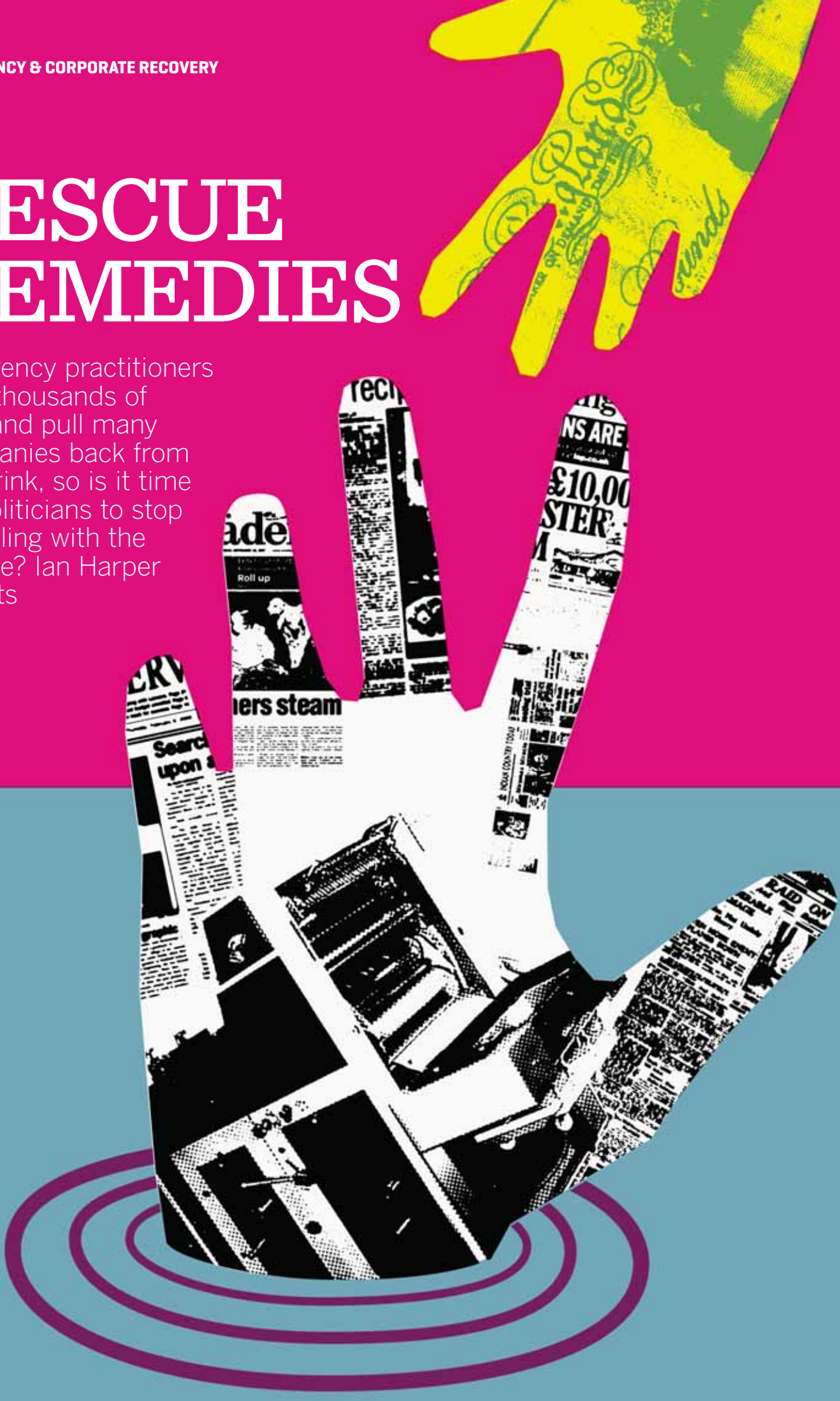
RESCUE REMEDIES

Insolvency practitioners save thousands of jobs and pull many companies back from the brink, so is it time for politicians to stop meddling with the regime? Ian Harper reports



THE UK'S insolvency profession "is a crucial part of UK plc". That's the assertion made by Andrew Tate, vice-president of R3, the trade body for insolvency professionals.

Figures compiled for R3 by ComRes show that from 2013/14, practitioners helped rescue about 20 per cent of insolvent businesses. Some 6,700 of these (41 per cent of formal insolvencies) continued trading in some way after entering insolvency, helping to save around 230,000 jobs.

Notwithstanding this apparent success, the UK insolvency regime hasn't been immune from political tinkering over the past few years, and several of the practitioners we spoke to feel it's time for a break to let things settle down.

David Menzies CA, director of insolvency at ICAS, says: "Changes to IP remuneration, pre-pack administration, the introduction of partial licensing, regulatory powers and insolvency rules modernisation have all been tackled by the previous government administration and are to be implemented by the profession in the coming 12 to 18 months. That's quite a lot of change, and we would like to think that there will be a period of reflection as all of those changes take effect before further substantial changes are contemplated."

Graham Bushby, head of restructuring and recovery at Baker Tilly, agrees: "There needs to be a period of time to allow these changes to bed down and the full impact to be assessed and understood before further changes are introduced. The sheer weight of these changes is confusing to stakeholders and the profession alike and is hampering transparency of the process." More negatively, he says: "The increased cost of regulation and change could drive a number of insolvency practitioners out of the market with the result that the work could be pushed back to the government."

"The general impression is that the Insolvency Service is targeting the low hanging fruit, rather than the serial offenders who are expensive to pursue"

Graham Bushby

Colin McIntosh, banking, restructuring and insolvency partner at law firm Brodies, warns: "The regulatory framework within which insolvency practitioners (IPs) now operate is such that any further regulation of their professional activities may be seen as potentially inhibiting their ability to perform their duties in the most efficient and cost-effective way."

MORE ISSUES TO ADDRESS

Nevertheless, there are still issues practitioners would like to see addressed by the insolvency minister Anna Soubry. For Bushby, the key one is a need to promote a "rescue culture". He says: "There's little empirical evidence to suggest that administrations are promoting a rescue culture. More could be done by the Government to encourage the use of company voluntary arrangements to promote a rescue culture. The current moratorium provisions in relation to this procedure are ineffective and little used which, combined with the almost ubiquitous demand for punitive extended terms and contributions, act as an effective barrier to access and do little to promote a rescue culture or entrepreneurial society."

For Yvonne Brady, head of corporate restructuring at law firm HBJ Gateley: "The time may be right to look at a Scottish equivalent for the Law of Property Act – receivers whose sole duty is to dispose of charged property, which is property against which any debts are secured. At the moment we need to use liquidation or administration under the Insolvency Act to deal with property."

Central to a "rescue culture" is preserving jobs and Graeme Smith, leader of Henderson Loggie's business recovery and insolvency team, wants Soubry to prioritise consultation with employees in an insolvency situation. "Current rules on redundancy and consultation with staff are not compatible with an insolvency situation where there is no time available to enable lengthy negotiations," he says.

Menzies agrees: "A significant area which attracts attention from politicians and the wider public is the treatment of employees when a company is facing insolvency. The inherent tension between employment law and insolvency law needs to be tackled."

LIFE AFTER CITY LINK

The high-profile collapse of delivery business City Link at the end of last year saw some 2,700 jobs lost. A joint report from the House of Commons Business, Innovation and Skills and Scottish Affairs committees concluded that the company's private equity owners, Jon Moulton's Better Capital, were "morally, if

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not legally, responsible for the difficulties that many of these individuals and small businesses now find themselves in", and called for tougher sanctions on company directors to protect staff and creditors.

But are such sanctions appropriate or necessary? Claire Middlebrook CA, managing director of Middlebrooks Business Recovery & Advice, thinks introducing overly tough sanctions may put people off doing business in the UK, but she adds: "That being said, the current scheme could be seen to be easy on directors."

Eileen Maclean, a director of specialist firm Insolvency Support Services, says: "A lot of the criticism over City Link came about because self-employed contractors lost out in the administration of the company, and the self-employed are not automatically classed as employees. Given there are more self-employed contractors in many sectors, I think there's a debate around the changing nature of work and workforce composition, and there is perhaps an argument for widening the definition of 'employee' in insolvency."

Blair Nimmo CA, head of restructuring with KPMG in Scotland, agrees and cautions: "A change in legislation should be carefully considered to balance the entrepreneurial requirements of the economy with the restriction from greater regulation. A single case should not be the catalyst for a significant legal change."

ROOTING OUT THE ROGUES

Insolvent directors are one thing, rogues are another, and a number of practitioners believe the time has come to tighten up.

The Insolvency Service struck off 119 company directors in the 12 months to March for criminal wrongdoing ranging from fraud to false record keeping. This was 83 per cent up on the previous year and this increase comes despite a cut in Insolvency Service staff from 2,500 in 2007 to 1,970 in 2014.

But are enough being caught? Jeremy Willmont, head of insolvency at Moore Stephens, told the *Mail on Sunday* in July: "While it's great to see more criminal directors banned from running firms, there's a feeling a number are slipping through the net due to lack of resources at the Insolvency Service. The Government should strongly consider increasing the Insolvency Service's budget."

Bushby says: "We would agree with the views expressed by Mr Willmont. We think that the Insolvency Service, despite the increase in disqualifications, is woefully under-resourced and that this is driving the targeting of disqualification actions. The general impression is that the Insolvency Service is targeting the low hanging fruit – that is those cases with the best chances of success – rather than the serial offenders who are expensive and time-consuming to pursue."

For Matt Henderson CA, head of restructuring with Johnston Carmichael (which was named Insolvency team of the Year at the 2015 Scottish Accountancy Awards), a lack of co-operation from directors is a problem. He says: "When appointed, insolvency practitioners must undertake an investigation into the conduct of directors of a company in the previous three years, which requires input from the individuals concerned. But in too many cases, there is complete lack of co-operation from the directors to the extent that important documents, such as a statement of affairs of the company setting out details of assets and liabilities, are not returned."

The Company Directors Disqualification Act 1986 needs new powers to compel directors to co-operate or face automatic disqualification for three years, he says.

Menzies notes that resources will always be limited, but says: "Of primary importance is that those finite resources are applied in pursuing disqualification of those directors who have demonstrated the worst types of behaviour. We have seen over the last few years a continuing upward trend in the average length of director disqualification. This would suggest that the Insolvency Service is pursuing effectively those directors whose activities cause substantial harm."

Smith says: "Perhaps more feedback from

"I would like to see a simplification of the language used, but still imparting the same message, which would allow greater engagement and understanding of what it is we do"

Claire Middlebrook

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City Link went into administration in December 2014

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ICAS HOSTS INSOLVENCY CONFERENCE

The ICAS Insolvency and Restructuring Conference takes place on 11 and 12 November at the Gleneagles Hotel, Auchterarder. As well as high-profile speakers, including Fergus Ewing MSP, Scottish minister for business, energy and tourism, the conference includes workshops for practitioners in three distinct strands: personal insolvency, corporate insolvency and restructuring.

Cost: £535 + VAT (members), £635 + VAT (non-members). For more details turn to page 54 or go online to icas.com and search for "insolvency conference".

the Insolvency Service on the quality of the reporting and investigation would make the system more robust and allow IPs to improve their style and content of reports."

For McIntosh, the fundamental issue is whether the funding is available to IPs and the Insolvency Service to allow them to pursue unfit directors. He says: "To put it more simply, if the necessary tools to fix your car already exist, but there is insufficient money to pay for the mechanic to use them, there is little point in simply spending more money to make more tools. Your car still won't get fixed."

WHAT ARE YOU CHARGING ANYWAY?

Most professions must now disclose their charges up front and under rules announced by then business minister Jo Swinson on 3 March, IPs in England and Wales must provide upfront estimates of the cost of insolvency work from 1 October. What impact might this have?

Derek Forsyth, head of business recovery and insolvency at Campbell Dallas, says: "IPs are now becoming used to the process of providing fee estimates at the outset of insolvencies and not only in relation to bank appointments. With the creditors effectively paying for the insolvency,

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Blair Nimmo

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prima facie this provides greater transparency to them and a clearer expectation at the outset of the possible recovery to them. In practice, the full facts behind a company's demise and its assets and liabilities are not always made clear at the outset and, in providing an estimate of fees, IPs must be aware of the fact that things may not be as straightforward as they have been portrayed."

However, while Bushby welcomes steps to improve transparency, he cautions against driving the insolvency market into a transactional regime driven by price. He says: "There's a risk that the consistent downward pressure on fees without a real understanding of the complexity of the process will render smaller appointments uneconomical and will push firms out of the market, as well as undermining the thoroughness of the process, particularly in relation to the investigation of director conduct. This would result in more insolvencies being dealt with by the government and the encouragement of bad behaviour by directors."

In his view, the UK regime outperforms those of other key economies, including the US, Australia, Germany and France.

"Practitioners would like to see the insolvency minister Anna Soubry (pictured) promote a 'rescue culture' and entrepreneurial society as well as prioritise consultation with employees in an insolvency situation"

PRE-PACKS

The "pre-pack" process, under which the sale of the business and its assets is negotiated prior to formal insolvency procedures, aims to save the viable elements of a business and avoid the negative impact of an insolvency. Criticism from some quarters over the potential for abuse in this route led to the introduction of a new pre-pack regime, which is set to come into force in October or November. Not everyone is happy with the new approach, however.

Tom MacLennan CA, partner with restructuring and insolvency advisers FRP, says: "It's difficult to see what value is going to be added by the introduction of the pre-pack panel, which is an entirely voluntary pre-transaction event that has to be initiated and paid for by the acquirer and where no account need be taken of the panel member report by the insolvency practitioner or acquirer."

Brady says: "In theory, the 'testing' of the pre-pack proposed should ensure more robustness on the other side of the sale. In practice, time can be very limited while funding is still difficult to get. The pre-pack option, while not perfect, may be the only chance for a business and its people. That said, the profession has worked hard to ensure that the pre-pack process has credibility and real commerciality behind each deal."

IN 2013/14 THE UK INSOLVENCY PROFESSION:

- assisted 10,400 businesses, employing 540,000 people
- advised 70,000 businesses about their finances
- helped 60,000 individuals through an insolvency procedure
- helped individuals with an average of £228,000 of debts (including mortgages); and
- helped individuals repay £5bn of personal debt to creditors within five years.

LOOKING AHEAD

Sian Aitken, corporate recovery partner at law firm CMS, looks to the EU: "With member states increasingly competing for the most flexible and successful restructuring procedures, a number of IPs will be hoping the Government looks seriously at introducing a formal restructuring procedure, backed by legislation and carrying the benefit of recognition under the EC Regulation."

But the most commonly repeated wish is for improved awareness of the insolvency regime and what it does. Maclean says: "The media, IPs and government have a role to play in making sure that our contribution to the economy, and the complexities of what we do, are understood and valued."

Bushby agrees, adding: "We would like the Government to avoid 'change for change's sake', and only introduce measures that add value to and streamline the process while promoting a rescue culture and regularising the market place in terms of the legislative and regulatory framework. It is our view that the wider public (and some MPs) do not have a great understanding of the complexity of the insolvency process, the experience and education required, as well as the need to grapple with legislation affecting many different industries."

For Middlebrook, easing the jargon would help: "I would like to see a simplification of the language used, but still imparting the same message, which would allow greater engagement and understanding of what it is we do." CA

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A TRADE CREDITOR'S LOT IS NOT A HAPPY ONE

After the political and media attention on the City Link collapse, could change be on its way for contractors in the event of an insolvency?

WE HAVE all heard of many formal insolvencies resulting in what would appear, to the man on the street, to be an unfair outcome for trade and other unsecured creditors. Recent headlines (including the demise of City Link) have highlighted how ordinary unsecured trade creditors, such as contractors and sub-contractors, can be left exposed.

Nothing of significance regarding the statutory ranking of claims and rights of distribution in a corporate insolvency has changed of late. The Enterprise Act 2002 introduced the Prescribed Part entitling unsecured creditors to a share in floating charge realisations, but the fundamental structure of the ranking of claims has not otherwise altered significantly. However, if MPs pursue the concerns raised in relation to City Link, it is possible that change could be on the way.

Political interest in City Link resulted in MPs expressing concerns that the current statutory regime did not provide adequate protection to employees, and that innocent trade creditors were left exposed with little prospect of any meaningful return. In reality though, from a legal perspective, the employees and trade creditors of City Link would be treated in exactly the same way, and in accordance with the same statutory rules of ranking, as creditors in any other insolvency. The nature of formal insolvency, unfortunately, is that there are typically insufficient assets to meet all liabilities. Who shares in what assets, and to what extent, is a matter of law. Should we now expect any changes in that regard?

In September 2014, the Department for Business, Innovation and Skills asked the Law Commission to examine the protections afforded to consumer prepayments and to consider whether such protections should be strengthened. The consultation is ongoing. Clearly consumer protection should be viewed differently from the way in which trade creditors and business (including employment) debt should be treated, but the political voices at the time of, and immediately after, the City Link administration appeared to be suggesting that additional protections for those categories of creditors should also be examined.

We could therefore expect a further reference to the Law Commission – this time to look at whether the existing statutory ranking regime remains fit for purpose and, of course, the likely consequences that any alteration would have on the availability of funding from traditional sources of secured lending.

Trade creditors can currently seek to protect themselves and limit exposure through a variety of measures, such as:

- Retention of Title – a favourite for suppliers of goods, whereby there is a provision in a contract that the title to the goods remains with the seller until payment is received.
- Very limited credit and payment terms that would reduce the magnitude of exposure.

Equally, future measures may include:

- A rise in the requirement for financial reporting and provision of information by a customer to provide as much advance notice as possible of potential challenges approaching.
- Security for trade debts – if that is feasible given pre-existing bank or other secured lending.
- An increase in the requirements for deposits being held as security during any period of trading.
- An increase in the obtaining of credit insurance – with the costs passed on.

None of these are new or novel mechanisms for the limitation of exposure in the event of a formal insolvency of a customer – and they are, of course, wholly dependent on the respective bargaining positions of the parties. However, recent political comment and media reporting on such matters may result in an increase in their prevalence – or at least requests for them. That, in turn, may directly impact on business itself. CA

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"Political interest in City Link resulted in MPs expressing concerns that the current statutory regime did not provide adequate protection to employees, and that innocent trade creditors were left exposed"