INSOLVENCY SERVICES CONSULTATION ON EU RECOMMENDATIONS

ICAEW welcomes the opportunity to comment on the call for evidence *European Commission Recommendation on a new approach to business failure and* insolvency issued by the Insolvency Service on 4 February 2015 a copy of which is available from this link.

This ICAEW response of 19 March 2015 reflects consultation with the ICAEW Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW licence holders.

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MAJOR POINTS

1. We believe that the UK's insolvency regime already meets the objectives set out in paragraph (1) of the Recommendation, namely to enable the efficient restructuring of viable enterprises in financial difficulty and to give honest entrepreneurs a second chance.

2. It is important to note that, in the UK, enterprises are free to seek help on restructuring at any time before they become formally insolvent, that we have a variety of alternative procedures and that there is a pool of skilled and experienced advisors available to assist them.

3. Different member states have fundamentally different approaches to insolvency and different social and legal frameworks, including on matters such as security rights and contract and employment laws. Attempts to harmonise particular aspects of insolvency on an EU wide basis may, therefore, adversely affect the coherence and efficiency of national regimes. There is an inherent risk of unintended consequences where laws or approaches of other member states are introduced into the UK's regime in a piecemeal way.

4. The UK's regime is well respected globally. While that is not a reason for the UK's approach to be adopted elsewhere, it is a reason for the UK government to adopt a cautious approach regarding changes that might affect the coherence of the UK's approach.

5. To the extent that the Recommendation is intended to result in a more debtor friendly regime, it should be noted that it may result in a reduced willingness of lenders and suppliers to extend credit in the first place. Making second chances easier may be at the expense of a first chance. The balance between debtors and creditors and, indeed, between different classes of creditor is a policy matter which we believe is best left to member states to determine and we do not comment further on that.

6. We are not convinced that this is an area where further harmonisation is in the interests of the UK. We are therefore commenting in a relatively general way on the assumption that the UK government will seek to preserve the current regime in the UK so far as possible.

7. The various insolvency procedures in the UK have different qualities which collectively afford a wide choice and flexibility for businesses and individuals to restructure. It is unclear to us whether the Recommendation applies to the procedures viewed collectively or individually.

8. In particular, it is unclear to us how the Recommendation on moratoriums would apply in the UK context in every case. In general, we would not favour extending moratoriums without careful consideration in the particular context. There is a risk that assets will be reduced to the detriment both of creditors and the prospects for continuing business. The Recommendation does not appear to provide safeguards or supervision in the moratorium period.

9. As regards discharge periods for bankrupt entrepreneurs (or, indeed, any individuals), there is a one year period for discharge from bankruptcy in the UK, but realisation and distribution continues after that time. It is important to distinguish between the release of the debtor from bankruptcy and the administration of the bankrupt estate. Administration of the estate may continue after three years (i.e. release of the debtor) and we see no reason to prevent that. As regards repayment plans, the parties involved may wish to agree a period longer than three years. We see no reason to preclude this. We also see no reason why courts should not be able to impose penalties for dishonest or reckless conduct which prevent discharge for a longer period.

10. With regard to Article 32(c) of the Recommendation, refers to provisions to safeguard the livelihood of the entrepreneur and his family by allowing them to keep certain assets. To the extent that this allows flexibility in relation to any discharge cut –off times, it is perhaps unproblematic, but it should not create any presumption that debtors would be entitled to keep any particular assets, such as private residences of families.

RESPONSES TO SPECIFIC QUESTIONS

Introduction

Q1: In general do you think the Commission's Recommendations if implemented by Member States, would meet the objectives as set out in Section 1 of the Commission's Recommendation?

11. We do not think that the Recommendations can be considered independently from the legal framework in which they would apply which, as noted above, vary in a number of material ways between members states. The quality or effectiveness of infrastructure, such as courts also varies between member states so that the effects of the Recommendations on cross border insolvencies are likely to be limited.

Definitions

Q2: Are the terms used by the Commission that are explicitly defined, clear?

12. We do not believe that all the terminology used in the Recommendation would be suitable for legislative purposes, but as this is only a Recommendation, we do not comment in detail. As a general observation, UK government needs to be prepared to depart from language used in EU publications where this is necessarily to take account of existing legislation. Language should be precise and its meaning clear. The use of the term 'honest bankrupt' is therefore unhelpful. Our regime provides for director disqualification or bankruptcy restriction orders, or undertakings in lieu, in defined circumstances which may, or may not, involve 'dishonesty'.

Q3: Are any of the explicit definitions problematic in a UK context?

13. See answer to Q2 above.

Q4: Are there any other terms, aside from 'an honest bankrupt' and 'a second chance', used in the Recommendation that would benefit from being better defined or that could be problematic if they were developed into law?

14. See answer to Q2 above.

Preventative Restructuring Framework

Q5: To what extent does the UK regime adequately provide for elements (a) to (e) of the Commission's Recommendation?

15. We agree with the general observations made in the consultation document about the efficiency of the UK regime as a whole. It is unclear whether the 'framework' referred to means that a single insolvency procedure (or every insolvency procedure) should contain all the elements (a)-(e) or whether the framework could encompass a variety of alternative procedures which collectively contain the elements. The UK provides for a variety of approaches which collectively appear to meet the objectives. We would expect the UK government to be concerned should the Recommendation result in a reduction of the variety of approaches in the UK.

16. The Companies Act regime for schemes of arrangement provides a flexible tool for a variety of purposes, including restructuring of companies in financial difficulty, but is not a formal insolvency processes; this regime is widely used by foreign companies. In addition administration and company voluntary arrangements provide mechanisms for restructuring. Each has different features.

17. With regard to (b) it should be noted that, in an administration, while the company (ie the debtor as defined) keeps control of day-to-day operation of its business, the company is operated by the insolvency practitioner not the directors. CVA's would not appear to meet (b).

18. Schemes of arrangement may not involve a stay on creditor action. These arrangement are used in a variety of contexts, not just for companies in financial difficulty. Objective (c) would appear to be met in administrations and CVAs, but, except in limited circumstances, the existing management is not left in control of the business. Any proposals to change this to require both objectives (b) and (c) to be met by the same procedure would involve material changes to established UK law and practice and we trust would not be accepted by the UK government without more consideration and extensive consultation.

19. The Call for Evidence refers to a moratorium for small companies planning a CVA. We are unclear how this could be expected to work in practice.

20. As regards objective (d), the UK's schemes of arrangement regime provides that dissenting creditors, by class, may be bound whilst also leaving other classes unaffected. [*cram down of out of money classes?]* A CVA, however, cannot modify the rights of secured or preferential creditors without their consent although all unsecured creditors are bound.

Q6. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objectives?

21. See answer to Q5 above. Schemes of Arrangement, while not an insolvency procedure, are capable of delivering some elements of the Recommendation.

Q7. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

22. We do not believe that the UK regime should be changed merely because of any discrepancy between it and the Recommendation. Any concern at EU level would need to be scrutinised carefully regarding potential impact on the UK's insolvency regime as a whole, bearing in mind the effectiveness of our regime as a whole in meeting the underlying objectives of the Recommendation. See answer to Q5 above.

Facilitating Negotiations on Restructuring Plans

Q8. To what extent does the UK regime already deliver the elements in this section of the Commission's Recommendation?

23. We agree with the general observations made in the consultation document about the flexibility of the UK regime. Again, the Recommendation does not seem to take into account the variety of options available to companies (and creditors) in the UK. [For instance, a scheme of arrangement does not involve any stay, but is a useful tool for companies.] As noted, administration involves the appointment of the official receiver or insolvency practitioner.

Q9. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objective?

24. See Q8

Q10. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime, for example by introducing additional options for a stay on enforcement action by creditors?

25. Although we consider that the UK regime in total does meet the criteria, we believe that if any elements of the Recommendation were to be introduced then it would be necessary to consult extensively to ensure that there are safeguards in the process. In the US there is a substantial degree of court supervision of a debtor in possession process which does not seem to have been fully considered here.

Q11. Do you agree with the Recommendation that a restructuring plan process should be commenced without court involvement?

26. Yes, but a moratorium should require supervision.

Restructuring plans

Q12. To what extent does the UK regime deliver the elements in this section of the Commission's Recommendation?

27. We believe that the information required for schemes of arrangement, CVA proposals and administration proposals delivers the requirements for content of restructuring plans.

28. We agree with the assessment in the consultation document regarding the binding of creditors. In particular, there may be good reasons why schemes of arrangement may be designed to affect certain classes only. Any changes to the UK regime in this respect would require careful consideration.

Q13. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objectives?

29. We do not think so.

Q14. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime, for example the ability to 'cram down' classes?

30. Cram down may be helpful but should be subject to safeguards.

Protection for New Financing

Q15. To what extent does the UK regime already provide protection for new financing?

31. We believe that the UK regime provides a high level of protection, although each individual case will, of course, depend upon its facts..

Q16. Is there anything in the UK regime which supports rescue finance which is not in the Commission's Recommendation but delivers the Commission's objective?

32. [New financing provided to administrations is an administration expense and therefore has priority over creditors. This supports rescue finance. However, security can only be granted if the existing secured creditors agree.}

Q17. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

33. We do not believe so.

Second chance for entrepreneurs

Q18. To what extent does the UK regime deliver a second chance for entrepreneurs through existing insolvency laws?

34. There is a short (1 year) term for non-culpable bankrupts. Directors of insolvent companies, unless pursued for misconduct, are free to take up new positions. We consider that the UK

delivers the Commission's objectives in this regard and indeed may be more flexible than is required, indeed it may be that the UK should review whether the effect of reducing the standard term of bankruptcy from three years to one year has met its objectives.

35. Of course, culpable directors may be disqualified for more than three years; it would be undesirable for the UK lose any discretion to set penalties of this kind.

36. The period of discharge referred to above should be distinguished from the time it takes for the trustee to deal with the assets from the estate. This is a separate matter and would be undesirable to impose statutory time limits on this as the time taken to recover assets may vary according to the circumstances.

Q19. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objective?

37. We do not believe so.

Q20. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

Forward look

Q21. In addition to the issues considered in the recommendation, are there other aspects of insolvency across the EU which the Commission should consider? For example:

Developing EU principles for fast, efficient out of court rescue procedures for small companies.

38. We do not support different procedures for small companies. The UK process is sufficiently flexible to deal with all sizes of companies.

Developing the conditions for rescue finance.

39. The UK seems to manage this well. It may be helpful to consider whether some form of "priming" so that rescue finance can take first ranking security would improve the provision of finance, but in general it is our experience that where there is a reasonable prospect of rescue the existing lenders are prepared to provide support. It is also worth noting that supply of credit to small businesses in the UK is influenced by many factors, not just the insolvency regime.

If so, what should the Commission consider?

40. N/A

Q22. Does the current EU landscape of different domestic insolvency laws create problems in practice? Is it a barrier to cross-border trade and investment in the EU?

41. Cross-border insolvencies can give rise to complex issues for insolvency practitioners, but differences in insolvency laws themselves are only one aspect of this. Different languages, culture and practices as well as varying employment and other laws all need to be taken into account. International insolvency practitioners experience these issues globally not just in the EU.

Q23. Should there be greater harmonisation or convergence of insolvency regimes across the EU? What are the benefits and risks to UK businesses?

42. Insolvency law relies on elements of almost every other area of law. Unless these are converged, insolvency law cannot be. We do not consider that harmonisation is necessary as the existing EU Insolvency Regulation (in its revised form) allows for an over-arching method of co-ordinating cross-border insolvencies within the EU.

Q24. Do you have any other comments?

43. No