



RESPONSE TO
A REVIEW OF THE
CORPORATE INSOLVENCY FRAMEWORK

INSOLVENCY SERVICE

Introduction

- 1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.
- 2 ICAS's Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.
- 3 ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.
- 4 ICAS is pleased to have the opportunity to submit its views in response to the Review of the Corporate Insolvency Framework issued by the Insolvency Service. We shall be pleased to discuss in further detail with the Insolvency Service any of the matters raised within this response.

Executive Summary

- 5 ICAS believes that in order to provide a vibrant economy and to support economic growth that businesses which suffer financial distress through factors largely out with their control and which would otherwise be viable deserve an opportunity to be restructured.
- 6 In the foreword to the consultation, The Rt Hon Sajid Javid, Secretary of State, Department for Business, Innovation and Skills said "...sometimes, insolvency is unavoidable. And should the worst happen to a business, we have a duty to give it [the company] the best possible chance to restructure its debts...". While the sentiments behind this statement are entirely correct, it must also be recognised that in some situations the most appropriate response is not to restructure the company. A distinction is required between viable businesses which are in temporary financial distress and non-viable businesses as a result of changing markets, economic conditions or incompetent management. For non-viable businesses, it is paramount that the company creditors, its employees, and its customers are protected as far as is possible.
- 7 Many of the proposals within the consultation are broadly welcomed. Further discussion will however be required with stakeholders to ensure that the detail behind any of the proposals taken forward do not result in unintended consequences and will deal with many of the practical concerns which we raise in our detailed comments.
- 8 A number of themes have arisen during our consideration of each of the consultation proposals under consideration. These include:
 - Whether the existing court structure in the UK would adequately support the proposed framework. The proposals would require the court system to be accessible, quick to react and with sufficient skills, knowledge and experience in insolvency, commercial, employment law amongst other areas to be effective. The UK court system is already under considerable strain and adding a further layer of complexity in relation to insolvency proceedings would require further resources. Consideration should be given to whether it is now appropriate to create separate insolvency courts in the UK to ensure there is access to appropriately resourced and skilled judiciary which is able to react quickly to matters requiring a decision.
 - Detailed discussions with UK bank and lenders will be required to understand their likely attitude to lending structures, security requirements against lending and the availability of finance were the proposals to be proceeded with. In particular, we are concerned that the proposals may result in a contraction of available credit lending and increase

in the cost of borrowing, particularly to the SME market which would restrict economic growth in the UK.

- We consider that the proposals may offer some benefit for companies backed by large syndicated lending facilities. Conversely, SME companies are perhaps unlikely to benefit from the proposals. We have suggested, where appropriate, alternative ways in which the objectives being pursued could be achieved to the benefit of SME companies in our detailed comments.

- 9 It is essential that any process which involves corporate restructuring or insolvency retains confidence of the relevant stakeholders. This relies on skilled and knowledgeable professionals who are appropriately trained and qualified to deal with such matters and backed up by a robust regulatory system. We therefore believe that any new restructuring regimes must be supervised only by insolvency practitioners.
- 10 A number of the proposals within the consultation are available or similar to procedures within CVAs. The consultation document highlights at paragraph 9.2 that the majority of CVAs fail. It is unclear from the consultation how the proposals will substantially change the underlying cause of failures seen within CVAs and hence how the proposals if implemented are likely to result in an increased number of rescued businesses.
- 11 We would suggest that in order to promote business rescue amendments could be made to existing legislation without the need to introduce substantially new proposals. In particular, we would suggest that the moratorium provisions which apply to CVA's could be extended to be available all companies. In addition, condition a) of paragraph 3(1) of Schedule B1 to the Insolvency Act 1986 (objective of administration) could be amended to refer to the 'business of the company'.

Detailed Comments

- 12 Our detailed responses to the questions posed within the Consultation document are set out in [Appendix 1](#)

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Appendix 1 – Responses to questions posed in the Consultation

The Introduction of a Moratorium

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

The current proposal is unclear. Paragraph 7.7 of the consultation documents refers to the moratorium as a 'single gateway to different forms of restructuring', while paragraph 7.8 acknowledges that '[not] all companies needing to restructure...[will need to] apply for a moratorium'. Is it the intention that the moratorium be available only where considered necessary by the company, but that the new moratorium process would replace the moratorium currently available in relation to a CVA or administration?

We consider that not every company entering or considering entering a restructure or insolvency process would require the benefit of a moratorium. To do so would eliminate the possibility of informal restructuring and turn every restructure into a formal process which would by necessity have a cost burden. In addition, there would be practical difficulties in defining the parameters of required entry into the moratorium process.

- 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?

We agree that an out-of-court process would be the most beneficial and efficient means for a moratorium to become effective. This represents a cost effective and time critical method of commencement.

We agree that the alternative of a court hearing would add additional cost and time delay. In addition, this would result in an increased burden on an already stretched UK court system. The proposed out-of-court lodgement with a right of appeal strikes an appropriate balance, although additional safeguards may be required to prevent abuse of the moratorium. In particular, we would consider it essential that an appropriately qualified, skilled and knowledgeable professional has agreed that a moratorium would be an appropriate protection available to the company (see comments at question 6).

We note that para 7.14 of the consultation provides that the relevant documents would also be filed at Companies House and sent to creditors. While we agree that transparency when dealing with a company in potential financial distress is appropriate, we would also highlight that many current restructuring projects that are undertaken with a successful outcome are only successful as they are carried out with minimal levels of publicity. This maximises the prospect of customer, employee and supplier retention. We would therefore encourage further consideration being given to the necessity and level of publicity provided during any moratorium.

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

We agree that it would be appropriate for eligibility criteria and qualification conditions to apply in order that only viable businesses could avail themselves of the provisions. This is necessary to avoid the prospect of abuse by businesses who have no realistic prospect of achieving a restructure and who simply wish to buy time to in order to put in place arrangements which would not maximise value for creditors.

The eligibility tests set out in the consultation document are broadly supported. We have concerns however on how practical it will be to define in sufficient detail the criteria with which to evaluate whether a company "is already or imminently will be in financial difficulty". Failure to define this appropriately and will either result in criteria which is too restrictive to allow companies access, or too wide such that it will be open to abuse. The criteria should not be subjective as to do so would increase the prospect of challenges being raised, increasing the time and costs associated with the moratorium.

We also note the proposed restrictions set out in in paragraph 7.20. We consider that the scope may warrant a wider application to prohibit those behind serial company failures from benefiting

from the moratorium. For example, the scope could be extended to include companies who in the previous 12 months have bought the business of a company in administration.

We note that there is no proposal to restrict eligibility according to size of company. We would draw attention to our general comments that further consideration is required to be given to the potential impact on availability, terms and costs of finance to SME companies.

The primary qualification condition that the company has sufficient funds to carry on in business during the moratorium period is appropriate, although again requires further discussion with stakeholders on the practical interpretation. Clarity is required on whether this is assessed on the basis of the moratorium in place (for instance by inclusion of the costs associated with the moratorium supervision) or otherwise.

We also question the practical implications associated with concluding that there is a reasonable prospect of a compromise or arrangement being agreed as part of the qualifying conditions. This would in practice mean that discussions would have to take place with key stakeholders prior to entering the moratorium where their support is necessary for the compromise or arrangement to be implemented. This would appear to be counter to the stated aim that the moratorium would allow such discussions to take place.

- 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?

We agree with the broad principle that any moratorium introduced should be implemented by directors via an administrative procedure with appropriate rights of challenge by creditors. Any such challenge would have to be heard and resolved as a matter of urgency.

We are concerned that with an already over-burdened court system that the speed which such challenge would be capable of being addressed, and the cost to both the creditors and the company, may result in a barrier to legitimate challenges. Unlike many other legal jurisdictions with similar provisions, the UK does not have separate insolvency courts. We would suggest that if these proposals are taken forward that consideration should be given to such provision within the UK in order to support the additional workload and ensure an appropriate skillset is available for the largely commercial decisions that will require to be made.

We note paragraph 7.28 setting out the right to challenge actions which unfairly prejudice the interest of a creditor or creditors. While this would at first instance seem appropriate, it is not uncommon for situations to arise where one or more creditors may be prejudiced by a course of action in the course of pursuing the wider objective of saving a viable business. It would be essential in drafting legislation to make it clear that the challenge must be assessed against the overall objective.

The position of employees and the obligation to consult must also be considered. There may be a requirement, when initiating a moratorium, to commence a consultation process with the employee base. The directors expose themselves and the company to risk if they do not. Consultation processes result in increased cost and uncertainty and could adversely impact the restructuring plan. Employers cannot require employees to continue working for them. The uncertainty of a restructuring could drive key workers to leave the business.

We also highlight that there are significant practical difficulties relating to the proposed provisions for essential goods and services. This is deal with further in question 9 below.

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

We are broadly supportive of the proposed arrangements for the duration, extension and cessation of the moratorium. We agree that a 3-month period provides a balance between allowing sufficient time to evaluate, commence and progress restructuring plans and ensuring that a moratorium is not used in an inappropriate manner.

The process of formulating restructuring plans can take anywhere between a few weeks and many months. This is dependent on many factors such as the availability of management

information within the company, its readiness and resource availability to dedicate to the restructure, the attitude of funders and credit availability, and many more factors specific to each individual restructure arrangement. We therefore consider that the proposed maximum moratorium period (without court sanction of an extension) of 3 months provides an appropriate balance to allow the majority of companies to benefit from the moratorium without overburdening the court where further time would be required.

We are however aware that for many creditors a period of 3 months will seem a significant period of time. We would therefore suggest that consideration should be given to amending the proposed moratorium arrangements such that the moratorium should be reviewed by the supervisor after 6 weeks and only continued where the supervisor is satisfied that appropriate progress is being made with arrangements. What is clear is that the proposed duration will not be appropriate in all cases.

We do not agree with the proposal set out in paragraph 7.37 that where a company enters administration after the moratorium period that the length of the administration is reduced by the period the company has already been in the moratorium. This acts as a disincentive for the company to make use of the moratorium. The company could enter administration immediately and benefit from the same moratorium provisions, reducing the risks for the directors through the company immediately coming under the control of the administrator. In addition, there would be significant practical implications and costs associated with insolvency practitioners requiring to adjust timescales relating to statutory obligations where the date of administration is effectively 'rolled back' to the commencement of the moratorium. We could also envisage that in particularly large and complex company restructures the moratorium period may have to be extended significantly with the result that the administration period may almost be over before the company actually enters administration.

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

No. It is essential that any process which involves corporate restructuring or insolvency retains confidence of the relevant stakeholders. This relies on skilled and knowledgeable professionals who are appropriately trained and qualified to deal with such matters and backed up by a robust regulatory system. We therefore believe that the moratorium should only be supervised by insolvency practitioners.

We would highlight that while many accountants are robustly regulated by professional bodies such as ICAS, accountancy is not currently a regulated profession in statute, unlike many other countries. Currently there is a very low barrier to entry and currently any unqualified individual can set up in business as an accountant. ICAS understands that at least one third of the sector in the UK has not undertaken any training or possess a formal qualification. ICAS has worked with Ipsos Mori to undertake relevant market research and we understand the Institute of Chartered Accountants in Ireland has undertaken a similar analysis. In the ICAS poll, 92% of the poll considered that all persons and business providing accountancy services in the UK should be qualified (that is, completed a period of formal training and examination on relevant skills, experience and values). 93% of the polled population considered that all persons and business providing accountancy services should be regulated.

ICAS has therefore been calling on the Government to designate accountancy as a regulated profession to ensure that every provider of these services are:

- Formally qualified, and required to keep up to date;
- Governed by a professional code of ethics and professional behaviour;
- Regulated for compliance with various regulatory requirements.

Without such statutory protection, there is a significant risk that unqualified persons providing accountancy services could be appointed as supervisors when they do not have the necessary competence or integrity to conduct this work with the appropriate due, care, skill and diligence. There is a risk that those who are not members of a professional body could utilise these provisions to facilitate the removal of assets during the period of the moratorium. In addition to the immediate detrimental effect on creditors, this would pose a significant risk to

the trust in the UK restructuring system and profession which in turn is likely to result in increased lending costs and potentially restrictions on credit lending as lenders factor these risks into lending criteria.

Even if the intention was to restrict supervisors to those who are regulated by a professional body we would have significant concerns in relation to the cost and regulatory burden associated with that. Paragraph 7.41 of the consultation indicates that the supervisor would be subject to certain minimum standards and qualifying criteria and have relevant restructuring expertise. This would suggest that a member of a professional body such as ICAS would require to be regulated and authorised to carry out the role of supervisor in order that the minimum standards, qualifying criteria and experience can be verified in order to provide reassurance that the member meets the relevant criteria. To create a separate regulatory system over and above that for insolvency practitioners would increase the regulatory burden on members and their professional bodies resulting in additional costs.

While we can understand the drive to separate the moratorium supervision and any subsequent insolvency appointment we do not agree that there should be a complete prohibition on a supervisor being prevented from taking a subsequent insolvency appointment. A company led restructure may involve the use of a formal insolvency procedure as part of achieving the overall restructure. Accordingly, the formal insolvency is 'part of the whole'. Preventing a subsequent appointment is likely to add additional costs with a resultant detrimental return to creditors.

We would recommend that where a subsequent insolvency appointment is required, that the supervisor may be permitted to take such appointment with the consent of creditors.

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

While broadly we are content with the proposals, we highlight that there may be a consequential impact on the availability and cost of lending, particularly to the SME sector, to reflect the additional risk and potential impact on recoveries to secured lenders.

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

We have substantial concerns that the benefits associated with creditors having the right to request information are insufficient to outweigh the cost and other disadvantages associated with the right to request information. Experience of our members indicates that there is a likelihood of spurious requests being made which will add unnecessary costs to the moratorium supervision process. The moratorium period proposed is a relatively short period and therefore it is doubtful that any additional information requested and provided will be of significant value as to be effectively acted upon. Where there is disagreement over whether information can or cannot be available this would require to be resolved by the Court, again at additional cost and with time delay.

We fully support transparency within insolvency processes. Although there may be no legislative requirement currently to provide additional information, insolvency practitioners regularly will provide information requested on an ad-hoc basis (subject to legal and commercial constraints). We are not aware of a particular mischief or substantial call from creditors or their representative organisations for further information to be made available in the manner suggested. We would therefore strongly oppose the suggestion that such a provision should be extended to all insolvency procedures.

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 agree that in certain businesses, essential suppliers can extend beyond the provision of gas, water, electricity and IT. As a result, in principle we would support the extension of essential supply provisions to other areas.

We do not necessarily agree that the continuation of essential supplies would in itself result in a higher number of business rescues. The factors contributing to a business rescue are far more complex. In particular, and of perhaps far more significance, is the continued support of customers and employees when a company is in financial distress. It is unfortunate that given the unanimous view of respondents to the 2015 Call for Evidence in relation to collective redundancy consultation in financially distressed businesses that there is an inherent tension between employment law and insolvency law, this consultation document makes no reference or contains any proposals in respect of employees.

The proposal also does not address the fundamental issue of actual supply. While it may be possible to prevent termination or variation of a contract, that does not equate to compelling a supplier to work co-operatively in relation to the supply and delivery of goods and services. For example, a supplier could provide lower priority to orders received, or reduce the dispatch speed in relation to a company who has designated their contract as an essential supply. The reduced performance of the supplier without changes to contractual terms could in certain circumstances cause the rescue to fail. Consideration should be given to strengthening the essential supplier provisions to provide sanctions against essential suppliers that do not continue co-operation with the company on the same terms as previously.

We also consider that there will be practical difficulties which require further consideration. For example, how will designation of essential supply interact with retention of title which the supplier may be entitled to, or how would landlords hypothec be affected?

- 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 are concerned about the potential burden on the court system where challenges are made to the designation of essential contracts. Such challenges must be resolved as a matter of extreme urgency in order not to fetter the chances of effecting a successful company rescue. We would suggest that where the essential supply is notified as part of the moratorium filing, it may be appropriate for any initial challenge to be referred to the supervisor for arbitration rather than the court.

Where the essential supply is designated by an officeholder in a CVA or administration then we consider that the safeguards currently provided for essential supplies, including the right to obtain a personal guarantee from the office holder are appropriate and therefore it is unnecessary to introduce further safeguards, including the ability to challenge inclusion through the courts.

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?

While we consider that the provisions could be deployed either as a new standalone procedure or as an extension to an existing procedure such as a CVA, our preference would be for a new procedure to be created.

It is our view that a multi-class restructuring procedure with cram-down provisions is likely only to be used in large scale and syndicated lending scenarios. We therefore believe that it would be most appropriate to differentiate between the existing CVA provisions and a new restructure procedure.

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

While we agree with the 'cram down' provision, we highlight that the opportunity will still exist for those dissenting creditors who are bound by the arrangement to be disruptive or obstructive in their co-operation and day to day dealings with the company during the restructuring implementation period. Provisions should be included to allow an order to be obtained against

such creditors where the circumstances justify and jeopardise the successful company restructure.

We note that the proposals do not make any mention of shareholders being crammed down. We would suggest that should the proposals be taken forward that provision should be made to ensure shareholders are included in the cram down otherwise they enjoy a windfall at the expense of the creditors.

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

We agree that the proposed safeguards provide adequate safeguards for creditors.

We would draw attention to the burden that will be placed on the court system to operate such safeguards. In order to be effective, substantial commercial and financial expertise rather than legal knowledge is likely to be of primary importance in ensuring an appropriate outcome.

- 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?

While we support the theory of a minimum liquidation valuation basis being included in the test for determining fairness, the practicalities may bring more significant challenge.

Many legal cases brought before the courts already focus on expert valuations. What is known from these cases is that valuations can be highly subjective, based on substantially different assumptions and based on either overly optimistic or overly pessimistic views depending on the perspective being taken. The range of assets likely to require valuation is wide and varied ranging from those which are highly commoditised to highly specialist and unique assets. Valuation of intellectual property is also highly complex and then there is the question of goodwill valuation. Without highly defined parameters it can be expected that a 'liquidation valuation' will be the subject of close scrutiny and challenge. Such argument in court will result in increased cost and time delay in approval of a rescue plan for a business which is already financially distressed. We are therefore unconvinced that there is a significant benefit including a minimum valuation basis within the test for determining reasonableness.

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. We are concerned that such provisions would substantially undermine core business finance models and as a result could significantly restrict finance availability, increase finance pricing and result in additional securities being required on lending, particularly in the SME market. This would have a significant impact on the ability of the UK economy to grow in the longer term.

We do not consider that such measures would result in a direct increase in business rescue. While the availability of finance is a factor in business rescue there are other factors which have a more significant impact and without being addressed will not result in increased business rescue. One such example is the fundamental tension between employment law and insolvency law. Resolving this issue would have a much greater impact in promoting business rescue.

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

As highlighted in our response to question 14 the valuation of assets is often fraught with difficulties. As our members are not valuers we do not express a view on how the charged property should be valued.

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

As stated in our response to question 15 we do not support the view that rescue finance should be provided super-priority.

Impact on SMEs

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

As highlighted in our response to various other questions, we consider that many of the proposals put forward in the consultation may be detrimental to SME's more generally due to potential lenders attitudes. Lending criteria may be tightened, finance pricing adjusted and additional security requirements to compensate for the potential erosion of secured creditor rights and return should a company require rescue procedures in the future are likely to affect SMEs.

One of the biggest barriers to corporate rescue is the inherent tension between employment legislation and insolvency legislation. The Government undertook a Call for Evidence in relation to collective redundancy in financially distressed companies during 2015. The summary of responses confirmed that stakeholders considered this tension to exist and was a significant barrier. We would call on the Government to address this as a matter of urgency.

We also note the significant failure rate of CVA's mentioned in paragraph 9.2 of the consultation. We are not aware of any empirical research into why CVA's have such a high failure rate. Anecdotally it is suggested that a significant proportion of CVA proposals will focus on financial/debt restructuring without addressing more fundamental and underlying operational restructuring or management change. Measures should be considered to focus more attention on how a company is going to change as a result of a CVA to ensure a higher prospect of success.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

Yes

No