



The Insolvency  
Service

# A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK

**A consultation on options for reform**

May 2016



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# A Review of the Corporate Insolvency Framework

An efficient and effective insolvency regime is central to the promotion of enterprise and helps to create a business environment that supports growth and employment by ensuring that distressed, yet viable, businesses can be rescued quickly and efficiently. Where businesses cannot be rescued the insolvency regime should provide procedures for liquidating businesses and returning funds to creditors.

This consultation seeks views on whether the UK's regime needs updating in the light of international principles developed by the World Bank<sup>1</sup> and the United Nations Commission on International Trade Law (UNCITRAL<sup>2</sup>), recent large corporate failures and an increasing European focus on providing businesses with the tools to facilitate company rescue. It seeks to establish whether legislative change would improve the UK corporate insolvency regime and provide a better environment to achieve the successful rescue of a viable business.

Issued: 25/05/2016

Respond by: 06/07/2016

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This consultation is relevant to insolvency practitioners, restructuring lawyers, academics and anyone with an interest in corporate insolvency.

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<sup>1</sup> [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015\\_Revised\\_ICR\\_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf)

<sup>2</sup> [http://www.uncitral.org/uncitral/en/commission/working\\_groups/5Insolvency.html](http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html)

## **1. Foreword from the Secretary of State**

Businesses change lives. They create jobs, they grow the economy, and above all they provide opportunity. Growing up above my parents' shop, I saw for myself how a well-run company gives employers and employees alike the chance to get on in life, to work hard and fulfil their ambitions – both for themselves and for their families.

That's why, as Business Secretary I have a very singular ambition: to make Britain the best place in the world to start and grow a business.

If we're going to make that vision a reality, entrepreneurs have to know that they can restructure when times are tough, without removing much-needed protection for creditors and employees. Getting the balance right will help more businesses survive, save more jobs and, in the long run, increase productivity.

The UK's corporate insolvency regime is already highly regarded. But with the business world becoming ever-more fast-paced and complex, it is time ask ourselves whether – and how – the system can be improved.

To remain at the forefront of insolvency best practice we also need to ask what a "good" regime looks like in 2016. An increasing international focus on company rescue has helped to shift the perceptions of what constitutes best practice; the UK needs to reflect this if our businesses, investors and creditors are to remain confident that the best outcomes can be achieved when things go wrong.

Whether it's a kitchen-table start-up or massive multi-national, nobody ever wants to see a company in trouble. But, sometimes, insolvency is unavoidable. And should the worst happen to a business, we have a duty to give it the best possible chance to restructure its debts and return to profitability while protecting its employees and creditors.

The measures detailed in this consultation are intended to create a regime that does that just that, and I welcome the views of all those with an interest in these proposals.

**The Rt Hon Sajid Javid**

**Secretary of State  
Department for Business, Innovation and Skills**

## 2. Executive Summary

- 2.1 The UK Government believes in the promotion of entrepreneurship, investment and employment. Having an efficient and effective insolvency regime is one of the ways through which the Government is seeking to achieve this. It helps to create a business environment that supports growth and employment by ensuring that viable businesses in distress can be rescued. Where businesses cannot be rescued, the insolvency regime should provide a low cost procedure for liquidating businesses and returning funds to creditors quickly. The UK regime delivers these objectives through a range of formal insolvency options (administration, company voluntary arrangements and liquidation) and pre-insolvency rescue options such as schemes of arrangement or informal creditor workouts.
- 2.2 The corporate debt market is changing. The development of the capital markets has provided more diverse options for financing businesses leading to, in some cases, complex debt structures which may hinder or undermine turnaround negotiations.
- 2.3 Many of the basic insolvency procedures have remained largely unchanged since 2004, since when there has been a global financial crisis, so this provides an opportunity to assess whether they are still fit for purpose. Additionally, in the Conservative party 2015 election manifesto, this Government committed itself to being in the top five in the world, and number one in Europe, in the World Bank's annual Doing Business Report.<sup>3</sup>
- 2.4 The Government is now consulting on possible improvements to the existing corporate insolvency regime. The intention is to enable more corporate rescues of viable businesses and ensure that the insolvency regime delivers the best outcomes.
- 2.5 The Government is consulting on four proposals:
- 2.6 **Creating a new moratorium**, which will provide companies with an opportunity to consider the best approach for rescuing the business whilst free from enforcement and legal action by creditors. The proposed moratorium would last for three months, with the possibility of an extension if needed. During the moratorium creditors would have a general 'right' to request information from the Insolvency Practitioner. The Government is considering extending this provision to all insolvency procedures to improve transparency and provide an additional safeguard for creditors.
- 2.7 **Helping businesses to continue trading through the restructuring process**, including making it easier for companies to maintain contracts that are essential for the continuation of the business. This should make it less likely for companies, particularly micro, small and medium enterprises (MSMEs), to be held 'hostage' by key suppliers seeking to profit from a company's distress, harming the prospects of a fair and successful rescue solution to benefit all creditors.
- 2.8 **Developing a flexible restructuring plan**, which would enable a rescue plan to bind secured as well as unsecured creditors and introduce a 'cram-down' mechanism. Presently, dissenting creditors may, depending on the procedure, have the ability to block a

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<sup>3</sup> The UK's 2015 report can be accessed here: <http://www.doingbusiness.org/data/exploreeconomies/united-kingdom>

restructuring proposal. Under a CVA, secured creditors can voluntarily join in a restructuring plan, but in practice many never do. The company then has to negotiate separate deals with secured creditors and this may undermine achieving an optimal rescue solution and delay the process, increasing the costs of a rescue and putting the company at greater risk of failure.

**2.9 Exploring options for rescue financing.** Currently, rescue financing is permitted as an expense in an administration procedure, and the Government is seeking to understand the extent to which the law should be reformed to further develop the market for rescue finance.

2.10 These measures would be available to all entities which have access to Company Voluntary Arrangements (CVA) and administrations.

2.11 The Government believes the measures set out in this document have the potential to encourage greater business rescue by providing new tools for businesses in distress. The consultation seeks your views on how we can ensure reforms make a positive difference to viable companies in financial difficulty, their creditors, investors, lenders and the economy as a whole.

### 3. How to respond

- 3.1 When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation form (Annex C) and, where applicable, how the views of members were assembled.
- 3.2 A list of those organisations consulted is in Annex B. We would welcome suggestions of others who may wish to be involved in this consultation process.
- 3.3 You can reply to this consultation online at <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>. The web version of the form is fully interactive and downloadable.
- 3.4 The consultation response form is available electronically on the consultation page: <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework> (until the consultation closes). The form can be submitted online/by email or by letter to:

Policy Unit  
The Insolvency Service  
4 Abbey Orchard Street  
London  
SW1P 2HT

Tel: 0207 291 6879  
Email: [Policy.Unit@insolvency.gsi.gov.uk](mailto:Policy.Unit@insolvency.gsi.gov.uk)

- 3.5 You may make printed copies of this document without seeking permission.
- 3.6 BIS consultations are digital by default but if required printed copies of the consultation document can be obtained from:

BIS Publications Orderline  
ADMAIL 528  
London SW1W 8YT  
Tel: 0845-015 0010  
Fax: 0845-015 0020  
Minicom: 0845-015 0030  
<https://www.gov.uk/government/publications?departments%5B%5D=department-for-business-innovation-skills>

- 3.7 Other versions of the document in Braille, other languages or audio-cassette are available on request.



## 4. Confidentiality & Data Protection

- 4.1 Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
- 4.2 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

## 5. Help with queries

- 5.1 Questions about the policy issues raised in the document can be addressed to:

Nicholas Blaney  
Policy Unit  
The Insolvency Service  
4 Abbey Orchard Street  
London  
SW1P 2HT  
Tel: 0207 291 6879  
Email: [policy.unit@insolvency.gsi.gov.uk](mailto:policy.unit@insolvency.gsi.gov.uk)

- 5.2 The consultation principles are in Annex A.

## 6. What happens next?

- 6.1 Following closure of the consultation, the Government will consider all responses and analyse them fully and publish a Government Response within 3 months of the close of the consultation.
- 6.2 Depending on the outcome of the consultation, the Government will, in its response, bring forward final proposals for possible inclusion in primary legislation as Parliamentary time allows. The Government will also issue a full summary of views expressed and reasons given for the decisions finally taken. This will be published on the GOV.UK website.

## 7. The introduction of a new moratorium to help business rescue

### Key Points

- Large businesses with complex financing structures and multiple classes of creditors face significant costs and risks when seeking to restructure
- The preliminary moratorium would be available to all businesses (except for certain financial institutions), lasting for up to three months, with the possibility of an extension
- It would act as a 'gateway' for a business to consider its options for rescue
- Directors may remain in control of the company's affairs during the moratorium, with no exposure, subject to safeguards, for personal liability
- To benefit from the protection of a moratorium companies would need to satisfy a set of eligibility tests and qualifying conditions
- An authorised supervisor will be involved in the application process and will monitor the company's compliance with the qualifying conditions throughout the moratorium

### Current Position

- 7.1 The World Bank Principle C5.3 recommends that 'a stay of actions by secured creditors should be imposed ... in reorganisation proceedings where the collateral is needed for the reorganisation. The stay should be of limited, specific duration, strike a proper balance between creditor protection and insolvency proceeding objectives and provide for relief from the stay by application to the court'<sup>4</sup>. This offers companies that need to restructure debts the option of a period of protection during which a restructuring deal can be negotiated and implemented, whilst providing safeguards for creditors through the appointment of a supervisor to oversee the moratorium and the provision of rights to seek court intervention.
- 7.2 In the UK there are currently a number of options for companies seeking a restructuring. Many businesses seek an agreement with their creditors on a consensual basis. Where such an approach is not possible, legislation provides ways of achieving a binding statutory compromise, through the use of a Company Voluntary Arrangement (CVA)<sup>5</sup> or a Scheme of Arrangement<sup>6</sup>. These statutory mechanisms are flexible and well-regarded internationally.
- 7.3 When using these procedures, companies will tend to go through an initial stage during which a compromise is negotiated with creditors and a full proposal developed, which is then put forward to creditors for formal approval.
- 7.4 Under the Insolvency Act 1986, small companies<sup>7</sup> can use the Schedule A1 moratorium, where the directors propose a CVA. This provides a breathing space through a stay on enforcement actions, while they restructure their debts. However, the limitation to small companies seeking a CVA means only a minority of companies seeking a formal rescue make use of it. Some respondents to the 2009 consultation 'Encouraging Company

<sup>4</sup> [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015\\_Revised\\_ICR\\_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf) (page 19)

<sup>5</sup> Part 1 of the Insolvency Act 1986

<sup>6</sup> Part 26 of the Companies Act 2006

<sup>7</sup> Section 382 of the Companies Act 2006

Rescue' argued that this is because the true benefits of a moratorium are most useful for large companies with complex financing and multiple creditors<sup>8</sup>.

7.5 Businesses also have a moratorium available to them when entering into administration. This lasts for the duration of the administration period (usually 12 months, but may be extended). The moratorium provides a breathing space for the administrator to formulate a rescue plan, by preventing creditors from enforcing certain actions without first obtaining the consent of either the administrator or the court. However, this moratorium does not prevent all suppliers from terminating essential contracts. The application of a moratorium should strike the right balance between debtors', creditors' and suppliers' rights. While a company still has a viable business, a moratorium prevents creditors from acting in a manner to benefit themselves at the expense of the company's rescue and other creditors. At the same time, creditors should have the right to be kept informed of the process and how any developments may impact on them.

### Proposal

7.6 The Government is keen to reduce the costs and risks of restructuring, to help improve the prospects for viable businesses to reach a compromise with their creditors. It also recognises the importance of encouraging directors whose company may be facing financial distress to act early to address their company's problems. Both are fundamental in establishing a secure foundation for successful company rescues. A moratorium will provide companies with time to explore options which will best deliver a successful rescue where possible.

7.7 To provide this flexibility, we propose that the restructuring moratorium:

- Precedes and acts as a single gateway to different forms of restructuring including a compromise with creditors, a contractual/consensual workout, a CVA, administration or a scheme of arrangement;
- covers both initial negotiations, aimed at developing a proposal, and, if needed, the time required for creditor approval of a statutory proposal;
- provides an opportunity for all businesses seeking to restructure their debts to explore options and develop a restructuring plan;
- incentivises directors, by removing the risk of liability for trading, providing the conditions of the moratorium are met;
- lasts no longer than three months, with the possibility of an extension; and
- is overseen by a supervisor throughout the process (further information on the role of the supervisor is available in paragraph 7.40 to 7.45).

7.8 We would not expect all companies needing to restructure their debts to apply for a moratorium. However, for larger businesses with more complex financing structures, for whom the costs and risks of restructuring are likely to be most significant, the option of a restructuring moratorium could result in significant savings and a faster completion of the restructuring process. It will also remove the need for companies to enter administration to get the protection of a moratorium, and remove some of the risks when preparing a scheme of arrangement.

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<sup>8</sup>[http://webarchive.nationalarchives.gov.uk/20120407112234/http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con\\_doc\\_register/responses/Encouraging\\_Company\\_Rescue\\_-\\_Consultation\\_response.doc](http://webarchive.nationalarchives.gov.uk/20120407112234/http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/responses/Encouraging_Company_Rescue_-_Consultation_response.doc)

7.9 We also believe that there should be a number of other benefits including:

- allowing a voluntary stay to be more effective because creditors know that a statutory moratorium can be obtained if required, thus reducing the incentive to adopt tactical approaches aimed at exploiting the threat of delay or disruption for financial gain;
- increasing the chance of company rescue by giving the company more time to develop its best option for rescue;
- providing an incentive for directors to act early to address their company's problems, rather than wait for the onset of insolvency, avoiding the damage associated with a further significant deterioration in its financial position;
- giving creditors the right to request information from the supervisor at any stage.

### Effects of a moratorium

7.10 The main purpose of a moratorium is to provide a protected grace period for companies in which they can explore options for rescue and a restructuring agreement can be negotiated with creditors. In line with the existing small company moratorium provisions in Schedule A1 of the Insolvency Act 1986 the moratorium would, in the absence of specific authorisation from the court, prevent:

- the presentation of a winding-up petition by a creditor, or the making of a winding-up order by the court (except for certain public interest petitions);
- the appointment of an administrator by the directors or a holder of a qualifying floating charge, the appointment of an administrative receiver, or the application for an administration order;
- forfeiture of a lease by peaceable re-entry of business premises by a landlord;
- the enforcement of security over the company's property (or repossession under a hire purchase agreement);
- meetings of the company being held, except with the consent of the supervisor; and
- the commencement or continuation of legal process against the company and its property.

7.11 When a company enters the moratorium, the arrears owed to creditors will be frozen, but the business will be obliged to meet ongoing trading costs and debt obligations during the moratorium.

7.12 These protections would remain in place until the moratorium came to an end, whether by the company successfully reaching an informal agreement with creditors, or entering into a formal insolvency procedure, or expiring once the time limit has been reached. The affected creditors can gain court approval to dissolve the moratorium where their collateral or interests are not sufficiently protected or the criteria are no longer met. The moratorium would also end when the time limit expires.

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

## How to apply

- 7.13 When a business is experiencing or anticipates imminent financial difficulty or insolvency, the directors would have the option of entering into a moratorium in order to agree a plan with creditors to restructure the company's debts. The moratorium will provide a stay on creditor enforcement action to provide a breathing space to develop a rescue plan.
- 7.14 In order for the moratorium to commence, the directors will propose a supervisor and will need to ensure that the company meets the eligibility and qualifying conditions set out below. When the directors are satisfied that this is the case, the company can file the relevant documents at court and with the registrar of companies. Once the application has been made, a copy of the application must be sent to creditors.
- 7.15 If the business proposes designating any supplies as essential (further information on essential supplies is in paragraphs 7.29 to 7.30 and Chapter 8) this would also need to be detailed in the papers filed. It is not proposed to require a court hearing for the moratorium to commence. The Government considers that the alternative, a court hearing to sanction the moratorium, brings unnecessary additional costs.

*2) Does the process of filing at court represent the most efficient means of gaining relief for a business and for creditors to seek to dissolve the moratorium if their interests aren't protected?*

## Eligibility and qualifying conditions

- 7.16 The proposals set out in this consultation are aimed at helping companies whose business might be viable but there is a need for swift action. For businesses that are not viable as a going concern, the proposals are not intended to take the place of existing insolvency procedures, such as administration or liquidation. A moratorium is not intended to allow failing businesses merely to buy time with creditors when in practice there is no realistic prospect of a rescue or compromise being reached.
- 7.17 To avoid abuse of the moratorium procedure we propose that, in order to obtain a moratorium, the company must satisfy certain eligibility tests and meet certain ongoing qualifying conditions.

### *Eligibility tests*

- 7.18 In order to be eligible for a restructuring moratorium the company must demonstrate that it is already or imminently will be in financial difficulty, or is insolvent. The Government is not proposing to restrict eligibility according to the size of the company.
- 7.19 The companies that are to be expressly excluded from the moratorium mirror, for the most part, those companies which are excluded from eligibility for the existing small company moratorium. These are insurance companies, banks, and other companies involved in

specific financial market transactions, where the obtaining of the proposed moratorium could affect the functioning and integrity of those markets<sup>9</sup>.

7.20 In addition, if a company has entered into a moratorium, administration or CVA in the previous 12 months or is subject to a winding-up order or petition, it will not be able to qualify for a moratorium.

### *Qualifying conditions*

7.21 The main purpose of the qualifying conditions below is to ensure that a company applying for a moratorium has the prospect of exiting the moratorium or other insolvency procedure as a going concern, and creditors are prepared to support the restructuring of the company's debts.

7.22 As a primary qualifying condition, the company must be able to show that it is likely to have sufficient funds to carry on its business during the moratorium, meeting current obligations as and when they fall due as well as any new obligations that are incurred. This is to ensure that existing creditors are no worse off.

7.23 The viability of a business is a commercial judgement that depends on a number of circumstances in each case. As part of an application for a moratorium, the company must satisfactorily demonstrate that although it is experiencing financial difficulties, at the outset there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors. The application will also contain details of the proposed supervisor.

7.24 All conditions must be met in order for a company to be granted a moratorium. If, whilst the moratorium is in force, circumstances change such that the company no longer meets the qualifying conditions, the supervisor will terminate the moratorium.

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

### Creditor rights

7.25 Under this proposal there is no grace period<sup>10</sup> during which creditors would be able to challenge the application prior to the granting of the preliminary moratorium, as the preliminary moratorium would come into force immediately once the relevant documents are filed at court. Creditors would instead have a general right to apply to court during the first 28 days of the moratorium. This provides the company with an immediate stay on creditor enforcement actions, while giving creditors a window within which to apply to the court to challenge a moratorium.

7.26 Allowing creditors to challenge a moratorium at a court hearing gives them an opportunity to represent their interests at that early stage, raise any objections on the grounds that it would result in unfair prejudice to their interests and dispute whether the qualifying

<sup>9</sup> Paragraph 3, Schedule A1 of the Insolvency Act 1986.

<sup>10</sup> For example as there is in an administration, with the interim moratorium in Paragraph 44, Schedule B1 of the Insolvency Act



conditions have been met. The company benefits from a stay on enforcement and other legal actions, meaning they are able to continue with their daily business without the threat of enforcement by creditors.

7.27 As a matter of practice it would be unusual for a company not to consult, as a minimum, its largest secured creditors before making an application for a moratorium, to ensure that there was support for the principle of restructuring. If that support was not forthcoming it would be questionable whether there was a realistic prospect of rescue, as required by the qualifying conditions.

7.28 We propose that creditors will also have the right to challenge in court the actions of an officer of the company, where these unfairly prejudice the interests of a creditor or creditors. A successful application could end the moratorium, at which point creditors would again be able to enforce their rights.

### Essential goods and services

7.29 Companies with contracts that they deem to be providing essential supplies can apply for these to be formally designated as essential when they apply for a moratorium. The continuation of supply of the good or service is dependent on the payment of debts on time and in full throughout the moratorium. If the business fails to meet this requirement, the supplier will have the ability to cancel or alter the terms of the contract.

7.30 Suppliers will have the right to apply to the court to challenge the decision to define their goods or services as essential supplies, but should this fail they will be obliged to continue providing them to the business during the moratorium in accordance with the original terms of supply. When the moratorium ends, so will the requirement to continue to supply a good or service. Further proposals for the continuation of essential supplies are outlined in chapter 8.

### Directors' powers and responsibilities

7.31 It is vital that creditors' and other stakeholders' interests are not negatively affected by the use of a moratorium, so for consistency across insolvency and restructuring procedures, directors' duties will remain unaltered in the moratorium. However, for the purposes of the moratorium, the Government may introduce new sanctions for actions such as:

- obtaining credit without first disclosing that a moratorium is in force;
- failing to send creditors a copy of the application; and
- failing to supply information required by the supervisor, or that is relevant to the supervisor's assessment of the qualifying tests.

7.32 Any breach of their duties by directors will also cause them to be liable for potential disqualification.

7.33 As mentioned in paragraph 7.20, to avoid abuse of the moratorium by companies that are not viable or are only seeking to frustrate creditor enforcement action, companies that have been subject to a moratorium in the previous twelve months will be ineligible for another moratorium (or a Schedule A1 moratorium). However, as outlined in paragraph 7.37, a business will be able to enter into administration following the expiration of the moratorium period.

7.34 During the moratorium, the directors may trade as a distressed or insolvent business which could ordinarily lead to exposure for liability, for example a claim for wrongful trading under section 214 of the Insolvency Act 1986. However during the moratorium the directors of the company, under the observation of the supervisor, will need to ensure the conditions for a moratorium are maintained meaning further harm to creditors should be avoided. Therefore in order to incentivise directors to make use of the moratorium to develop a rescue plan, it is proposed that directors would be protected from liability for trading a company through a moratorium period should the conditions for a moratorium be maintained and the directors perform their duties as required under law. Should the conditions not be met, and the moratorium fails, exposure for liability would resume.

*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?*

### Duration and extensions

7.35 The moratorium will commence when an application is filed with court. We propose that the moratorium be limited, initially, to a period of three months. However, this period could be extended:

- if more time is required to agree or implement a non-statutory proposal, an extension would be available, with the moratorium automatically coming to an end after this period if a proposal had not been agreed; and/or
- where the restructuring proposal involves a statutory procedure, such as a Scheme of Arrangement, in which case the moratorium could need to be extended to cover the period required for formal approval.

7.36 We propose that any extension of the moratorium should require a vote in favour by creditors. This provides an incentive to conclude negotiations as quickly as possible and minimise the period during which creditors' rights are suspended. The threshold needed for extending the moratorium would be consent from all secured creditors and greater than 50% of unsecured creditors by value who respond to a request for an extension from the supervisor<sup>11</sup>.

7.37 In the event that a company enters administration after the moratorium period, the length of the administration will be one year minus the period the company has spent in the moratorium, meaning the total combined length of time a company can spend in a moratorium and administration is 12 months, unless the administration is extended under existing provisions.

### Cessation of a moratorium

7.38 We anticipate that the outcomes of a moratorium will be a formal procedure or an informal consensual workout. The commencement of one of these procedures or proceedings, either through the appointment of an Insolvency Practitioner, supervisor or nominee (henceforth referred to as officeholder), the filing of papers with court or a court's ratification

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<sup>11</sup> This is in line with Paragraph 76(2)(b), Schedule B1



of a plan, will bring the moratorium to an end. In the event the company enters into a CVA or administration, this would be succeeded by the existing moratoriums for these procedures.

7.39 If a solution has not been proposed by the end of the three months and creditors do not agree to an extension, the moratorium will come to an end. In addition, as outlined in paragraph 7.24, if a business fails to meet the qualifying standards, the supervisor will terminate the moratorium.

*5) Do you agree with the Government's proposals regarding the duration, extension and cessation of a moratorium?*

### The role of the supervisor

7.40 During the period of the moratorium the directors remain in control of the company's affairs. However the Government proposes that there is a role for a supervisor during the moratorium, in order to help safeguard creditors' interests and ensure the business meets the ongoing qualifying conditions.

7.41 It is proposed that the supervisor can be any individual who meets certain minimum standards and qualifying criteria; must have relevant expertise in restructuring and be a member of the following regulated professions; Insolvency Practitioner, solicitor or accountant<sup>12</sup>.

7.42 On commencement of the moratorium, the supervisor will need to be satisfied that the company is eligible. The supervisor will be expected to base their assessment on evidence requested from and prepared by the directors.

7.43 For the duration of the moratorium the supervisor's role will be to ensure that the qualifying conditions continue to be met. If they are not met the supervisor will make the creditors aware and report it to court. In addition, to ensure the supervisor has proper oversight, they should be able to attend board meetings, request information from the directors and should sanction transactions not in the ordinary course of business, such as happens in a moratorium in a CVA<sup>13</sup>.

7.44 Directors will be obliged to disclose information relating to the qualifying conditions to the supervisor and to agree with the supervisor what further information is required and how often it should be provided.

7.45 In the event a company enters a formal insolvency process where an Insolvency Practitioner is appointed, after a moratorium, an Insolvency Practitioner who had previously acted as supervisor would be prevented from taking the appointment. This would be to ensure that during the moratorium, the supervisor acted independently and to avoid potential conflicts of interest that may arise.

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<sup>12</sup> Any EU national who can work in the UK and meets these criteria would also be eligible to act as a supervisor: [http://ec.europa.eu/growth/single-market/services/free-movement-professionals/index\\_en.htm](http://ec.europa.eu/growth/single-market/services/free-movement-professionals/index_en.htm)

<sup>13</sup> Paragraphs 18 and 19, Schedule A1 of the Insolvency Act 1986.

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

### Costs incurred

7.46 It is proposed that debts incurred running the business and the cost of paying the supervisor during the moratorium will be treated in the same way as costs in administration; they will be repaid first by the company as an expense of the process. Any unpaid debts incurred during a moratorium and the supervisor's costs would be treated as a first charge if a company proceeds to enter a formal insolvency process after the moratorium has ended. This is to ensure that those who continue to trade with the business during the moratorium are adequately protected.

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

### Creditors' right to request information

7.47 Currently an Insolvency Practitioner is required to provide creditors with information at certain stages of an insolvency procedure. This gives creditors a basic overview of the procedure and progress that is being made but may not provide adequate information on which to base decisions regarding their relationship to the company and its impact on their business.

7.48 We therefore propose that in a moratorium, creditors will have the right to reasonably request information from the supervisor at any point in the process, as long as the information can be provided in accordance with any legal requirements on sharing such information. This will allow creditors to make better informed decisions and assumptions for the future of their own business whilst they wait for the conclusion of the moratorium and the potential impact that may have.

7.49 The Government is considering extending this provision to all insolvency procedures (administration, liquidation, CVA and the new restructuring plan discussed in Chapter 9), to improve their transparency and provide an additional safeguard for creditors during formal and informal insolvency procedures.

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

## 8. Helping Businesses Keep Trading through the Restructuring Process

### Key Points

- In the moratorium, the company is to be given the right to designate some contracts as essential contracts (in addition to the existing continued provision of IT and utilities)
- These contracts, subject to safeguards, cannot be terminated or varied during a moratorium or subsequent CVA or administration.

### Current Position

- 8.1 When a business enters an insolvency procedure, it can trigger the use of a termination clause by a supplier, even if their invoices are being paid on time and in full. This can severely impede any chance of business rescue
- 8.2 With the power to withdraw supplies, suppliers are also able to demand ‘ransom’ payments or vary the terms of supply before they agree to continue to provide the service. Such payments may also result in certain creditors effectively receiving ‘preferential’ payments at the expense of other creditors, overriding the basic insolvency principle whereby all creditors within a class are treated equally.
- 8.3 A 2013 survey found that in 41% of cases key trade suppliers withdrew their supply during formal insolvency and 49% of key trade suppliers demanded ransom payments or attempted to renegotiate contract terms as a condition of continuing supply in trading insolvencies<sup>14</sup>.
- 8.4 These actions can put greater pressure on the finances of an insolvent business at a critical time, damaging the chances of survival by diverting funds that could otherwise be used to facilitate a rescue. This can affect the remaining creditors as it reduces the likelihood of a business rescue and reduces the funds available to be returned to them. Reducing the chances of a successful business rescue also increases the risk of redundancy for employees.
- 8.5 On 1st October 2015, the Insolvency Act 1986<sup>15</sup> was amended to ensure continuity of supply of utilities and IT goods or services to insolvent businesses. The Government’s objective, with this proposal, is to ensure that viable businesses stand a greater chance of rescue, whilst ensuring that adequate safeguards are in place for suppliers.
- 8.6 However, in the interests of helping businesses to continue trading while undergoing a restructuring process, the Government believes that the scope of contracts which can be defined as essential should be widened.

<sup>14</sup> R3 and ComRes: Association of Business Recovery Professionals Membership Survey, August 2013, Termination Clauses.

[https://www.r3.org.uk/media/documents/policy/research\\_reports/R3\\_Membership\\_Survey\\_Termination\\_Clauses\\_09\\_August\\_2013.pdf](https://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf)

<sup>15</sup> <http://www.legislation.gov.uk/ukxi/2015/989/contents/made>

## Proposals

- 8.7 In order to improve the possibility of successful company rescue the government is proposing to provide companies with the ability to designate certain supplies as essential. This provision would be available to businesses entering into a moratorium, administration, a CVA or an alternative restructuring plan in insolvency, as set out in Chapter 9. This provision would only be available to a company undergoing liquidation if essential supplies contracts had already been designated in a prior insolvency procedure.
- 8.8 The proposal to expand the definition of essential supplies further would not affect the provisions outlined above in paragraph 8.5. It would acknowledge that there are supplies of goods and services outside the provision of gas, water, electricity and IT that can also be essential to the survival of a business.
- 8.9 For example, a printing company that needs special paper in order to continue its operations would consider the supply of that paper essential to the continuation of the business. If this paper was only available from one supplier, that supplier would be an essential supplier to the printing company. Alternatively, a garage or dealership that only services one make of car would consider the supply of parts from this manufacturer essential. By classifying such supplies as 'essential' and ensuring their continuation in insolvency, the aim is to increase the likelihood of business rescue as a going concern. Further explanation of what elements are considered for an essential contract is outlined in paragraph 8.15.

## How to apply

- 8.10 The Government recognises that preventing suppliers from relying on termination clauses would interfere with the right of freedom to contract, and believes that such interference is only justified where absolutely necessary.
- 8.11 A distressed business will be able to file a Court application to prevent the use of ipso facto clauses such as termination clauses by designated essential suppliers when entering a moratorium (as discussed in Chapter 7), administration, CVA, or the proposals in chapter 9.
- 8.12 The officeholder, or the company if the designation is made as part of a moratorium, would determine which contracts are essential. The decision will be based on whether the continued provision of a good or service by the supplier would contribute to the success of the rescue plan and whether alternative arrangements can be made at a reasonable cost within a reasonable time.
- 8.13 When filing at court, the paperwork would have to provide justification as to why the supply or service is deemed essential to the continuation of business. The supplier would have the ability to challenge the application, in which case the court would be required to approve the application. The supplier would have to provide objective justification as to why their supply should not be designated as essential.
- 8.14 The Government does not wish to create an unnecessary legal burden by providing a definition of essential that is too stringent and would involve specifying what goods and services would constitute essential supplies. Conversely, contracts should not automatically be deemed essential.

8.15 When considering designating contracts as essential, the officeholder or company would be considering whether:

- the continued provision of a supply will be essential to the successful rescue of the business and its ongoing viability;
- an alternative supply can be found within a reasonable time frame at a reasonable cost;
- the business will still be able to meet its payments as they fall due; and
- the supplier can objectively justify the refusal to supply.

*9) Do you agree with the criteria under consideration for an essential contract? Is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?*

### Safeguards

8.16 The Court will only be required to approve which contracts are essential in the event of a challenge by the supplier. This will prevent the abuse of this procedure, as the court will determine what is essential. Suppliers will have the power to argue to the court if they consider that their good or service is not essential to the continuation of business.

*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?*

### Continuation and cessation of essential supplies

8.17 We believe that if a business requires the continued supply of an essential good or service in order to be viable, the supplier of that good or service would need to be in agreement with a proposed restructuring plan or contractual workout in order for the plan to be successful. As a result, any restructuring proposal should make provision for the continuance of essential supplies.

8.18 If a restructuring plan cannot be achieved, the most likely alternative is that the business will enter into a formal insolvency procedure. In the event that a company enters an administration following a moratorium, the officeholder will be required to review whether the company will benefit if the existing designated essential supplies contracts are continued. If, during the course of an administration the decision is made to liquidate all or part of the company, the officeholder will be obliged to review whether the continued provision of essential supplies is necessary in order to maximise the value of the assets.

8.19 If the continued provision of essential supplies is necessary, the protection will continue for as long as the office holder deems necessary, within the limit of the total of 12 months allowed for a moratorium followed by administration or until no longer needed in the case of a liquidation.

## 9. Developing a Flexible Restructuring Plan

### Key Points

- Companies will be able to bind all creditors to a restructuring plan.
- Introduce ‘cram-down’ provisions allowing for a restructuring plan to be imposed on a junior classes of creditors even if they vote against the plan, as long as they will be no worse off in liquidation.
- The classes of creditors would be proposed by the distressed company on a case by case basis
- For a class to vote in favour, 75% of creditors by value, and more than 50% by number must agree to the plan.

### Current Position

- 9.1 Capital structuring has become increasingly complex, which involves diverse interests from a number of stakeholders. These varied interests can impede a consensual workout to restructure a company’s debt. In cases where dissenting creditors are blocking a restructuring plan, it would be beneficial to have a tool or lever in order to gain consent, if the plan is in the best interests of the majority.
- 9.2 The most common existing debtor-in-possession option currently used by companies looking to restructure is the CVA. In 2014 there were 563 CVAs, of which 388 failed, equating to a failure rate of 60%<sup>16</sup>. The Government believes that the CVA regime in its current form and scope is limited as a tool for company rescue, particularly as it currently lacks the ability to bind secured creditors to a plan.
- 9.3 In CVAs the rights of a secured creditor to enforce their security are protected and can only be affected with the agreement of the creditor concerned. In practice many secured creditors do not join CVA plans, forcing the distressed business to conduct separate negotiations with individual secured creditors. However, a minority of dissenting unsecured creditors can be bound to a proposal without their agreement, if the requisite number of creditors and shareholders vote in favour (see paragraphs 9.19 to 9.20 below).
- 9.4 In some cases these negotiations between individual secured creditors and the business can significantly increase the cost and duration of the restructuring process. It can also lead to unfair benefits for secured creditors which are in a position to dissent in order to further their own interests.
- 9.5 Companies also have the option of undertaking a scheme of arrangement in order to restructure their debts. In a scheme of arrangement creditors are divided into classes and each class votes on the proposed plan. If classes vote in favour of the plan, the court must then decide whether or not to confirm the plan. Often companies enter into an administration for protection from creditor action while undertaking a scheme of arrangement.

<sup>16</sup> Impact Assessment: <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework> (page 14)



- 9.6 Schemes of Arrangement also tend to target a specific group of stakeholders and comprise only part of a restructuring solution. The introduction of a flexible restructuring plan would provide companies with the benefits of both a moratorium and restructuring plan in one streamlined process and the ability to bind all creditors to a plan.
- 9.7 World Bank Principle C14.3 (which relates to reorganisation proceedings) refers to the need for clear criteria for plan approval based on fairness to similarly situated creditors. It recommends that the law should provide the opportunity for plans or proposals to be approved if a minority of creditors reject it, on the condition that the plan complies with rules of fairness and offers the opposing creditors or classes an amount equal to or greater than would be received in a liquidation scenario<sup>17</sup>.
- 9.8 One tool that can be used to achieve this is a ‘cram-down’, whereby a restructuring plan can be imposed on dissenting classes of junior creditors, on the condition that they would not be worse off under the restructuring than if the business went into liquidation.
- 9.9 The cram-down of a rescue plan onto ‘out of the money’ creditors is currently possible in the UK only through a costly mix of using a scheme of arrangement and an administration. The Government believes that developing a more sophisticated restructuring process with the ability to ‘cram-down’ may facilitate more restructurings, and the subsequent survival of the corporate entity as a going concern.

### Proposal

- 9.10 The Government is proposing to introduce a statutory, time-limited to 12 months, multi-class restructuring procedure to aid company rescue. This will include the use of a cram-down mechanism and the ability to bind secured creditors into a restructuring plan, on the basis that creditors will not receive less in a restructuring than they would in a liquidation.
- 9.11 The cram-down mechanism would allow the plan to be imposed on impaired classes, meaning the business can force out of the money classes to accept a plan, an option which is not currently available in a CVA or Scheme of Arrangement. This would give a company the ability to collectively bind all creditors to a plan.
- 9.12 As is the case in a Scheme of Arrangement, when a class votes in favour of a plan in line with the requirements set out in paragraph 9.19, all creditors that are members of that class would be bound to the plan.
- 9.13 By introducing a cram-down mechanism and the ability to bind secured creditors when developing restructuring plans, the Government wants to address the scenario where a relatively junior secured creditor can block or delay a company rescue, despite the proposals being supported by a majority of senior secured creditors.
- 9.14 These tools could either be introduced as a new optional type of plan within the existing CVA framework or developed as part of a separate restructuring procedure, which would sit alongside the existing rescue options.

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<sup>17</sup> [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015\\_Revised\\_ICR\\_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf) (page 51)

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?*

### Class Structure

9.15 The Government wants to introduce a flexible restructuring procedure that is accessible to all types of business. For that reason it is proposed that classes would be grouped by similar rights or treatment<sup>18</sup> on a case by case basis, rather than predefined in legislation.

9.16 It has been argued that the introduction of class voting would make the voting process fairer and less at risk of challenge. However, a sensible safeguard is to introduce court approval of the construction of the classes, as experience of Schemes has shown that this can be the most contentious area when proposing a rescue agreement.

9.17 Classes would be proposed by the distressed company, and filed with court. The company would also be obliged to provide creditors with an overview on the class structure and where creditors sit within it. This will take place prior to the plan being submitted to creditors for approval.

9.18 To retain an efficient process, classes will be decided by the company and approved by the court. Creditors will have a window in which to apply to the court to challenge their class if necessary, between the filing of the classes at court and the presenting of a plan to court for approval. When a restructuring plan has been approved by creditors, it will then be confirmed by the court.

### Voting Requirements

9.19 Presently, in a scheme, a plan needs “*a majority in number representing 75 per cent in value of the creditors or class of creditors*”<sup>19</sup> to vote in favour in order for the court to sanction the plan. This enables the objections of a minority of creditors to be over-ruled, and for a proposal to proceed in those circumstances. The Government is proposing to retain both voting rules in the new restructuring plan for each class with the ability to then cram-down the proposal on junior classes that disagree.

9.20 In considering the nominee’s application, the court would apply two tests, to determine whether a class can be crammed down:

- That at least 75% (measured by value of gross debt) and more than 50% of each remaining class of creditors have agreed to the terms of the restructuring plan;
- That the plan is in the best interests of the creditors as a whole, in that it recognises the economic rights of ‘in the money’ creditors and all other creditors are no worse off than they would be following liquidation.

9.21 If approved by the court the restructuring plan would be declared binding on all creditors. The court would have the ability to reject a plan if the rights of those voting against it would

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<sup>18</sup> How the company proposes to treat creditors that would normally be grouped in the same class on the basis of having similar rights, but are instead grouped together as the restructuring plan impacts on them differently.

<sup>19</sup> Section 899, Companies Act 2006, <http://www.legislation.gov.uk/ukpga/2006/46/section/899>



be reduced to less than they would receive in the event of liquidation, protecting creditors and preventing abuse of the system. The court would also have the ability to overrule the class (or classes) that voted against the proposal and declare it universally binding if it considers that the plan is fair and equitable.

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

9.22 According to the World Bank, the UK insolvency regime currently has the 7<sup>th</sup> highest recovery rate in the world, returning money to creditors quicker and at a lower cost than the United States, Germany and France<sup>20</sup>. To retain the efficiency and speed of the current regime, it is proposed that the company will, by default, provide relevant information to creditors and shareholders electronically and that voting on a proposal will take place electronically. Creditors and shareholders will have a right to request documents and voting papers in hard copy.

### Exemptions

9.23 Insurance companies, banks and other companies involved in specific financial market transactions will be excluded, in line with the proposed moratorium. This is because the cram-down proposals could affect the functioning and integrity of those markets.

### Safeguards for creditors

9.24 Previous industry discussions and consultation responses on the topic of cram-down have highlighted the importance of having the right safeguards in place to protect creditors and/or shareholders<sup>21</sup>.

9.25 To prevent abuse of the cram-down mechanism, the new procedure will have in place a number of safeguards for creditors to make sure that their rights and interests are duly considered at all stages of the process.

9.26 As previously mentioned in paragraph 9.17, classes will be proposed by the distressed business and approved by the court, as is currently the case with Schemes of Arrangement<sup>22</sup>. The court will have the power to refuse the classes if it considers they are incorrectly formed and do not reflect the similarity in rights between creditors.

9.27 The role of the court in the proposed cram-down mechanism will make sure that the rights of creditors are fairly considered and that cram-down only takes place when it is fair and equitable and leaves impaired creditors no worse off than would be the case in liquidation. The power to reject a plan if it is not fair and equitable is a key protection to counterbalance the new class structure and cram-down option.

9.28 Creditors or shareholders who disagree with the court's decision to declare a procedure binding will also have a right to appeal.

<sup>20</sup> <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>

<sup>21</sup> <http://webarchive.nationalarchives.gov.uk/20120407112234/http://www.bis.gov.uk/assets/insolvency/docs/insolvency%20profession/consultations/restructuring-response/restructure-response-2-summaryofresponses.pdf>

<sup>22</sup> <http://www.legislation.gov.uk/ukpga/2006/46/section/896>

## Court confirmation

9.29 For a restructuring plan to take effect it must be approved by the court, and the plan must contain the following information:

- the restructuring plan is fair and equitable and will last no more than twelve months;
- each class was fairly represented by those voting;
- confirmation that correct notice has been given of the restructuring plan to members and creditors;
- any explanatory statement to the restructuring plan was appropriately distributed;
- any voting requirements have been met; and
- whether junior creditors had the ability to challenge the restructuring plan.

9.30 In addition, if the restructuring plan has been created during a moratorium, as outlined in Chapter 7, the court could decide to extend the moratorium over the duration of the plan.

9.31 The purpose of the court at the restructuring stage is not to be a ‘rubber-stamping’ exercise. The court should have discretion to not confirm a plan, as has happened with scheme of arrangements<sup>23</sup>.

9.32 A restructuring plan will be considered fair and equitable if the following conditions are met:

- all creditors will be no worse off than in liquidation;
- secured creditors will be granted absolute priority on repayment of debts; and
- junior creditors should not receive more on repayment than creditors more senior than them.

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

## Valuations

9.33 Valuations will need to be used by the court in order to ensure that creditors will be no worse off through the cram-down than they would be in a liquidation. These valuations will be established by the nominee, with any evidence supplied by the company as requested by the nominee. In addition, the valuation will provide guidance for providers of rescue finance in terms of what value remains against which the provision of finance can be secured as part of the plan.

9.34 For the avoidance of doubt in terms of business valuations, these will be made based on the current value of a company’s assets and will not include the value of any potential future earnings they may provide.

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<sup>23</sup> For example: *British Aviation Insurance Co Ltd (2005)* & *Scottish Lion Insurance Company Ltd vs Goodrich Corporation & Ors (2010)*

9.35 Valuations in a restructuring can be particularly contentious<sup>24</sup> and numerous valuations are used in different situations (for example going concerns, fair market, break up and liquidation). For this proposal, the Government is considering legislating for the use of a minimum liquidation valuation, so when determining the value of interests in a restructuring plan, impaired classes should receive *at least* what they would have received in a liquidation situation. This provides flexibility for the use of other methods of valuation where appropriate, whilst providing a minimum liquidation valuation as part of the court's 'fair and equitable' determination of the plan.

*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?*

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<sup>24</sup> See "*In the matter of Bluebrook Ltd and Others [2009] EWHC2114 (CH)*", (commonly referred to as *IMO Carwash*)

## 10. Rescue Finance

### Key Points

- Re-ordering the current priority of administration expenses to encourage rescue finance
- The introduction during administration and debtor in possession rescue of provisions permitting companies to grant security to new lenders over company property already subject to fixed charges, which would rank as a first or equal first charge or an additional but subordinate charge on the property
- Providing safeguards for existing charge holders

### Current position

- 10.1 The availability of finance is a key aspect of any effective corporate rescue regime. Whilst short term cash flow difficulties may not always precipitate a company's entry into formal insolvency, finance will almost always be a vital piece of any solution which seeks to remedy a company's current plight.
- 10.2 Providing credit to a company which is already suffering financial difficulty will often require a very careful assessment on the part of the lender and this will typically be undertaken by specialist lenders or specialist departments within mainstream lenders. When considering whether or not to offer finance in such circumstances, priority of payment relative to the company's other creditors and the availability of collateral will be vitally important, particularly in the event of insolvency if attempts to rehabilitate the company fail.
- 10.3 Unlike some jurisdictions<sup>25</sup>, the UK lacks a broad and long-established market in specialist rescue finance and the Government is keen to encourage greater access to finance for distressed companies seeking new funding<sup>26</sup>. Greater availability of rescue finance should contribute to a reduction in the number of companies with viable futures failing. It should also increase competition and therefore reduce the cost of such funding and this should further assist the financial rehabilitation of distressed companies.
- 10.4 Due to the nature of the UK business environment, both in terms of the dominance of bank lending as a source of business funding and likewise that of floating charge security arrangements, encouraging greater access to rescue finance is likely to require strong incentives to potential providers of rescue finance. We believe this requires consideration of proposals that include altering the priority of different creditor classes in the event of insolvency, albeit with necessary safeguards for existing creditors, with providers of rescue finance being given enhanced priority.
- 10.5 In 2009 the then Government published a consultation<sup>27</sup> which included proposals around super priority for rescue funding in administrations and CVAs. In light of the responses

<sup>25</sup> For example, Finland and the United States.

<sup>26</sup> [http://ec.europa.eu/finance/capital-markets-union/index\\_en.htm](http://ec.europa.eu/finance/capital-markets-union/index_en.htm)

<sup>27</sup> 'Encouraging Company Rescue – a consultation' (2009)

received, these proposals were not taken forward. The Government believes changes in market conditions mean it is now appropriate to seek views again from interested parties.

- 10.6 The insolvency framework already permits a degree of high priority status to be conferred on finance providers in certain situations (see below), though the lack of formal structure for rescue finance, in particular around negative pledge clauses, may serve to discourage providers of rescue finance.
- 10.7 In administration, administrators have statutory powers allowing them to borrow funds and grant security<sup>28</sup> over the property of a company, and the costs of finance rank highly in the hierarchy of administration expenses<sup>29</sup>.
- 10.8 In addition, the CVA framework provides some flexibility and creditors may agree to proposals put forward by the company conferring high priority, even super-priority, status on finance providers if a majority of creditors agree to this.
- 10.9 However, the Government believes that such options are rarely used. It has been suggested that this is because new funding in administrations is typically provided by the existing floating charge holder, who has no need to vary their existing security, and any assets not covered by the floating charge will already be subject to fixed charges.
- 10.10 Negative pledge clauses, a common feature of corporate lending agreements, limit a company's ability to grant security against property already subject to a security arrangement. We believe this acts as a strong barrier to distressed companies obtaining rescue finance even though such property may have sufficient value to discharge additional finance. In some circumstances, the difficulty in obtaining additional funding due to this inability to grant the new lender satisfactory security may lead to the company failing when it could otherwise have been rescued.

### The UK context

- 10.11 In other jurisdictions the availability of super-priority rescue finance has been established for some time and commentators have acknowledged the importance of this as a tool to those seeking to restructure and reorganise distressed companies<sup>30</sup>.
- 10.12 It must, however, be remembered that what works in one jurisdiction may not work in another, owing to various factors including the wider legal framework, nature of the court system and prevailing business culture and practice.
- 10.13 When considering proposals on super-priority financing, some key features of the UK legal and business environment should be considered:

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<sup>28</sup> Insolvency Act 1986, Sch1

<sup>29</sup> Insolvency Rules 1986, rule 2.67

<sup>30</sup> <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB16-Chapters/DB16-CS-RI.pdf>

- debt remains the principal source of business finance and, during a period of historically relatively low borrowing rates, has been greatly preferred over equity as a means of raising funds;
- traditional lenders still provide the majority of lending and alternative sources of debt finance, such as the capital markets, are still in their infancy;
- floating charge security arrangements typically mean assets not subject to fixed charges, such as stock and cash, may be covered by the floating charge, leaving relatively few or effectively no unencumbered assets in the company; and
- the lack of a specialist bankruptcy court similar to that of the USA.

### Achieving the objective of encouraging rescue finance

10.14 The Government acknowledges that the issue of business finance is one that requires a balance to be drawn between the interests of creditors, including finance providers, and the debtor company, as well as a consideration of the impact on the wider economy. The UK insolvency regime has been developed in a way that encourages lenders to advance credit knowing that their interests will be protected by any security arrangements they have entered into. At the same time, to facilitate rescue, the insolvency regime allows limited circumstances in which interference with such security rights is permitted in order to achieve specific statutory aims. In exploring attempts to encourage the availability of rescue finance, the Government is mindful of the risk of reducing the availability of business finance generally or of increasing the cost of such finance. Access to finance, particularly for small start-up companies, is a key factor in driving growth.

10.15 The Government therefore seeks views from interested parties on how the objective of encouraging rescue finance can be achieved and sets out below some possible options that could be considered.

### *Super-priority of rescue finance in administration expenses*

10.16 In 2009, as part of the then Government's consultation on measures to encourage company rescue, one proposal suggested giving super-priority status to rescue finance costs in administration. This would have meant these costs would have ranked ahead of all other administration expenses.

10.17 Consultation responses suggested, as administration expenses are discharged in full in most administrations, the impact of this would be modest. Some respondents also suggested that raising such costs above the administrator's own expenses may discourage insolvency practitioners from taking appointments as administrators, therefore harming prospects of business rescue.

10.18 The Government therefore seeks views on whether or not the current framework and order of priority work to encourage rescue finance and, if not, how should the framework be developed to, not only encourage rescue finance to be advanced, but to encourage insolvency practitioners to take appointments and treat different classes of creditors in a fair manner.

*Negative pledge clauses in security arrangements and permitting new security in addition to existing secured charges in restructuring plans*

10.19 Security for any new finance extended to a company in distress will usually be a key determinant in whether or not that finance is provided. Where a company has equity in charged assets, the Government does not believe it is fair for the company and for creditors as a whole not to be able to secure rescue finance because an existing charge holder, by relying on a negative pledge clause, refuses to permit the granting of new security even though their indebtedness could be fully discharged by the proceeds of sale of the charged assets.

10.20 The Government's aim is to improve flexibility so that companies in distress have as many options as possible to give effect to their own rescue where feasible. Where an existing charge holder acts unreasonably by refusing consent to grant security where doing so has no negative effect on them, the Government considers it would be beneficial for the company and creditors as a whole, if a negative pledge clause could be overridden in debtor in possession rescue or administration.

10.21 In addition, to further encourage rescue, the Government seeks views on the impact and effect of introducing provisions permitting companies to grant security to new lenders over company property already subject to charges, where such new security would rank:

- as an additional but subordinate charge on the property; or
- where the existing charge holder(s) does not object, or the Court permits, as a first charge (ahead of other charges) or an equal first charge on the property; and
- where assets against which the new charges are secured against are insufficient to discharge the amounts owed, any shortfall will rank above preferential and floating charge holders.

10.22 In such cases, robust safeguards would be required to protect the interests of any existing creditors whose security has been overreached.

*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?*

10.23 Whilst a fixed charge holder may already consent to the registration of an additional fixed charge over company property subject to their charge, including where their priority is overreached by the new charge, no provision exists to impose such action where consent is not forthcoming. The proposals would allow an existing charge to be subordinated even where consent is not given, meaning negative pledges in existing security arrangements would be overridden and existing security overreached. We acknowledge this would be a significant development and one that requires safeguards for creditors whose security is being impacted by the giving of super-priority to new lenders.

10.24 A proposal to obtain rescue finance under which such funds are advanced in return for the lender(s) being given super-priority security could be made during the moratorium proposed in chapter 7 of this document or during an administration, CVA or an alternative



insolvency restructuring plan. In any instance those approving the proposals, whether it be the company's creditors or the court, would have to be satisfied that:

- the granting of such security for the rescue finance is necessary in order to obtain that finance;
- the interests of existing charge holders are adequately protected; and
- obtaining the rescue finance is in the best interests of creditors as a whole.

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

10.25 Where existing charge holders are not the providers of the proposed rescue finance, they would be given notice and invited to consent to the new security. Where the existing charge holder declines to consent or has failed to respond, the insolvency practitioner/nominee would be required to communicate to them that they intended to proceed with the financing proposal and demonstrate that the existing charge holder was not being disadvantaged. The existing charge holder would then have 14 days in which they may apply to court to challenge the financing proposal so far as it affected their existing priority.

10.26 In the event of challenge, the court would then determine whether or not the proposed financing proposal should proceed. The burden of proof would fall upon the insolvency practitioner to convince the court that the three requirements set out in 10.24 above have been met. Where the insolvency practitioner is able to do so, the court may sanction the financing proposal according to the terms already agreed by the new lender and the company. The Government does not propose to allow the court wider discretion to impose modified terms on the financing proposal as this may not be acceptable to the new lender(s).

10.27 Rescue finance is a broad term and the Government does not intend to restrict these proposals to finance provided by financial institutions. Such finance may be crucial to company rescue but so may other forms of finance, such as trade credit. Careful consideration will be needed as to precisely which categories of payments qualify for super priority.

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

10.28 The options set out above are simply some suggested ways of potentially achieving the Government's objective of encouraging rescue finance but we are interested to hear any alternative options that may be effective. We note this is a complicated issue and any option put forward will, almost inevitably, have its advantages and disadvantages and be accompanied by varying degrees of risk.



## 11. Impact on SMEs

### Key Points

- A rescue regime should deliver for SMEs as well as larger businesses.
- Any protections should not be prohibitively expensive.
- The existing pre-pack system is not being amended as it has recently been subject to an independent review.
- SMEs should benefit from the revised provisions around essential supplies.

### Current Position

11.1 SMEs are an integral part of the UK economy, and account for 60% of all private sector employment in the UK<sup>31</sup>. Therefore, the insolvency regime should promote and deliver a rescue culture for SMEs as well as larger business. While many large companies will benefit from the proposals, it is important that SMEs are able to benefit too. Under the current insolvency framework, SMEs have two main options available to them.

11.2 Firstly, there is the existing SME moratorium under CVAs. As explored in chapters seven and eight, CVAs are under utilised and the majority of them do not succeed. The Government believes that the under utilisation of CVAs is largely caused by the inability to bind secured creditors.

11.3 Secondly, the pre-pack administration regime is a favoured tool amongst SMEs as it encourages swift business recovery. The pre-pack regime has been the subject of much Parliamentary debate recently, an independent review<sup>32</sup>, and subsequently the introduction of voluntary pre-pack pool, and a requirement for Government to review the policy. Therefore, the Government is not proposing to make any changes to this regime.

### Impact of proposals

11.4 With the introduction of a wider moratorium, SMEs will benefit from gaining access to a period during which directors will be able to consider their options and whilst having the protection of a stay on enforcement proceedings. The ability for a nominee to be of a regulated profession provides an SME with a larger pool of expertise to choose from, leading to increased competition and reduced cost.

11.5 Secondly, the proposals around essential supplies will offer SMEs greater protection. On entering into insolvency, SMEs are at risk of suppliers amending the terms and conditions of their contracts even if those contracts have been paid in full. This in turn increases the likelihood that the business will fail.

11.6 Thirdly, the development of a more flexible restructuring plan will provide SMEs with a greater range of tools. Whilst they are unlikely to require access to a 'cram-down' mechanism, they might benefit from the ability of having a restructuring proposal that will

<sup>31</sup> <http://www.fsb.org.uk/media-centre/small-business-statistics>

<sup>32</sup> The Graham Review, <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>

allow them to bind their creditors. This will provide greater opportunity for a successful recovery.

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

## 12. Consultation questions

12.1 An Impact Assessment is also available online. In addition to responses to the questions below, we would welcome comments and further recommendations for change with supporting evidence, referencing the evidence provided in the Impact Assessment.

12.2 Please identify any unintended consequences or other implications of the proposals and provide comment on the analysis of costs and benefits. Are there any alternatives to the changes and regulations proposed?

### The Introduction of a Moratorium

- 1) Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?
- 2) Does the process of filing at court represent the most efficient means of gaining relief for a business and for creditors to seek to dissolve the moratorium if their interests aren't protected?
- 3) Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?
- 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?
- 5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?
- 6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?
- 7) Do you agree with the proposals for how to treat the costs of the moratorium?
- 8) Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

### 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?
- 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?

### 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?
- 12) Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissent from some creditors?
- 13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
- 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?

### 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?
- 16) How should charged property be valued to ensure protection for existing charge holders?
- 17) Which categories of payments should qualify for super-priority as 'rescue finance'?

### Impact on SMEs

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

## Annex A: Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>

### Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Angela Rabess  
BIS Consultation Co-ordinator,  
1 Victoria Street,  
London  
SW1H 0ET

Telephone Angela on 020 7215 1661  
or e-mail to: [angela.rabess@bis.gsi.gov.uk](mailto:angela.rabess@bis.gsi.gov.uk)

However if you wish to comment on the specific policy proposals you should contact the policy lead (see section 5).

## Annex B: List of Organisations consulted

Akin Gump Strauss Hauer & Feld	Deloitte
AlixPartners	DLA Piper
Allen & Overy	Ernst and Young
Ashurst	Eversheds
Asset Based Finance Association	Faculty of Advocates
Association for Financial Markets in Europe	Federation of Small Businesses
Association of British Insurers	Field Fisher Waterhouse
Association of Chartered Certified Accountants	Freshfields Bruckhaus Deringer
Association of Corporate Treasurers	Grant Thornton
Association of Her Majesty's District Judges	Hausfeld
Association of High Court Masters	Herbert Smith Freehills
Begbies Traynor	Insolvency Lawyers' Association
British Bankers' Association	Insolvency Practitioners' Association
British Property Federation	Institute for Turnaround
British Venture Capital Association	Institute of Chartered Accountants in England and Wales
Chartered Accountants Regulatory Board	Institute of Chartered Accountants in Scotland
Chartered Institute of Credit Management	Institute of Directors
Cifas	KPMG
City of London Law Society – Financial Law Committee	Law Society of Northern Ireland
City of London Law Society – Insolvency Law Committee	Law Society of Scotland
Clifford Chance	Linklaters
CMS Cameron McKenna	London School of Economics
Confederation of British Industry	Nabarro

Norton Rose Fullbright

Nottingham Trent

PricewaterhouseCoopers

R3 (Association of Business Recovery Professionals)

Squire Patton Boggs

The Law Society

Turnaround Management Association

University College London

University of Leeds

University of Nottingham

University of Oxford

## Annex C: A Review of the Corporate Insolvency Framework response form

The consultation response form is available electronically on the consultation page: <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework> (until the consultation closes).

The closing date for this consultation is 06/07/2016.

The form can be submitted online/by email or by letter to:

Policy Unit  
The Insolvency Service  
4 Abbey Orchard Street  
London  
SW1P 2HT

Tel: 0207 291 6879

Email: [Policy.Unit@insolvency.gsi.gov.uk](mailto:Policy.Unit@insolvency.gsi.gov.uk)

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes. Please see page 9 for further information.

If you want information, including personal data, that you provide to be treated in confidence, please explain to us what information you would like to be treated as confidential and why you regard the information as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

I want my response to be treated as confidential

Comments:



## Questions

**Name:**

**Organisation (if applicable):**

**Address:**

	<b>Respondent type</b>
	Business representative organisation/trade body
	Central Government
	Charity or social enterprise
	Individual
	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

An Impact Assessment is also available online. In addition to responses to the questions below, we would welcome comments and further recommendations for change with supporting evidence, referencing the evidence provided in the Impact Assessment.

Please identify any unintended consequences or other implications of the proposals and provide comment on the analysis of costs and benefits. Are there any alternatives to the changes and regulations proposed?

## **The Introduction of a Moratorium**

- 1) Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?
  
- 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?
  
- 3) Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?
  
- 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?
  
- 5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?
  
- 6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?

- 7) Do you agree with the proposals for how to treat the costs of the moratorium?
  
- 8) Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

### **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?
  
- 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?

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- 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?
  
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### **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?
  
- 16) How should charged property be valued to ensure protection for existing charge holders?
  
- 17) Which categories of payments should qualify for super-priority as 'rescue finance'?

### **Impact on SMEs**

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

**Do you have any other comments that might aid the consultation process as a whole? Comments on the layout of this consultation would also be welcomed.**

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



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