IAN HARPER LOOKS AT A RAFT OF MEASURES AIMED AT UPDATING INSOLVENCY PRACTICE AND ASKS – IS THIS A CASE OF 'ALL CHANGE' OR SMALL CHANGE?

A WAVE OF REFORM

THE PERSONAL and corporate insolvency regimes are set for change as a result of new regulations and legislation from Westminster and Holyrood.

The key measures affecting the insolvency regime are wrapped up in three pieces of legislation, a set of reforms on the 'pre-pack' system proposed by the Graham Report, and proposals announced alongside Teresa Graham's recommendations by UK business minister Jenny Willott to toughen up regulation of the insolvency profession, of which more later.

SO WHY DOES THE CURRENT INSOLVENCY REGIME NEED REFORM?

Bryan Jackson CA, BDO business restructuring partner and convener of the ICAS Insolvency Committee, says there is an issue with the perception of the role of the insolvency practitioner that has been exacerbated by the tough economic times.

He says: "The lack of understanding of the role of IPs has not abated over the years. During the recent recession, understandably to an extent as there has been considerable financial pain endured by many, I believe the hostility towards IPs and what they are trying to achieve has increased."

According to Fraser Gray CA, partner at Zolfo Cooper, there is a need to resolve the uncertainties hanging over the insolvency industry caused by a lack of legislative clarity. He explains: "As a current example, there's the question of whether an administrator or liquidator should be responsible for liabilities arising out of a lease following their appointment, and whether such a liability should be calculated on a pro rata basis or not. What might seem a simple matter, and on which it might be presumed that the legislators had an opinion almost 40 years ago when they drafted the Insolvency Act and Rules, is still in flux."

Andrew Davison CA, executive director at EY, points to the conflict between insolvency and employment legislation: "When seeking to achieve their objective of maximising returns to creditors, insolvency practitioners are increasingly facing challenges when simultaneously attempting to comply with employment legislation as the two are often at odds."

Johnston Carmichael partner Donald McNaught CA says a big challenge to the profession centres on fees: "Within the profession, most would say that there is a robust and transparent fee-approval process. This does not necessarily need legislative change, however. What we need to improve upon is the way we demonstrate to stakeholders that we've provided value for money and educate them as to the complexity of insolvency work and the huge personal risks that insolvency practitioners take. That cannot be overestimated."

The acts and bills affecting the insolvency regime are the Bankruptcy and Debt Advice Act 2014 [Scotland]; and the Small Business, Enterprise and Employment Bill and the Deregulation Bill, both going through Westminster.

Key measures introduced by the Bankruptcy and Debt Advice Act, or BADAS, aim to ensure debtors get good advice before entering an insolvency agreement, eg through the provision of financial education, and the introduction of a "common financial tool" (CFT) to help ensure consistent procedures.

> "We support the provision of financial education although we have concerns that the measures within the act will have limited effect"
>
> **David Menzies**

David Menzies CA, insolvency adviser, technical policy with ICAS, says: "We support the provision of financial education although we have concerns that the measures within the act will have limited effect, and the cost-benefit case for this measure was not demonstrated. We would encourage financial education to be provided much earlier to individuals through schools and other education initiatives."

He adds: "The common financial tool is broadly welcomed and supported to bring consistency across all debt procedures. We remain concerned, however, that the CFT does not recognise that the different debt procedures have different characteristics and intended outcomes, and as a result perhaps consistency in this way is not as helpful as it first seems."

McNaught says: "At the moment there's an imbalance with personal insolvency options. For example, a debtor would currently find a sequestration potentially less punitive than a trust deed. The act aims to address that, which is a good thing. I'm in favour of the concept of a CFT as it removes the scope for argument around allowable expenditure by a bankrupt."

Regarding the Deregulation Bill, Jackson disagrees with the proposal to allow IPs to qualify as specialists in either corporate insolvency or personal insolvency. He says: "It is difficult to carry out in some cases the functions in a corporate insolvency without having the full knowledge of personal insolvency and perhaps to a lesser extent vice versa. Also, the industry is already saturated with qualified IPs and there is massive competition in the sector which has resulted in a huge erosion of margins."

Menzies adds: "ICAS does not support the measures to introduce partial licensing. There's no evidence that there's an unduly high barrier of entry to the profession and we believe that the introduction of partial licensing could result in unintended consequences, including polarisation of the marketplace, particularly in personal insolvency. If licensing of insolvency practitioners required to be reviewed, perhaps a different solution could have been identified as part of a wider discussion on regulation."

Insolvency and corporate restructuring firm MLM Solutions has announced the appointment of director Charles Turner, to lead MLM's new office in London.

Turner, a previous president of the Insolvency Practitioners Association, joins the firm from FRP Advisory LLP in London, where he was a partner.

MLM was formed in December 2004 following a buy-out of the business recovery practice of Baker Tilly in Scotland. The firm employs 32 staff in offices in Glasgow, Livingston and Edinburgh, and now London.

Davison also cautions against partial licensing: "Insolvency practitioners are frequently asked to advise on situations where there's an overlap between corporate and personal insolvency, so knowledge of both regimes is essential. The introduction of partial licensing could lead to a lowering of professional standards and increase the risk of the public receiving inappropriate, inconsistent or contradictory advice."

McNaught agrees: "There's a danger of 'dumbing down' the profession which is dangerous when some of the most complex cases we could come across could be a bankruptcy."

On the Small Business, Enterprise and Employment Bill, Menzies says that while measures to make the insolvency process more efficient and increase returns to creditors are positive aspects, some of the measures appear to be at direct odds with the government's stated aims. He explains: "For example, the requirements to hold creditor meetings being removed except in certain circumstances, together with the presumption of deemed approval for the majority of resolutions, doesn't seem to be harmonised with the government's desire to have creditors more engaged as stakeholders."

Gray says: "It appears to be an intention that IPs will not need to move a company from administration to liquidation in future, as there are now provisions for administrators to bring fraudulent and wrongful trading actions on the company's behalf, to assign actions to third parties, to increase the maximum length of an administration extension by consent from six months to a year, and to promote payment of a prescribed part-distribution to creditors in administrations by allowing payment without court permission, and forbidding a move to corporate voluntary liquidation (CVL) solely to pay the prescribed part."

Taking these changes together, Gray says, one of the most significant changes that could result is "the exemption for insolvency from the reforms that abolish the successful party's ability in litigation to recover success fees under conditional fee agreements, and 'after the event' insurance premiums from the losing party, will run out in 2015".

He says that if the government does not extend the exemption, or make it permanent, then "... one of the key elements to assist in the recovery of funds from delinquent directors and shareholders will be lost".

Another important potential change, says McNaught, is "the prospect of an Official Receiver in Scotland, a liquidator of last resort. This will affect many practitioners, with those currently providing liquidation services to HM Revenue & Customs losing out. At the same time, if properly funded, it should mean that delinquent directors will be investigated and not let off the hook just because there are insufficient assets or funding to meet the costs of a liquidation."

Moving to the recommendations by Teresa Graham CBE in her review of 'pre-pack' sales, where the sale of a business is arranged prior to formal insolvency procedures, Graham raised concerns that such sales were not always transparent and not delivering the best outcomes for customers and suppliers.

Jackson says: "I don't think there was substance to these concerns and they were based on perceptions which were influenced by aggrieved creditors. An investigation into a sample number of pre-packs disclosed that the abuse of the process had been absolutely minor and businesses and jobs were saved."

Menzies adds: "What the report concluded was not that pre-packs were bad but that in certain transactions (involving connected parties) there is a lack of confidence in the process used and the recommendations largely focus on addressing these issues."

However, Stewart MacDonald CA, head of corporate finance and corporate recovery at Scott-Moncrieff, says: "If it is possible to save jobs and turn a business around quickly enough to allow it to grow and develop then sometimes that is the best option – and pre-pack can often deliver this with minimal disruption."

The central reforms proposed by Graham involve creating a "pre-pack pool" where details of a proposed sale to a connected party can be shown to an independent person prior to the sale, so increasing transparency and the confidence of creditors that a deal has undergone independent scrutiny; a requirement for connected parties to complete a "viability review" to help the new company improve its chances of success; valuations to be carried out by a valuer with professional indemnity insurance, to increase confidence that the sale is for a fair price; and ensuring proper marketing is undertaken to help maximise sale proceeds.

THE EVOLVING LANDSCAPE
INSOLVENCY AND RESTRUCTURING CONFERENCE 2014

An essential event for insolvency practitioners (IPs) and their senior members of staff, this ICAS conference is also highly relevant to lawyers and other professionals with an interest in insolvency.

Speakers include experienced IP Robin MacGregor; pensions expert Emma Hilton of 2020 Trustee Services; Teresa Graham (pictured above), chair of the Government's report on pre-pack services; James Lloyd, head of the Insolvency team at Harper Macleod; and Mike Norris of Max Recovery Limited.

The conference is sponsored by Close Brothers and Sweeney Kincaid.

Date: Wednesday 12 and Thursday 13 November 2014
Time: Wednesday 9.30am–5pm and Thursday 9am–3.45pm
Location: Gleneagles Hotel
Cost: Members – £586.50 + VAT
CAPS Firm – £552 + VAT
Non-members – £690 + VAT

Davison notes connected-party sales account for two-thirds of pre-pack sales and says that while the proposed pre-pack panel has the potential to increase public confidence, "there are questions surrounding the calibre of those that could be attracted to the panel and whether it can add value to a process that is designed to last no longer than half a day".

He adds: "The risk is that the panel requires significantly more time to properly understand the proposed transaction, jeopardising the pre-pack sale, or that the panel has insufficient time to make meaningful comment."

MacDonald agrees: "There's a real risk that the amount of information included in the reports for the pool becomes unmanageable, though, as existing business owners try to protect themselves from any potential litigation by disclosing as much as possible in their pre-pack proposal. If pool members are swamped in documents this could make it very difficult for them to make an informed decision within half a day."

Will the Graham recommendations improve the results for creditors without imposing undue costs? "No," says Jackson. "I don't think the Graham recommendations would improve the results for creditors and they will potentially increase costs."

Menzies says: "Undoubtedly there will be costs attached to some of the recommendations and one of the practical issues will be where they fall. The majority will fall pre-administration and likely be incurred by the proposed purchaser. It is likely that purchase prices will reflect this and, ultimately, creditors may end up bearing the costs."

> "If it is possible to save jobs and turn a business around quickly enough to allow it to grow and develop, then sometimes that is the best option – and pre-pack can often deliver this with minimal disruption"
>
> **Stewart MacDonald**

Gray adds: "Until the recommendations have been implemented, it's difficult to determine the additional cost. For SMEs, the cost may be prohibitive. This may remove pre-pack administration as a possibility to rescue the business unless the cost of the Graham recommendations is minimised."

Business minister Jenny Willott has announced proposals to strengthen the regulation of the insolvency profession, including new regulatory objectives and stronger powers for the Insolvency Service as oversight regulator. What do these changes mean for insolvency practitioners?

Jackson believes the profession is already well regulated but does agree they "should ultimately cut costs". Menzies says: "On a day-to-day basis the changes being proposed are unlikely to significantly affect the job that IPs carry out."

According to Gray: "It is generally accepted that the number of regulators of insolvency practitioners is greater than needed for the number of practitioners. Much of the public's disquiet at insolvency matters stems from the practices of individuals and companies who operate outside the regulated insolvency profession. Greater efforts by the government to stamp out such unregulated advisers would help to strengthen public confidence in the profession." CA

IAN HARPER IS A FREELANCE BUSINESS JOURNALIST