2. The conflicting legal requirements are revealed most starkly in the case of compulsory liquidation where contracts of employment terminate immediately upon appointment of the liquidator as a matter of law. It will then be impossible (or, if possible, pointless) for the company to consult, but it seems (from European case law) that consultation would still be required.

3. We express no views on whether priorities of creditors should be changed, this being a matter for government; so far as the distribution of assets is concerned, the role of an IP is to follow the priorities prescribed by law. However, any change to existing priorities would need to be considered carefully taking into account not only the interests of particular persons such as employees or suppliers, but implications for the wider economy, including on investment.

4. We are making this response as the representative body for our licensed IPs and in the interests of assisting the government. Nothing in this response is intended to have any bearing on our consideration, as a disciplinary body, of any particular case, neither would the outcome of any particular case be expected to have a bearing on our comments. We are concerned here with the principles arising from the legal framework itself.

5. Many of the concerns expressed here have been raised in the past, including by R3 in its response to the calls for evidence issued by the Department for Business Innovation and Skills in November 2011 and its submission to the public bills committee on the Enterprise and Regulatory Reform Bill. That response contains further detail on some of the statutory provisions and case law concerned.

6. By way of background, we would note that an IP is appointed as office holder only if and when the business enters a formal insolvency procedure. A person who advises a company before this time may, or may not be the same person (and may or may not be a qualified IP). The role of the IP is governed by statute, whereas the duties of an adviser are determined by contract.

7. The consultation does not directly ask for comments about the role played by the National Insurance Fund in connection with collective consultations and protective awards. However, we wish to make clear that the implications for the taxpayer, again, arise as a result of the legislative regime, not as a matter of discretion of the IP.

RESPONSES TO SPECIFIC QUESTIONS

Current Practices

Q1: What are the considerations undertaken when deciding whether or not to start consultation? How is this decided in practice where an employer is facing, or has moved into, insolvency? Please provide examples where possible.

8. Considerations will be many and depend upon the circumstances of each case. Deciding whether or not the relevant thresholds are met, for instance, may involve consideration of the meaning of 'establishment' and relevant case law. The purpose of this response, however, is to highlight areas where insolvency itself gives rise to issues of principle and degrees of conflict in relation to the legal framework.

9. A company is required to consult when it is 'proposing' to make relevant redundancies and the consultations must begin 'in good time' before the first dismissals take place (at least 30 or 45 days before, where the relevant thresholds are met). A key consideration for directors

will, therefore, be at what point the prospect of redundancies of the requisite scale becomes a 'proposal', as opposed to, for instance, a possibility. Considerations in that context include whether or not there is any prospect of the business being sold as a going concern, in which case the redundancies might be avoided (or would become a matter for the purchaser) and whether or not necessary sources of finance can be found or will be maintained.

10. Where the directors believe that there is no longer a reasonable prospect of avoiding an insolvent liquidation they are also required **to take every step with a view to minimising the potential loss to the company's creditors** [*emphasis added*] (s214 Insolvency Act 1986). This obligation is to protect the interests of all creditors; but entering into a collective redundancy consultation process may lead to the enterprise value of the business being reduced, which may not be in the interests of the general body of creditors. Similarly, it is not reasonable to expect directors to delay filing for insolvency in order to carry out lengthy consultation.

11. The duty to consult does not arise where there are 'special circumstances' so that it is not reasonably practicable for the employer to consult. However, insolvency in itself (i.e. the ability of the company to pay its employees during any period of consultation) has been held by case law not, of itself, to be a special circumstance.

12. Exactly when redundancies are 'proposed' may be a difficult issue to determine. It is dependent upon all the facts and requires exercise of judgment in often fraught circumstances. In the case of a company in financial distress, the position may change from one where there is a prospect of redundancies being avoided to one where redundancies become inevitable in a very short timeframe.

13. Given the difficulties involved, directors might consider whether to err on the side of caution and consult before there is a 'proposal' (or when it is uncertain whether or not plans amount to a proposal). There are, however, risks in taking this approach where a company is in financial distress, including, most obviously, that it might result in employees seeking employment elsewhere and that the action would become widely known, so undermining the confidence of suppliers and customers in the business and, potentially leading to (or accelerating) its collapse. It might also mean that the consultation process as a whole would be more drawn out because the fixed periods start to run only from the time that there is a 'proposal' and consultation before this time would not count.

14. The requirement for consultations to take place 'in good time' before the dismissals take place leads to a dilemma for directors, because by the time redundancies are 'proposed' (for instance, because a potential purchaser has withdrawn), the company may be unviable and redundancies inevitable.

15. At this point, the company may be insolvent, or likely to become insolvent, and an IP may be appointed, but whether the proposal is implemented by the directors or an IP, the law requires the company to consult for the relevant time (eg, at least 45 days) (the **minimum consultation period**') before making any redundancies. If, as is often the case, there is no realistic prospect that the company will be able to afford to pay all employees during the minimum consultation period, the company has an uncomfortable choice. Either it continues all contracts of employment in the knowledge that it cannot pay the employees (and that they will not be able to accept alternative employment, claim unemployment benefits or claim against relevant insurance they may have, as they will still be employed) or it makes redundancies despite the fact that this will not be in accordance with the regulations on collective consultation. It is unclear which of these unattractive alternatives is less disadvantageous for employees, but in normal circumstances the protective award regime ranks only as an unsecured creditor to which dividends cannot be paid until sums are available and claims agreed (and very few unsecured claims receive dividends of 100 pence in the pound).

16. This is not, however, the only consideration because, once the company has become insolvent and an IP is appointed, insolvency law also applies. The obligations of an IP depend upon the insolvency procedure concerned. As noted in our introductory comments, in some cases, it will be impossible for an IP to comply with the regulations on collective consultation.

17. In the case of administration, the IP's duties are prescribed by the Insolvency Act 1986 (the '**Insolvency Act**'). In particular, the administrator of a company:

- **must** perform his functions to meet one of three specified objectives. The first of these objectives is to rescue the company as a going concern and the third involves distribution to secured or preferential creditors only. However, in this context, we generally assume that rescue will not be possible and that there will be sufficient assets to result in a distribution of some kind to unsecured creditors. It is, therefore the second objective which applies, namely that the administrator is to **achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration)** [*emphasis added*]**;**

- must perform his functions in the interests of creditors as a whole; and

- must perform his functions as quickly and efficiently as reasonably practicable.

18. In order to meet the objective of administration, the administrator will (if a sale of the business as a whole is not feasible), seek to wind the business down in an orderly way and continue elements of the business that may be saleable. This frequently requires swift action to minimise outgoings, including salaries or wages. In some cases, redundancies may be made within hours of the appointment and continue over a period of time, for instance as contracts are performed. The interests of creditors as a whole may be best served by making dismissals before the minimum consultation period expires even though this may result in a protective award.

19. The time limits prescribed in the Insolvency Act (Paragraph 99 of Schedule B1) suggest that an administrator has 14 days in which to decide whether, and if so which, employees' contracts will be adopted. As noted above, in a compulsory liquidation all contracts are automatically terminated by operation of law, and in a voluntary liquidation, under section 87 of the Insolvency Act, the company must cease to carry on its business except as required for its beneficial winding up. Clearly none of these situations correspond with the time limits for consultation. In many cases even a 14 day period may be unachievable depending upon the funding available.

Q2: How does meaningful consultation with a 'view to reaching agreement' work in practice? How does notification work in practice? Please provide examples where possible.

20. Where a company is facing insolvency, the 'meaningfulness' of any consultation is likely to be very limited as the IP is required to meet the statutory objectives outlined above. It is not clear what additional purpose the collective consultation regulations are intended to serve in this context as an IP would be required under the Insolvency Act to consult with employees if necessary to meet the objectives set out in that Act. This might be the case, for instance, if the IP had reason to believe that the employees might purchase the business.

21. Regardless of the effectiveness or otherwise of the consultation regime in the ordinary course, where the company is insolvent the scope for avoiding or reducing the number of dismissals or mitigating the consequences is likely to be extremely limited and it is unclear what employees would have to gain by agreeing or disagreeing with the proposals.

22. In the experience of our members, employees often recognise for themselves that consultation will not result in improved prospects for employment and they want the process

to be over with as quickly as possible so that they can make any claim that they may have and seek new employment. It is at least questionable whether, at a time when there is uncertainty and complication in their lives, making employees go through a consultation exercise of this kind in an insolvency situation is the most humane approach.

23. As regards notification to the Secretary of State, similar difficulties arise as for consultation. The requirement to notify arises only when the employer 'proposes' to make redundancies and the notice must, where the thresholds are met, be given at least 30 or 45 days before relevant dismissals take effect, with no recognition that this may be impossible or impracticable where the reason for the redundancies is insolvency of the company. Similar risks would also arise were directors (or IPs) to notify the Secretary of State before there is a legal obligation for them to do so.

Q3: What do you understand to be the benefits of consultation and notification where an employer is facing, or has become insolvent? Please provide examples where possible. What further benefits do you think we could encourage?

24. Notification to the Secretary of State of proposals for large scale redundancies helps the Government prepare to provide assistance to those affected. However, this does not justify the continuance of the existing regime, particularly regarding the fixed time periods involved. The fixed periods are a crude measure in this context, where the extent of Government support required (and, therefore, the amount of notice that would be desirable) will vary according to many different factors, not simply on whether the number of redundancies over a given period will, for example, be 19 or 20, or 99 or 100.

25. We do not believe that the collective consultation regulations are beneficial in the insolvency context as currently applied. The main reasons for this should be apparent from our earlier comments. The legal obligation to consult applies whether or not consultation could be 'meaningful' in practice. In some cases where a company is insolvent, consultation is futile (in terms of any prospect of saving a material number of jobs), is a distraction for the IP and distorts the pari passu principle, as employees are retained and paid, as an expense of the administration, for more time than they are required for the benefit of the administration, thereby gaining an advantage over trade and other creditors which is not currently provided for by the priorities laid down in law. The process adds to the costs of administration or liquidation and, therefore, potential returns to creditors (which may include HMRC and, therefore, the taxpayer).

26. IPs may consider it necessary to defend claims for protective awards with a view to protecting interests of other creditors in accordance with the IP's duties under insolvency law (and, incidentally, to reduce cost to the National Insurance Fund). The harm arising from the conflict in legal requirements could, to some extent, be ameliorated were employment tribunals to take account of the practicalities involved where a company is insolvent in a consistent and predictable way, when determining the amount of any protective award. However, the experience of our members suggests that it is difficult to predict the approach of any given tribunal and that a full award may be made even when IPs have made a genuine effort to consult with the employees and minimise the effect of the situation in the light of the circumstances and information available to them but where dismissals are made before the end of the fixed consultation periods. The shortcomings of the legal provisions therefore have an additional indirect effect of increasing legal costs payable by insolvent companies at the expense of creditors.

Q4: In practice, what role do employees and employee representatives play in considering options to rescue the business and to help reduce and mitigate the impact of redundancies?

27. By the time that insolvency has occurred, the options are very limited. Frequently, the company has made considerable efforts to achieve a rescue or to find a buyer but has already been unsuccessful.

Facilitators and Inhibitors

Q5: What factors, where present, best facilitate effective consultation when an employer is imminently facing, or has become insolvent? Please provide examples to illustrate this where possible.

28. The ability of an IP to undertake consultation effectively is hugely dependent upon the preparedness of the employing company, for instance regarding keeping of employee records (and so the effectiveness of communications), understanding of the law, practices on employee engagement generally and whether or not the infrastructure for consultation is already in place. It is unrealistic to suppose that an IP can create the ideal environment for consultation if there are shortcomings in this respect given the short timeframes of insolvency proceedings.

29. An IP is also often reliant upon the accuracy of information provided by management. For example if management state that a particular person has been appointed as a staff representative, the IP may, in practice, need to rely upon this in deciding who to involve in consultation, but a tribunal may not take full account of the practicalities in assessing the amount of any protective award.

Q6: What factors, where present, act as inhibitors to starting consultation or notifying the Secretary when an employer is imminently facing, or has moved into an insolvency process? Please provide examples to illustrate this where possible.

30. As regards consultation, the administrative burdens involved in the collective consultation process may inhibit directors of companies in difficulties from starting consultations (and, therefore, from making redundancies) and this may result in corrective action being taken later than might otherwise be the case (for instance, when the company is insolvent and an IP has been appointed). Once the consultation process has extended beyond a few employees it is likely that the matter will become public knowledge (irrespective of confidentiality obligations), with potential risk to the prospects of sale or continuation of the business.

31. As regards notifying the Secretary of State, we have noted the difficulties arising under the current regime above.

Q7: What factors, where present, negatively impact upon the quality and effectiveness of consultation when an employer is facing insolvency, or has become insolvent? Please provide examples to illustrate this where possible.

32. The critical constraint in insolvency is that, in most cases, there are simply not funds available to pay all employees for the length of time that meaningful consultation of the kind envisaged in the employment legislation takes while fulfilling the objectives in the Insolvency Act to achieve the best outcome for creditors.

33. The regulations themselves are not best designed to produce quality or effectiveness in the insolvency context.

The Role of Directors

Q8: Are advisors (accountants, HR professionals, or where an insolvency practitioner is acting as an advisor pre-insolvency) informing directors of their need to start consultation when there is the prospect of collective redundancies? How do directors respond to such advice?

34. Where our members, whether or not licensed IPs, are acting as advisors to a business, the scope of their role will be as agreed between the advisor and the relevant business. This may, or may not, cover employment related issues. ICAEW members are subject to ongoing requirements regarding professional standards so that, where advising on these matters is within the scope of their engagement we would expect them to provide relevant information to directors.

35. It is the duty of the company to decide when, and then to meet, their statutory obligations. When acting as advisor, our members may, subject to the above paragraph, remind the company and its directors of their obligations, but our members have no locus to enforce compliance unless and until they are appointed as insolvency officeholder.

36. In many cases where a company is insolvent or at risk of becoming so, the directors have apparently conflicting duties: the duty to consult but also to maximise the value of the estate for its general creditors. They will therefore be reluctant to declare publicly that the business is, or may be, distressed because of its impact on the enterprise value.

Q9: Are directors facing insolvency starting consultation, and notifying the Secretary of State, as soon as collective redundancies are proposed and at the latest when they first make contact with an insolvency practitioner? If not, how can this be encouraged?

37. The requirements to notify and consult arise from the date that collective redundancies are proposed, as noted above (not when directors 'make contact' with an IP). One of the reasons that directors sometimes delay starting the redundancy process is because of the cash flow implications on the business relating to the cost of redundancy payments. When administrators are appointed they often find that the business is over staffed and potential purchasers are either put off a purchasing or significantly reduce their offer to take into consideration the costs of redundancies after transfers have taken place under TUPE; there are generally concerns about making dismissals which are in contemplation of a sale and are therefore generally automatically unfair and carry financial penalties. This results in a risk that the amount available for creditors is either restricted by lower offers from purchasers or unfair dismissal claims.

38. The largest companies which typically have HR and legal resource are more likely to be aware of the requirements and endeavour to make the notifications and consult at the required time, although they too face the issues noted above and the situation varies from one company to another. However, smaller companies will often be less aware of the regulations and, where they are, may be deterred from making redundancies as part of a corrective action plan by the prescriptive nature of the regime itself. It is often the case, therefore, that by the time professional advice is sought (or an IP appointed) it is too late for the business to be rescued or for meaningful consultations to take place. Notification and some degree of consultation might be encouraged by making the regulations less prescriptive in matters of detail (eg fixed timeframes).

39. If the government were to require notification and consultation at an earlier stage than is currently required (or done in practice), this would further protect one group of unsecured creditors (employees) at the potential expense of the other unsecured creditors, in circumstances where the employees are already provided with the safety net of the National Insurance Fund.

Q10: Normally are employee representatives already in place? What are the practicalities of appointing employee representatives when no trade union representation is in place?

40. We doubt that many businesses (particularly small ones) appoint representatives for redundancy consultation purposes unless and until redundancies are contemplated. The process can be time consuming and disruptive.

Q11: How does the hand over from directors to insolvency practitioners work when a company becomes insolvent in relation to engagement with employees?

41. The practice varies from case to case according to relevant circumstances, including the cash flow situation and prospects of sale of all or any parts of the business. The IP becomes responsible upon appointment as administrator and will seek to understand the business, including the position regarding staff, as quickly as possible, including through discussions with the directors.

Ensuring Effective Notification and Consultation

Q12: How might the process for notifying the Secretary of State and sharing information with third parties be improved?

42. The process of notifying the Secretary of State could be de-linked from that for consulting with employees so that notification could be made (on a strictly confidential basis) to the Secretary of State earlier in the process. However, the form of notification requires certain details to be completed, including the number and location of proposed redundancies, so that it would also need to be amended or notification made in stages. We are therefore not confident that this would be effective.

Q13: Could the process requirements for consultation be further clarified or improved

43. We believe that the law needs to be amended so that the obligation to consult does not apply where the redundancies are being made due to insolvency (eg insolvency should be treated as a special circumstance). If this proves incompatible with EU law, then efforts should be made to change the Directive.

Q14: Would further guidance be helpful and if so, what should this cover, who should it be aimed at and how could it be marketed most effectively?

44. The two areas of law are in direct conflict and it is difficult to see how this can be resolved otherwise than through legislative action.

Incentives and disincentives

Q15: How can Government best incentivise or disincentives the behaviour of directors and insolvency practitioners to ensure that consultation and notification are conducted in a timely and effective way in insolvency situations?

45. The Government should provide a coherent legal framework. Failure to notify the Secretary of State is already subject to possible criminal sanctions. IPs face personal liability in certain circumstances and sanction by their regulatory bodies. If the current system does not work, it is because it is flawed, not because IPs are systematically failing to perform their obligations under the Insolvency Act. Passing the financial burden to IPs to fund the consultation period where insufficient funds are available within the case can be expected merely to lead to more liquidations and a less effective rescue culture.

46. IPs will naturally wish to comply with law and do not need to be incentivised to do so (where remunerated generally on a fair basis). Where the law provides for priorities they will apply those priorities. In order to rectify the current situation, the Government would need to make clear whether consultation is a priority in itself, over and above the prospects of saving a business (or parts of it) and increasing returns to creditors as a whole, if that is, in fact, what the Government believes.

Q16: What would most encourage constructive engagement by employees when in this situation? And do you have any suggestions for how employee representatives can best be supported?

47. Where IPs are involved in the consultation process, we believe that they do try to encourage constructive engagement, within the significant constraints outlined above.

Q17: Do you have any examples of where constructive consultation and engagement has happened in an insolvency situation? If so, what was done and how?

48. Whether or not constructive consultation is possible (or what is meant by 'constructive') will depend upon the circumstances of each case. The means by which consultation is effected may also need to vary depending upon circumstances (and the insolvency procedure concerned).

Sanctions

Q18: Do you think that the current sanctions for failing to meet the notification requirements are proportionate, dissuasive and effective?

49. We believe that the current sanctions are sufficient and that if the notification regime is nevertheless found to be ineffective, then it should be reformed.

50. It should be noted that, if the risks involved in taking IP appointments increase due to the regulatory regime, there may be consequences, for instance, increased insurance costs that would be passed on through increased fees, something that would be contrary to the government objective to minimise costs of insolvency processes.

51. No one aspect of the regime should be considered in isolation because it may have implications in related areas. For instance, if sanctions for failing to notify the Secretary of State when a 'proposal' is made are increased with the intention that notifications would be made sooner than might otherwise be the case, then consultations may also begin earlier with potential consequences regarding returns to creditors outlined above.

Memorandum of Understanding

Q19: How well is the memorandum of understanding between R3, Job Centre Plus and the Insolvency Service working?

52. We believe that this question is best addressed by the parties to the MOU and do not comment here ourselves.

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