Summary of Responses:
A Review of the Corporate Insolvency Framework
September 2016
1. Executive summary

Introduction

1.1. In May 2016 the Government published a consultation seeking views on measures to update the UK’s corporate insolvency regime. The proposed changes should facilitate the rescue of a greater number of viable, financially distressed companies. The UK’s corporate insolvency regime is highly regarded internationally (ranked as one of the top 15 in the world by the World Bank), but Government wants to ensure it continues to deliver the best possible outcomes for business. The consultation ran from May to July 2016. During the consultation period officials met with a wide range of stakeholders, including at two roundtable events held in June 2016 at which representatives from law firms, trade bodies, creditor organisations, banks, regulators, academia and industry were present.

1.3. 71 written responses were received from a range of interested organisations and individuals. These responses will help shape the Government’s policy to enable the rescue of viable distressed businesses, and we are very grateful for the time respondents took to provide constructive feedback on the proposals. Government looks forward to maintaining this dialogue with stakeholders over the coming months, and is continuing to consider the proposals in the light of the responses received.

1.4. This paper provides a summary of respondents’ views. The full responses can be found at Annex 2. Some respondents asked that their responses be kept confidential or provided responses that could not be published (e.g. for copyright reasons). They have not been listed in Annex 1 and their responses have not been published in Annex 2, but they have been included in the analysis below.

Background

1.5. The consultation sought views on four proposed areas for reform of the UK’s corporate insolvency framework:

- Creation of a new moratorium period for financially distressed (but ultimately viable) companies. Creditors would not be able to take action against the company in this period. 


2 Doing Business - Economy Rankings: http://www.doingbusiness.org/rankings

period, during which it would be making preparations to restructure;

- Provision to require **essential suppliers** to continue to supply to a financially distressed company on existing terms and not use termination clauses or demand ‘ransom’ payments;

- Creation of a ‘**new restructuring plan**’ – a company rescue vehicle that would enable (for the first time in the UK) a ‘cram down’ of classes of dissenting creditors;

- Measures to encourage ‘**rescue finance**’ (money lent to a company in an insolvency procedure to assist in its survival).

**An overview of responses**

1.6. Stakeholders welcomed Government’s exploration of reforms that could improve the restructuring tools available to companies. While there was broad support for the principles behind the proposals, a range of views were expressed on the technical detail. Government will continue to liaise with stakeholders while establishing this detail, considering policy options further and refining the proposals in light of responses received to this consultation.

**A new moratorium period:**
Two thirds of respondents who commented on this proposal agreed in principle that the introduction of a pre-insolvency temporary moratorium would facilitate business rescue. Stakeholders provided helpful feedback on the proposed length of the moratorium period, its supervision, and on suggested safeguards.

**Essential supplies:**
There was support for the broad objective of helping businesses to continue trading through the restructuring process. Over half of the 24 respondents who commented on whether the proposal would bring about more business rescues thought that it would do so. Respondents provided constructive comments on how the proposal might operate in practice, and on how the associated safeguards for suppliers might be strengthened.

**A new restructuring plan:**
There was support for the principle of the proposal, and agreement that a restructuring plan which could be made binding in the face of opposition by a minority of creditors would be a valuable addition to the insolvency framework. Stakeholders provided a range of valuable perspectives on how the new plan might operate in practice.
Rescue finance:
In 2009, the Government published a consultation which included proposals relating to super-priority for rescue funding in administrations and CVAs. As a result of responses received to that consultation, the proposals were not taken forward at that time. Given changes in market conditions, the Government believed that it was appropriate to seek views again from interested parties. Responses to this consultation indicated that a lack of finance rarely prevents the rescue of viable businesses; the existing framework does permit rescue financing, and there is currently a market for rescue finance.

2. Summary of responses: moratorium

General views on the proposal

2.1 The majority (67%) of respondents who commented on this proposal expressed their support for the introduction of a preliminary moratorium during which viable distressed businesses could consider their options for rescue. Of those who supported the proposal, 37% (16 respondents) agreed with the proposal as outlined in the consultation document. 63% (27 respondents) agreed in principle that a moratorium would promote business rescue, but felt that the detail of the proposal needed refining.

2.2 Those who supported the proposal felt that a new moratorium, upstream of formal insolvency, could encourage directors to act earlier to tackle financial difficulties. A turnaround professional commented that: ‘the very existence of a moratorium may encourage earlier intervention and consensual commercially negotiated solutions without even having to resort to a formal moratorium’.

2.3 A common view – both among those who supported the moratorium and those who opposed it – was that safeguards for creditors needed to be strengthened.

Obtaining and dissolving the moratorium

2.4 29 of the 44 respondents (66%) who commented on the process of filing to court to obtain a moratorium agreed that this was the most efficient way in which a business could gain relief from creditor action. There was widespread concern that a full court hearing could involve costs and delay, at a time in a company’s life cycle when speed is crucial.

2.5 20 of the 35 respondents (57%) who expressed a view on how creditors could best seek to dissolve the moratorium if their interests were not protected agreed that doing so in

court was the most appropriate option. Those who disagreed highlighted that access to court and the costs of mounting a challenge could be problematic.

**Eligibility tests and qualifying criteria**

2.6 24 of the 63 respondents (38%) who expressed a view in relation to this question agreed that the proposed eligibility tests and qualifying criteria provided the right level of protection for suppliers and creditors. 13 respondents (21%) felt that there was insufficient detail in the consultation document. 25 respondents (41%) felt that the proposed tests and criteria did not provide sufficient protection to those dealing with the company.

2.7 Several respondents noted that the test proposed in the consultation document (i.e. that a company must demonstrate ‘that it is already or imminently will be in financial difficulty, or is insolvent’) could be more clearly defined.

**Rights and responsibilities of creditors and directors**

2.8 20 of the 58 respondents (34%) who commented on the proposed rights and responsibilities for creditors and directors agreed that they strike the right balance between safeguarding creditors and increasing the chance of business rescue. 32 respondents (55%) did not think that the safeguards were sufficient as drafted, and 6 respondents (10%) thought that insufficient detail was provided in the consultation document to make a judgement.

2.9 Respondents had mixed views on the proposal to suspend director liability. One respondent noted that: ‘it would be anomalous if directors operated under one regime in an informal moratorium and under a different regime in a statutory moratorium’. Government is further considering the costs and benefits of suspending liability for wrongful trading during the moratorium period.

2.10 Several respondents commented that creditors should have the right to challenge the moratorium in court. Government has noted stakeholder concerns, and is considering whether creditors should have a general right to apply to court during the moratorium if they think that their interests have been unfairly harmed.

2.11 Discussion also focused on the issue of whether a moratorium supervisor should be eligible to be an office-holder for the company during any insolvency or restructuring proceedings that may immediately follow on from the moratorium. Views were mixed, and some respondents noted that the requirement for a new office-holder would lead to delay and increased costs. Others felt that the requirement for a new office-holder was an important safeguard, and that it would help to ensure that the supervisor acted independently during the moratorium.
Duration, extension and cessation of the moratorium

2.12 The majority of respondents (76%) who commented on this issue disagreed with the proposals for the length, extension and cessation of the moratorium as outlined in the consultation document.

2.13 Several alternatives were proposed by the 41 respondents who disagreed with the proposed length. Most thought that it should be shorter than three months, citing difficulties with funding a lengthy moratorium period, and suggesting that a shorter period would reduce the risk of abuse.

2.14 The most common length suggested was 21 days (proposed by seven respondents), then ‘variable depending on size of company’ (five respondents). Others fell somewhere in the middle, maintaining that 21 days was too short, but that three months was too long. Three respondents thought that the moratorium should be longer than three months, commenting that, for example, it would not be possible to negotiate and sanction a scheme of arrangement within that window.

2.15 Respondents commented on the suggested process for extending the moratorium. Of the 36 who expressed an opinion, 21 (58%) were of the view that the agreement of all secured creditors should not be a requirement. Alternatives proposed were the same majority as required for the new restructuring plan, or that an extension could be approved by court if secured creditor agreement could not be obtained.

2.16 There were a number of comments on the proposal to subtract the length of the moratorium from the 12-month period permitted for a subsequent administration. 16 of the 19 respondents who raised this issue said that a subsequent administration should not be shortened. They noted that this could cause practical administrative difficulties, might act as a disincentive for those considering a moratorium, and suggested that insolvency practitioners would be less likely to take on post-moratorium administrations if they knew that they would have less time to conduct them than if there had not been a moratorium.

The supervisor

2.17 Of the 52 respondents who expressed an opinion on the qualification requirements for a supervisor, 31 (60%) were of the view that appropriate supervision of the moratorium period could only be provided by a licensed insolvency practitioner. These respondents felt that insolvency practitioner supervision would constitute an important safeguard, and suggested that it would be crucial for obtaining and maintaining creditor confidence in the moratorium procedure.
Dealing with the costs of the moratorium

2.18 39 of the 53 respondents (74%) who commented on how the costs of the moratorium should be dealt with agreed with the proposals outlined in the consultation document. Eight respondents (15%) disagreed, and six respondents (12%) felt that there was insufficient detail in the consultation document. Government is continuing to consider this matter.

Allowing creditors to request information

2.19 Of the 59 respondents who commented on this proposal, 44 (75%) agreed that there was benefit in allowing creditors to request information.

2.20 34 of the 35 respondents who commented explicitly on the need for safeguards and exemptions agreed that these would be necessary. Respondents agreed that the time and cost burden of dealing with unreasonable requests should be minimised, and that exemptions would be needed for dealing with commercially sensitive information.

2.21 21 respondents suggested that regular updates should be given, either by the supervisor or via a creditor portal, rather than creditors having a freestanding ability to request information. It was felt that this would guard against the risk of demands for information proving a distraction and hindering progress during the moratorium period. Others suggested that the supervisor should act as arbiter of what does or does not constitute a reasonable request.
3. Summary of responses: essential supplies

Definition of essential contracts

3.1 47% of the 59 respondents who answered this question agreed with the criteria under consideration for an essential contract.

3.2 41% of respondents disagreed with the proposed criteria under consideration for an essential contract as drafted. Several respondents suggested that a ‘one size fits all’ approach would not work. Some respondents also commented that the criteria as drafted were too debtor-friendly.

3.3 A number of respondents stipulated that some suppliers should be carved out. In particular, some respondents stated that the provision of finance and of financial services should be excluded from the proposals. It was also suggested that suppliers should be able to request a personal guarantee from the company’s directors.

3.4 12% of respondents felt that there was insufficient detail in the consultation document to make a judgement on the criteria for an essential contract. Some questioned how the proposals would be enforceable in relation to international suppliers and what would happen if a supplier suffered production difficulties.

3.5 24 respondents answered separately on whether the proposal would bring about more business rescues. 13 respondents thought that it would increase the number of successful rescues, whereas 11 respondents thought that it would not.

Court’s role and safeguards for suppliers

3.6 Of all respondents, 31% felt that the court’s role in the process and a supplier’s ability to challenge their designation as ‘essential’ were sufficient safeguards to ensure that a supplier would be paid when required to continue supplying.

3.7 69% of respondents did not agree that the proposals as drafted offered sufficient safeguards for suppliers. A number of respondents commented on the additional burden that the proposals may place on the courts, and questioned whether the courts would have the requisite resources to deal with the potential increased workload. Government notes stakeholder concerns, and is continuing to consider the matter.
4. Summary of responses: a new restructuring plan

Standalone procedure vs. extension of an existing procedure

4.1. 41% of the 68 respondents who commented on this issue were in support of a new restructuring plan operating as a standalone procedure, rather than as an extension of an existing procedure (e.g. a CVA). They suggested that this would promote flexibility and allow a wider range of companies to benefit from the plan. Several respondents who supported a standalone process suggested that it would be more effective if it was viewed as a ‘restructuring’ process rather than as an ‘insolvency’ procedure.

4.2. The respondents who disagreed and felt that the restructuring plan should operate within the existing CVA framework made up 22% of the replies (15 responses).

4.3. A number of respondents commented that the procedure should not be time-limited to 12 months, and that it should instead be flexible in length.

4.4. Seven of the 68 respondents who answered this question queried the need to introduce a further procedure (whether standalone or as an extension to an existing process), as they felt that existing provisions were sufficient.

Views on cram down

4.5. 42 of the 69 respondents (61%) who answered this question agreed with the principle that a court-approved ‘cram down’ should be possible in some circumstances. Many respondents agreed with the suggestion that creditors should be grouped in court-approved classes. The proposed voting requirements (at least 75% of creditors by value and more than 50% of each remaining class by number) were generally felt to be suitable. A number of respondents envisaged that this option would be used mainly by large companies because of costs. Others commented that protections would be needed to ensure that junior creditors’ rights were not unfairly expropriated.

4.6. A number of respondents who supported the proposals suggested that shareholders should be included in the ‘cram down’. It was also suggested that it could be more cost effective to go straight to the courts without junior creditors voting.

4.7. Some respondents opposed the idea that a restructuring plan should be universally binding on the grounds that existing creditors’ rights should be recognised and the existing priority of claims should be respected.

Safeguards for creditors, including the role of the court

4.8. Over half of the 68 respondents who answered this question felt that the proposed safeguards offered sufficient protection for creditors. Many felt that court involvement was
fair and offered sufficient protection.

4.9. However 15% of respondents (10 responses) felt that the proposals as drafted would not provide sufficient protection for creditors. They expressed their concern that the courts may not be resourced to deal with the likely increase in applications and the costs associated with the new process. A further concern expressed was that the safeguards as drafted provided sufficient protection for larger creditors but were not sufficient for smaller creditors.

Valuation

4.10. 40% of the 69 respondents who answered this question agreed with the proposal that there should be a minimum liquidation value test for determining the fairness of a plan which is being crammed down onto dissenting classes. There was widespread recognition from all respondents that valuation is a contentious topic. Over a quarter of respondents argued that liquidation is not the right comparator, and that a ‘next best alternative’ value should be used instead. Government is continuing to consider the issue.
5. Summary of responses: rescue finance

**Background**

5.1. In 2009, the then Government published a consultation which included proposals relating to super-priority for rescue funding in administrations and CVAs. As a result of responses received, these proposals were not taken forward. Given changes in market conditions, Government believed that it was appropriate to seek views again from interested parties in this consultation.

5.2. Of the 52 respondents who commented on rescue finance, 38 (73%) disagreed with the proposals. Several respondents commented to the effect that a lack of rescue finance rarely prevents business rescue, and that as long as a business is truly viable, there is no shortage of funding available. The existing framework does permit rescue finance, and there is currently a market for rescue financing. 23 respondents were concerned that any changes made to the order of priority would have a negative impact on the lending environment by increasing the cost of borrowing.

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### 6. Annex A: list of respondents

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Category</th>
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<tbody>
<tr>
<td>Akin Gump Stauss Hauer &amp; Feld LLP</td>
<td>Legal representative</td>
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<td>Large business</td>
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<td>Allen &amp; Overy LLP</td>
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<td>Other</td>
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<td>BBA</td>
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<td>Micro business</td>
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<td>Individual</td>
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<td>British Property Federation</td>
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<td>Clifford Chance LLP</td>
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<td>CMS Cameron McKenna LLP</td>
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<td>Ernst &amp; Young LLP</td>
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<td>Federation of Small Businesses</td>
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<td>ICAS</td>
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<td>Professor Jennifer Payne, University of Oxford</td>
<td>Individual</td>
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<td>K2 Business Partners Ltd</td>
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<td>Sarah Paterson</td>
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<td>Stephens Scown LLP</td>
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<td>The Chancery Judges</td>
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<td>Turnaround Management Association (TMA)</td>
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6 July 2016

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

Dear Sir or Madam

Re: Response to the Consultation on a Review of the Corporate Insolvency Framework

Introduction

1. Akin Gump Strauss Hauer & Feld ("Akin Gump") has a market-leading practice advising creditors – particularly bondholders and mezzanine lenders – of financially distressed companies on complex cross-border restructurings. Akin Gump also has significant experience representing office holders in formal insolvency proceedings.

2. Akin Gump welcomes the opportunity to respond to the consultation entitled "A Review of the Corporate Insolvency Framework: A consultation on options for reform" issued by the Insolvency Service in May 2016.

3. Our comments are divided into two parts. Part 1 of this paper sets out our general comments on the proposals, while Part 2 addresses certain of the specific questions set out in the consultation document.

4. For brevity, the abbreviation "IA 86" is used to mean the Insolvency Act 1986.

Part 1: General Comments

5. We welcome these proposals as a thoughtful and workable initiative to increase the tools available to achieve company rescue while protecting the interests of debtors and creditors. Our general comments focus on the following issues, which are relevant to a number of the specific questions in the consultation:

   (a) protection of junior creditors;

   (b) international recognition of the moratorium and the restructuring procedure;
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(c) financial collateral considerations; and

(d) rescue financing.

Protection of junior creditors

6. Probably the most significant issue arising from the new proposals is the suggestion that junior creditors could have their interests divested by another class of creditors based on a valuation. Under our existing law, creditors’ rights and recoveries on a company failure are ultimately determined by the amount for which the company’s assets are actually realised on a sale, and the equity of redemption available to the company and its junior creditors. As the consultation paper recognises, the moratorium and cram-down plan procedures will necessitate a different approach involving the preparation of theoretical valuations. The new approach will allow the economic interests of junior creditors to be divested – perhaps without any payment at all – through a plan and with no actual marketing or sale of the assets. We consider that the credibility of the new procedures will require robust structures to protect those junior creditors (as well as preference shareholders, etc) from unfair expropriation of their economic interests. The paper is silent on these protections. We consider that, as a minimum, to avoid complaints of unfair expropriation, the new procedures will require:

(a) a valuation system that provides a fulsome valuation for the company – and certainly not a minimalist liquidation valuation – and that will be open to challenge by all affected stakeholders. The opportunity to challenge the valuation should come at an early stage in the process, before the convening of creditor meetings to vote on the restructuring, and the valuation should be subject to a judicial determination;

(b) an ‘absolute priority’ rule to ensure that (i) junior stakeholders – importantly including the company’s shareholders – retain no economic interest at all in the company when more senior stakeholders are impaired, (ii) disenfranchise senior creditors who will be entirely (or almost entirely) unimpaired under the restructuring plan, from voting to cram down a plan on junior creditors, and (ii) would compel the continued availability of facilities from senior creditors whose rights are entirely unimpaired under the plan; and

(c) cost cover for all affected creditors to ensure that they have a genuine entitlement to challenge valuations and other aspects of the restructuring plan.
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7. The supervisor of the moratorium should be entitled to recognise, and approve payment of reasonable professional fees from company funds for, ad hoc committees of creditors which represent the majority of, or constitute the largest group of, a particular class of creditors. This would allow junior creditors who, unlike senior lenders, may not have a contractual right to reimbursement by the company of their fees and costs, to have their interests represented during the restructuring process. We suggest that fee arrangements and costs be subject to approval by the supervisor, with a right to apply to the court in case agreement cannot be reached. We would expect a body of case law to develop in the reasonably short term to make clear the scope of acceptable costs. As a further safeguard, the relevant professionals should be required to disclose the identity of the members of the ad hoc committee.

8. One issue which the government may wish to consider is the impact of intercreditor arrangements on the position of junior lenders. Intercreditor agreements between senior and junior lenders often contain provisions which allow senior lenders to vote on behalf of junior lenders or require junior lenders to vote at the senior lenders’ direction. Such contractual provisions may require a junior lender to vote at the senior lender’s direction on a resolution to consent to extension of a moratorium or to vote on a “cram-down” restructuring procedure and would effectively disenfranchise the junior lender.

Cross-border aspects of the moratorium and the restructuring plan

9. Both the moratorium and the restructuring procedure are likely to be used by corporate groups with complex capital structures, involving debt instruments with different governing laws and dispute resolution clauses, borrowers and guarantors incorporated in multiple jurisdictions and creditors based all around the world. It is therefore important that the moratorium and restructuring procedure are able to achieve cross-border recognition, a requirement which is complicated by the 23 June 2016 referendum vote in favour of “Brexit”. The consultation does not deal with cross-border issues.

10. This section of the response focuses on the jurisdictional criteria which should apply to companies seeking to make use of the moratorium and the restructuring procedure and on whether the moratorium would benefit from the recognition processes available under Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings.
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(the “EC Insolvency Regulation”)\(^1\) and/or the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the “Model Law”)\(^2\).

11. To promote international recognition of the moratorium and the restructuring procedure, we would suggest that they are available only to companies which are incorporated in the United Kingdom or have their centre of main interests (“COMI”) or an establishment in the UK. We would also suggest that the moratorium and restructuring procedure be included in Annex A to the EC Insolvency Regulation and the Recast Insolvency Regulation.\(^3\)

12. Whether the moratorium would be recognised in a jurisdiction that has implemented the Model Law would depend on the implementing legislation in the relevant country. If a jurisdiction has simply copied into its implementing legislation the definition of “foreign proceeding” in the Model Law (i.e. a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation), there may be concerns in this regard.

\(^1\) Regulation EU 2015/848 on Insolvency Proceedings (Recast) (the “Recast Insolvency Regulation”) will apply to insolvency proceedings commencing on or after 26 June 2017.

\(^2\) E.g. the United States, which has implemented a modified version of the Model Law as Chapter 15 of the Bankruptcy Code

\(^3\) Once the United Kingdom leaves the EU, depending on the arrangements which are reached with the EU, companies using UK insolvency procedures may be able to rely on the Model Law for cross-border recognition within EU countries which have adopted the Model Law. As at the date of this response, only the following members of the EU (other than the UK) have adopted the Model Law: Greece; Montenegro; Poland; Romania (http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html).

There is a question as to whether the moratorium may be listed in Annex A of the EC Insolvency Regulation, on the basis that the moratorium is not a collective insolvency proceeding which entails the partial or total divestment of a debtor and the appointment of a liquidator (as required by the EC Insolvency Regulation). This issue does not arise in relation to the Recast Insolvency Regulation, which applies to public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation:

(a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed;
(b) the assets and affairs of a debtor are subject to control or supervision by a court; or
(c) a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors, provided that the proceedings in which the stay is granted provide for suitable measures to protect the general body of creditors, and, where no agreement is reached, are preliminary to one of the proceedings referred to in paragraphs (a) or (b).
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13. Even if the moratorium does not benefit from the recognition processes under the EC Regulation and the Model Law, it may be possible to bind overseas creditors who are subject to the in personam jurisdiction of the English court. The moratorium should purport to have worldwide effect and to prevent creditor action outside the UK.4

Financial Collateral Directive

14. In 2003, the UK Financial Collateral Arrangements (No.2) Regulations 2003 (the “FCAR”), the prohibition on enforcement of security over the property of a company in administration or CVA does not apply to the enforcement of a security interest created or otherwise arising under a financial collateral arrangement.5

15. Security agreements typically provide that security may be enforced upon the occurrence of an “Event of Default”, as defined in the facility agreement, bond documents or related security documents. A moratorium in respect of the borrower’s indebtedness is a typical Event of Default. “Financial collateral” is defined in the FCAR as “cash, financial instruments or credit claims”.6 The definition of “financial instruments” includes shares and bonds tradeable on the capital market.

16. Accordingly, as the FCAR are currently drafted, in many cases a lender who has taken security over the shares in the debtor’s subsidiaries, could, if those security interests constitute a financial collateral arrangement, enforce security as soon as the debtor files for the moratorium.7

17. The government may wish to consider amending the definition of “financial collateral” to exclude private company shares to avoid a situation where initiation of the moratorium precipitates the collapse of the company instead of giving it breathing space to negotiate a restructuring.

Rescue Financing

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4 This is necessary in light of the unhelpful decision of the Court of Appeal in Harms Offshore Ahi “Taurus” GmbH & Co Kg v Bloom & Ors [2009] EWCA Civ 632, in which the Court held that the administration moratorium did not have extra-territorial effect. This defect should be fixed for administration as well as the moratorium.
5 Reg.8(1), FCAR
6 Regulation 3.
7 In Cjukrova Finance International Limited, Cjukrova Holding AS v Alfa Telecom Turkey Limited [2009] UKPC 19, both parties and their experts had accepted, at first instance, that private company shares fell within the scope of the FCAR (see para 25 of the judgment).
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18. We agree that it is important for companies to be able to obtain rescue financing in times of financial difficulty. We also agree that, under the current regime, it is often challenging for companies to obtain the large debt facilities (e.g. of several hundred million pounds) which may be required to rescue the company as a going concern.

19. We also agree that any effective rescue financing regime will need to provide for super-priority for rescue finance, including the ability to grant security which ranks equal to or in priority to existing security. In consensual restructurings, where a party provides new money, it will usually do so only if it obtains priority over existing creditors (including existing secured creditors) through the use of contractual intercreditor arrangements.

20. However, if the Government chooses to pursue such a rescue financing regime, it must ensure that other creditors enjoy the full panoply of protections provided to existing creditors in US Chapter 11 proceedings, and must be prepared to accept the legal issues and significant increase in costs which a full-blown rescue financing regime will entail.

21. To ensure that property rights are protected, secured creditors whose security is “primed” by equal ranking or super-priority charges given to providers of rescue financing will need to receive “adequate protection” (either through cash payments or additional or replacement security) to compensate that creditor for diminution in value of its collateral. We think it is also likely that, as in the United States, providers of rescue financing will seek to improve their position through the use of roll-ups, cross-collateralization and inappropiate control of the insolvency, which will inevitably lead to litigation.

22. To ensure fairness, the rescue financing should be subject to judicial approval, with existing creditors (for example, secured creditors or unsecured creditors wishing to

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8 In a “roll up” scenario, the lender prior to the filing of the Chapter 11 petition provides the post-petition debtor in possession or “DIP” loan facility. The post-petition facility is used to pay off the pre-petition debt, and the DIP lender, who may have been granted additional security or payment priority for its DIP loan, has effectively improved its own position at the expense of other creditors.

9 “Cross-collateralization” involves an unsecured or undersecured pre-petition lender that extends post-petition credit to obtain a security interest in previously unsecured property of the bankruptcy estate. The lender thus improves the position of its unsecured or undersecured pre-petition claim. US bankruptcy courts are typically reluctant to allow cross-collateralization.

10 The DIP loan will often contain covenants which require the debtor to meet certain restrictive milestones in the bankruptcy case, failure to satisfy which will lead to an event of default under the DIP facility. DIP lenders seek to use these milestones as ways to control the debtor’s bankruptcy case to their own advantage.
challenge the proposed level of adequate protection, or unsecured creditors challenging a “roll-up) having the opportunity to challenge the proposed terms of the financing. For the challenge to be meaningful, creditors would need the opportunity to compel disclosure of documents and cross-examine witnesses in adversarial proceedings.

23. Accordingly, while we see merit in the proposed rescue financing regime, in our view the Government should be alive to the costs and difficulties associated with a “creeping Chapter 11” regime.

Part 2

Response to consultation questions

The Introduction of a Moratorium

Q1: Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?

24. We agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses.

Q2: 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?

25. We agree that the proposed process for filing at court represents an efficient, cost-effective way for a company to gain the protection of the moratorium. The implementing legislation should make clear that, as with filing for administration under paragraph 22 of Schedule B1 of the IA 86, both the company (in general meeting) and the board of directors may file for the moratorium and appoint a supervisor.

Q3: Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

26. We broadly agree with the eligibility tests proposed and the qualifying criteria proposed. However, there should be additional criteria. A company or board of directors should only be allowed to file for a moratorium to:
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(a) implement a pre-agreed restructuring, as happened in the case of BlueCrest
Mercantile BV v Vietnam Shipbuilding Industry Group [2013] EWHC 1146
(Comm), where the Commercial Court stayed proceedings against Vinashin to
allow a well-advanced scheme of arrangement to proceed; or

(b) provide a company with breathing room to agree a contractual standstill
arrangement with its creditors, in circumstances where the directors
reasonably believe that they will be able obtain such a standstill.

A company should not be able to obtain a moratorium simply to prolong its demise. If
neither (a) nor (b) above apply, the company should go into administration.

27. In addition, the primary qualifying condition set out in paragraph 7.22 of the
consultation should be modified to remove references to existing creditors being no
worse off. Any major restructuring will involve a significant cash burn as the
company continues to operate and pays professional fees to its and its major creditors’
legal and financial advisers. This cash burn is likely to be particularly heavy during
the moratorium, which gives a breathing space for the parties to negotiate and
document the terms of a restructuring. Where the company has a balance sheet, rather
than a liquidity, problem – for example a debt maturity twelve months from the date
of the moratorium – the company may well be able to meet current and new
obligations as they fall due during the moratorium. However, the existing creditors
whose payments fall due twelve months later will, in fact, be worse off. Accordingly,
rather than referring to existing creditors being no worse off, an additional limb of the
primary qualifying condition should be that the directors reasonably believe that there
will be sufficient benefit from the restructuring to justify the expense incurred.

Q4: 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?

28. No. As explained in paragraphs 6 to 8 of our General Comments above, we think it
vital that the proposals provide fundamental protections for the interests of junior
creditors, whose interests risk being expropriated. The right for creditors to be
covered for the costs of challenging the moratorium is an important protection.

Q5: Do you agree with the proposals regarding the duration, extension and cessation
of the moratorium?

29. In our view, the moratorium should be limited to an initial period of 2 months. This
should provide sufficient time to implement a pre-agreed restructuring or agree a
contractual standstill, which are the only two purposes for which, in our view, the moratorium is appropriate.

30. We do not agree with the thresholds proposed for an extension to the moratorium and do not agree that paragraph 76(2)(b) of Schedule B1 to the IA 86 is an appropriate comparator. Although the primary purpose of administration is to rescue companies as a going concern, in our experience almost all administrations in practice pursue the second or third statutory objectives, the business and assets being sold to satisfy creditor claims with no prospect of company rescue.

31. In contrast, the moratorium is intended to be a pre-insolvency procedure which will facilitate company rescue and protect the enterprise value of the company for the benefit of all stakeholders. By requiring unanimous secured creditor consent to extend the moratorium, the proposal, as currently drafted, would allow a single secured creditor to torpedo a restructuring, potentially damaging value for junior creditors.

32. Accordingly, in our view:

(a) any extension to the moratorium should require the consent of 66\(\frac{2}{3}\)\% by value of secured creditors and 66\(\frac{2}{3}\)\% by value of unsecured creditors who respond to a request for extension from the supervisor;

(b) in both cases, as with a CVA, a resolution in favour of an extension would be invalid if those voting against it include more than half in value of the creditors which are not connected with the company; and

(c) in line with the contractual principle of majority voting in syndicated facility agreements and bond trust deeds, the legislation should provide that, where the requisite contractual majority under the relevant debt instrument has voted in favour of an extension to the moratorium, 100\% by value of that debt will be deemed to have voted in favour of the extension.

33. However, as noted in paragraph 8 of our General Comments above, in practice contractual provisions relating to voting in intercreditor arrangements may limit the ability of junior lenders to vote freely on a resolution to consent to extension of a moratorium, or to apply to the court to challenge the moratorium or otherwise to protect or promote their interests, which would effectively disenfranchise the junior lenders.

Q6: Do you agree with the proposals for the powers of and qualification requirements for a supervisor?
Q7: Do you agree with the proposals for how to treat the costs of the moratorium?

Yes. In addition, we would recommend that the supervisor of the moratorium should be entitled to recognise, and approve payment of reasonable professional fees from company funds for, ad hoc committees of creditors which represent the majority of, or constitute the largest group of, a particular class of creditors (please see paragraph 7 of our General Comments above).

Q8: Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

To ensure that there is equality of information between senior lenders, junior lenders and trade creditors, and as a way to reduce cost, companies availing themselves of the moratorium (other than small companies which are eligible for a CVA moratorium under Schedule A1 to the IA 1986) should be required automatically to publish on their websites substantial financial information. This information should include, at a minimum:

(a) copies of loan agreements and trust deeds / indentures;
(b) copies of security documents;
(c) copies of intercreditor agreements; and
(d) an up-to-date balance sheet.

Companies should be allowed to redact from those documents only information of the kind which, under section 859G of the Companies Act 2006, may be redacted from the certified copies of security documents lodged at Companies House.

Although most contractual confidentiality clauses contain carve-outs allowing disclosures required by law, to deal with any such conflicts, the implementing legislation should make clear that the statutory requirement of disclosure overrides and disappplies the contractual confidentiality clause, regardless of the governing law of the instrument.

Helping Businesses Keep Trading through the Restructuring Process
Q9: 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?

Q10: 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

Q11: 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?

39. In our view, the restructuring plan would work better as an extension of the existing scheme of arrangement. The new restructuring procedure seems likely to be used in restructuring substantial companies with large and complex balance sheets. Schemes of arrangement already allow for class voting and the restructuring of both secured and unsecured debt. A significant body of case law regarding schemes of arrangement procedure provides a clear existing framework, that would only need to be extended to manage the new elements proposed. The Irish examination procedure provides a useful precedent of just such an extension of the scheme of arrangement procedure.

Q12: Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissent from some creditors?

40. We agree in principle that a restructuring plan should be capable of cramming down some creditors. The existing scheme of arrangement already provides for minority lenders to be bound by a qualified majority vote, and it makes sense to extend this approach to out-of-the-money junior stakeholders. Thus, a restructuring plan should be capable of binding a class of out-of-the-money junior creditors if it is approved by a more senior class of creditors but, for the reasons set out in paragraphs 6 to 8 of our General Comments above and in our responses to Question 13 below, extensive protections are necessary to ensure that junior creditors’ rights are not unfairly expropriated.

41. It is critical that dissenting shareholders should be bound by a restructuring plan as much as junior creditors. If the value of the company is insufficient to cover all creditor claims, then the equity should be transferred to those creditors whose claims are impaired under a restructuring plan. Restructuring procedures in other countries, such as the United States and Germany, provide for shareholders to be bound by a
restructuring plan – and in practice to lose their equity where creditors are impaired – it seems to us hard to impose a cram-down plan that binds junior creditors but not shareholders.

42. We broadly agree with the proposed requirements regarding class composition. Creditors, restructuring professionals and judges are all familiar with the class requirements in schemes of arrangements and the grounds for challenging class composition. However, we note that in practice class composition is rarely challenged in a properly adversarial process and that, when minority creditors do object, the courts are typically sympathetic to the debtor’s chosen class composition. As the restructuring procedure will bind all creditors, the Government should be mindful of the relative lack of precedent on class composition issues and should consider whether certain ancillary arrangements (such as voting fees and other incentives) or the differing interests of creditors (e.g. unsecured financial creditors versus unsecured trade creditors) should be considered as impacting class composition, rather than simply the fairness of the plan.

43. As to the voting requirements, we consider that a restructuring plan should be capable of sanction if it is approved by 75% of those voting at a class meeting. We see little continuing purpose in the numerosity requirement, which only in practice provide opportunities for hold-outs by holders of small but fragmented debts, particularly in cases which involve bonds held through central clearing systems.

44. To ensure that insiders cannot use intercompany or shareholder loans to force through plans over the objections of external creditors, we suggest that, as in CVAs, a class vote in favour of the restructuring will be invalid if those voting against it include more than half in value of the creditors in that class which are not connected with the company.

45. However, as noted in paragraph 8 of our General Comments above, in practice contractual provisions relating to voting in intercreditor arrangements may limit the ability of junior lenders to vote freely on a resolution to consent to the restructuring plan, which would effectively disenfranchise the junior lenders.

Q13: Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

46. No. While we welcome the safeguards proposed to protect creditors, they would not, for example, protect junior creditors from the complete divestment of their debt at a
short-term low point in the economic cycle, through the approval of a plan by unimpaired senior creditors based on a liquidation valuation.

47. The consultation paper recognises that the introduction of moratorium and cram-down plan procedures will necessitate the preparation of theoretical valuations of the company. For the reasons explained in paragraphs 6 to 8 of our General Comments above, we consider that the credibility of the new procedures will require robust structures to protect junior creditors (as well as preference shareholders, etc) from unfair expropriation of their economic interests. We consider that, as a minimum, to avoid complaints of unfair expropriation, the new procedures will require:

(a) a valuation system that provides a fulsome valuation for the company – and certainly not a minimalist liquidation valuation – and that will be open to challenge by all affected stakeholders (see our response to Question 14 below). The opportunity to challenge the valuation should come at an early stage in the process, before the convening of creditor meetings to vote on the restructuring, and the valuation should be subject to a judicial determination;

(b) an ‘absolute priority’ rule to ensure that (i) junior stakeholders – importantly including the company’s shareholders – retain no economic interest at all in the company when more senior stakeholders are impaired, (ii) disenfranchises senior creditors who will be entirely (or almost entirely) unimpaired under the restructuring plan, from voting to cram down a plan on junior creditors, and (iii) as in Chapter 11 of the US Bankruptcy Code, would compel the continued availability of facilities from senior creditors whose rights are entirely unimpaired under the plan; and

(c) cost cover for ad hoc committees of affected creditors to ensure that they have a genuine entitlement to challenge valuations and other aspects of the restructuring plan (see paragraph 7 above).

48. The proposal in paragraph 9.32 that a plan will be considered fair and equitable if, among other things, junior creditors do not receive more on repayment than creditors more senior than them does not go far enough. The court should not be able to confirm a restructuring plan which impairs a class of creditors if any shareholder or creditor of a class junior to an impaired class receives or retains any property under the restructuring plan.
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Q14: 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?

49. We strongly believe that the minimum liquidation valuation basis, as currently proposed, offers necessary but insufficient protection to junior creditors and could result in a windfall to more senior creditors. For example, the very fact of the company’s financial distress will reduce its value, and there are times when the liquidation valuation of a company – in other words the value assuming a fire sale of the company’s assets – will hit a cyclical or temporary low: when prices are hit by foreign exchange fluctuations, economic recessions, industrial action. While the “no creditor worse off” test is an important minimum standard, it should not be the valuation used for the purposes of distributing the interests in the company under a restructuring plan.

50. In our view, there are sound reasons why that valuation should be prepared on a going concern basis:

(a) First, it is vital that all stakeholders should have confidence that the new debt restructuring procedure will produce a fair result. The use of a going concern valuation will greatly reduce complaints of unfair expropriation when a restructured company is sold at a high valuation shortly after creditors have suffered impairment on a debt restructuring. Nothing could be more damaging to the credibility of the new procedure than situations where senior lenders obtain large windfall gains following a debt restructuring that has impaired other creditors and shareholders.

(b) Second, very little damage will be done by using a higher valuation. In practice, the junior impaired class of creditors is likely to be the one receiving the equity in the company under the restructuring plan. If the valuation for a restructuring plan has proved to be too high, a second restructuring may be necessary – and that is a less serious consequence than expropriation of a junior creditor’s rights.

(c) Third, a going-concern valuation is more appropriate than a liquidation valuation in the context of a procedure which aims at rescuing companies as a going concern. A liquidation valuation assumes a fire sale of the company’s assets but, if the restructuring plan is successful and the company is deleveraged, there will be no fire sale; instead, the company will immediately have access to new capital, its suppliers will drop their demands for cash on delivery
payments and customers will gain confidence — and the value of the company will increase dramatically. There is no justification for giving the benefit of the valuation increase as a windfall to a class of creditors who are only impaired on a liquidation valuation basis.

Rescue Finance

Q15: 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?

Q16: How should charged property be valued to ensure protection for existing charge holders?

Q17: Which categories of payments should qualify for super-priority as ‘rescue finance’?

Impact on SMEs

Q18: Are there any other specific measures for promoting SME recovery that should be considered?

Yours faithfully

Akin Gump LLP
A Review of the Corporate Insolvency Framework
response form


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

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

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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?

Although a moratorium would provide valuable time for troubled companies to formulate a restructuring plan, there are potentially significant problems that such moratoriums may create that will require safeguards to be put in place before such moratoriums are made available.

In particular, the protection of creditors is crucial as their position may be significantly worsened during the lifetime of the moratorium and few safeguards have been advanced against this in the proposals. The circumstances envisaged by the proposals for businesses that would require such a moratorium, actual or anticipated “imminent financial difficulty or insolvency” implies that the business must have made losses or experienced some cash-flow crisis. Unless this crisis was very transitory in nature, then losses or cash outflows will continue during the moratorium.

Unless rescue finance has been obtained, or working capital introduced by the directors or shareholders for the moratorium period, then losses incurred in trading during a moratorium would be borne by the secured floating charge holder, or by the unsecured creditors. If a restructuring cannot be successfully implemented, then those creditors may seek to hold the directors or Supervisor responsible for the deterioration in their position. It is proposed that the directors are to be exempt from wrongful trading consequences during a moratorium. In such circumstances, the Supervisor will need to be satisfied that the legislation protects him from liability for losses caused to creditors. Alternatively, is it envisaged that the Supervisor (or Directors) will need to take out insurance to cover such losses?

The proposals are also silent on the issue of unsecured trade creditors who have supplied goods which are subject to reservation of title clauses, and whether such clauses would be enforceable following a company entering a moratorium. In an insolvency scenario, such suppliers would be entitled (should their claims be valid) to receive either their goods back or the invoice value of those goods. If no provisions are put in place to protect such suppliers, then they will be forced to stand by whilst the goods are used to fund the working capital requirements of the business during the moratorium. Such an inconsistency would be resented by creditors, and may lead companies to seek a moratorium where not appropriate, for the advantages this would bring.
Whilst it is noted that the intention of a moratorium provision is to encourage directors to address the company’s problems at an earlier stage, rather than when the value of its business has been damaged and its financial position has deteriorated, it is a concern that directors may seek to use the moratorium in circumstances where it is not warranted. It is vital that creditors are given confidence that the professional advisers to the business are regulated and appropriately qualified whose role is to protect their interests. For this reason, we believe that qualified and licensed insolvency practitioners would be the appropriate individuals to perform this function.

There is also a concern that where a moratorium is made available to all businesses, then access to that moratorium will become a default course of action followed by businesses even where not appropriate. Empirical research in the United States (The Success of Chapter 11: A Challenge to the Critics by Elizabeth Warren and Jay Lawrence) shows that size is the true defining factor that determines whether US companies use Chapter 11 or Chapter 7 (liquidation proceedings). Among companies filing for bankruptcy with $1 million or more of debt, 95% begin in Chapter 11.

That same research shows that small businesses are unable to afford the cost of Chapter 11 proceedings and therefore elect to liquidate the business and not seek a restructure or rescue; 97% of companies sampled by Warren & Lawrence entering Chapter 7 (i.e. liquidation) had less than $500,000 of assets. One of the strengths of the current UK insolvency regime is the ability for SMEs to have affordable access to rescue procedures. The proposed changes to the UK insolvency framework will increase the level of court involvement, which implies a greater level of cost. The low take up of the existing CVA moratorium suggests that SMEs are less likely to derive benefit from the moratorium even if access to it is broadened to all insolvency procedures.

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?

There is no doubt that the court could provide an appropriate facility for both the application for and recording of a moratorium, and for any appeal by creditors or the parties against the moratorium. However, given the current shortage of available Court time in the UK, any such proposals would have to be accompanied by a significant investment in the expansion of court resource.
In the US, where Chapter 11 applications which are the most analogous to the proposals are used, there are specialist bankruptcy courts. To implement a moratorium system which is intended to facilitate the swift production of restructuring plans at an early stage of a company’s financial difficulties, any challenges to the moratorium or actions taken by the company or Supervisor must be dealt with expeditiously. This will require significant investment in court resources should the proposals be implemented.

In addition, as mentioned above, empirical research in the US shows that one of the factors that discourages businesses from seeking the protection of a moratorium from their creditors is cost. If the costs of seeking to obtain a moratorium and defending it against the challenges of creditors are to be made through the court, there is a real risk that access to restructuring tools will be restricted to larger businesses. A corresponding concern is that the ability to challenge inappropriate moratorium applications or conduct of the company will likewise be restricted to creditors above a certain size, because of the cost of access.

An additional concern raised by the consultation proposals is that the process of directors selecting a supervisor and seeking for them to obtain protection of a moratorium from creditors is to be done with minimal contact with creditors, other than major secured creditors. The reason for not consulting creditors ahead of a moratorium is clear; to prevent them taking unilateral action that might harm the value of the business. And yet the necessary secrecy in the period leading up to a pre-packaged administration sale is one of the factors that creditors are most unhappy about, leading to criticism that creditors’ rights are being abused. Again, this means that the Supervisor must be able to have the confidence of creditors.

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

Although the proposals state that the moratorium is not intended to allow failing businesses to merely buy time with creditors where there is no realistic prospect of a rescue or compromise being reached; in reality at the point at which a moratorium is applied for, the deliverability of a rescue or restructuring of the company will very likely be uncertain, as little contact will have been made with creditors. The presence of key drivers of a successful restructuring; creditor willingness to forgive debt, a viable business, and availability of working capital finance, will in many cases only be made clear after the moratorium has been applied for and put in place.

**Eligibility test**

The requirement that the business must be already or imminently be in financial difficulty or insolvent may lead to businesses delaying seeking a moratorium until
they are already in significant difficulty. It is difficult to reconcile this requirement with the aim of promoting the early address by directors of corporate distress.

The exclusion of banks and insurance companies appears sensible.

The availability of working capital and funding to enable the trading on during a moratorium is a concern that will have to be addressed by the government as part of these proposals. Without available specialist rescue finance, it is likely that the bulk of cases where a moratorium might be of use will be prevented from achieving this due to the lack of such funding.

In addition at the outset of the moratorium it will be very difficult to show there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors, without being aware of the views of those creditors. Conversely, the requirement to consult with senior secured lenders before seeking the protection of a moratorium presents an obvious challenge to legislators; what prevents the secured lender from taking enforcement action to protect their interests, particularly if they believe their position may be undermined by the potential costs of the procedure taking priority over their repayment?

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We have concerns that in practice the timescale may act against the protection of creditors’ rights. There is no statement in the proposals as to the date by which the business seeking a moratorium will have to notify its creditors that a moratorium is in place. Assuming that the current notification standard of five business days is applied, it may be more than a week after the moratorium has commenced that a creditor finds out that it is in place. This would then give them less than 21 days to make an application to court to contest it. As noted above our concern regarding court resource is that such applications should be heard within a reasonable period of time, particularly if the supplier has been deemed an essential supplier. Without prompt access to court, there is a risk that creditor rights may not be adequately protected or could even be eroded.

Also as previously noted, it is not clear what protection is to be given to suppliers who have provided goods subject to reservation of title clauses or who hold liens. If they have no protection, then they would be forced to watch their stock being used by the company in the moratorium. However, if their rights are enforceable, this would increase the working capital requirement that the business would need to fund its trading during the moratorium period, as such stock would then have to be paid for. Clarity on the approach to such matters in a moratorium will be essential before any legislation is enacted.
We agree that the company should as a matter of course consult with its largest secured creditors before making application for a moratorium. Particularly where those secured creditors are also the only practical source of funding for the moratorium period, this will be an imperative. However, as noted above, what prevents a notified secured lender from then taking enforcement action to protect their interests, particularly if they believe their position may be undermined by the potential costs of the procedure taking priority over their repayment?

The exception from claims for wrongful trading under section 214 of the Insolvency Act 1986 during a moratorium will need careful construction. It is unlikely that a business seeking protection from a moratorium will be profitable or cash generative during the moratorium period, and therefore its net liabilities to creditors will be increasing. Unless such increases in liability are covered by rescue finance, then should a restructuring plan not be accepted by creditors, those creditors whose interests have been prejudiced during the moratorium will wish to know who will recompense them for their losses. This makes the requirement for an appropriately qualified and licensed insolvency professional to act as Supervisor all the more critical, and highlights the need for them to be adequately protected to enable them to accept appointment.

The protection of creditor interests during the moratorium is a real concern, particularly where creditors are forced to continue trading with the company as an essential supplier, in circumstances where they would might prefer to seek a more profitable or long term business relationship elsewhere, but are prevented from doing so by their designation. Their ability to challenge the decision of the court will be unhelpful if they are not able to do so within reasonable timescales, or at reasonable cost.

Pensions

Often one of the largest unsecured creditors of the company may arise in cases where the company had a defined benefit pension scheme. Pension schemes, and treatment of the debts owed to them have been very high profile of late, due to cases such as BHS, Lehman and Nortel. However, there is no mention of pension schemes in either the consultation document or the impact assessment that accompanies it.

It is unclear whether obtaining a moratorium would become an insolvency event for Pension Protection Fund purposes. If so, the PPF would in most such cases be the largest creditor, whose size of vote would determine whether any restructuring plan would be approved. However, it is also unclear whether or not in such circumstances their rights could be crammed down. Nor is it clear whether or not the moratorium would prevent the Pension Regulator (tPR) from using its moral hazard powers. It is crucial that the treatment of a defined benefit pension scheme under a moratorium is clarified as part of any legislation to bring these proposals into effect. It would seem logical to make the position of a pension scheme
consistent with that under a formal insolvency process, to be sure that abuse of the pension scheme does not occur.

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

The duration of the moratorium of three months does not appear an adequate amount of time to formulate detailed plans to put in front of creditors for a business of any size. Empirical research in the United States ([The Success of Chapter 11: A Challenge to the Critics](https://www.chambers.co.uk/publications/the-success-of-chapter-11-a-challenge-to-the-critics)) by Elizabeth Warren and Jay Lawrence) stated that 82% of successful small business restructurings under Chapter 11 took longer than 6 months to complete.

Firstly, the period of three months will in practice be a shorter time, as the necessary notification period to creditors to enable them to vote on the proposals, or on any extension to the moratorium will have to take place in the three month period. There is a real risk that major creditors may use their voting power to block the extension of the moratorium, particularly secured creditors who are not fully secured, or who believe any extension of the moratorium will further diminish their position. It may be prudent to include an option to seek the permission of the court to extend the moratorium.

Conversely, in addition to the proposals for extension moratoriums, we propose that in accordance with the current CVA procedure, the Supervisor of a moratorium should have a duty to apply to court to seek the end of the moratorium, should they believe that the reasons for the moratorium’s commencement are no longer valid.

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

It is vital that the supervisor commands the confidence of the creditors and company in balancing the rights and responsibilities of each. The proposal that a Supervisor may be someone other than a licensed insolvency practitioner or equivalent is a concern, for the reasons detailed in our answers to previous questions.

Although the restriction of the Supervisor from taking a subsequent role in a formal insolvency process would prevent a potential conflict of interest for the Supervisor, it would create an additional conflict of interest, insofar that the Supervisor may have an interest in retaining or extending the moratorium where there is no real prospect of a successful outcome, and not be objective in making such a decision.
It is unclear from the proposals whether the current rule that “an insolvency practitioner who previously acted as supervisor would be prevented from taking an appointment” would apply to another IP from the same firm. However, should it be felt that there should be no connection between the Supervisor and a subsequently appointed insolvency practitioner, this would cause increased costs due to the time required for the staff involved to become familiar with the company, and passing on all the relevant knowledge.

Further detail is required when formulating the requirements for the supervisor and we believe that he should be qualified, licensed and have a bond and also that matters regarding his selection and any veto by creditors are covered to ensure that he is able to have the confidence of creditors.

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

It is correct to seek to ensure that those who trade with the business during the moratorium are adequately protected. However provision of such protection may be at the expense of other creditors, particularly secured creditors who hold a floating charge. As previously noted there is a risk that losses incurred during the moratorium period may lead to an impairment of the creditors’ positions.

Given that one of the conditions to enable an application for a moratorium is the availability of funding for that period, the potential for unpaid costs to exist at the end of the moratorium suggests that this condition has not been met. It must be considered whether in such circumstances it is correct that secured or other creditors should meet those costs, or whether they should be met from those responsible for the trading, via insurance or a bond.

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

The provision of information to creditors is important to give creditors an overview of the procedure and help them gain confidence in the process. However the provision of such information must be balanced against the cost of its provision and to ensure that what is provided is of genuine value to creditors.

We propose that in the moratorium creditors are provided with information, but that it should be prescribed in both its contents and frequency to prevent creditors from adding additional cost to the process without generating additional value from the information that is provided. There is a real danger that the provision of information may become a distraction from the primary focus in the moratorium period.
Any intention to extend this proposed provision to current insolvency procedures should be balanced against the additional costs that may be added to those procedures, particularly where information may be requested by creditors who may not be the stakeholders who are bearing such costs. There should be safeguards put in place to prevent creditors who have no stake in the process from requesting information to frustrate the process or (for example from competitors) to serve their own agendas. This may have a detrimental effect where there is a sale of the business being attempted in an insolvency process.

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?

The protection of businesses by enabling them to compel critical suppliers to provide goods or services required for the continuation of trade will be of benefit to many businesses seeking to restructure. We believe that providing an open definition of what constitutes an essential supply will both enable the court to determine this on the basis of the circumstances of the case in case of challenge, and future proof legislation against changes brought by technology or other market forces which may create new essential utilities.

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?

It is possible that the designation of a supplier as essential may prove onerous to them, should they wish to reassign their resources to more profitable or potentially longer term trading partners, and that the cost of challenging the matter in court restricts their rights.

It is not confirmed in the proposal is whether or not the continued supply will be on the same terms as was made prior to the moratoriums or whether the supply will be able to change those terms.

As previously noted the operation of this proposal will be dependent on access to the court at reasonable cost, and within acceptable timeframes, which requires additional sufficient court resources to facilitate this. It is not made clear what would happen if the supplier refused to provide goods or services, notwithstanding...
their designation as essential. It would not take very long before such non supply would cripple a trading business, so court intervention would have to be almost immediate, if it was to be of help.

Also, contemporary supply chains often cross borders, and involve companies from other jurisdictions. Is it envisaged that such suppliers could be compelled to continue to provide goods or services?

**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?

The CVA procedure was first brought in as part of the 1986 Act, and its practices have been established and confirmed over time by case law. It is a mature procedure which is well understood by creditors and companies, and therefore the addition of a change to enable the binding of all creditors to a restriction plan, and to enforce the will of the majority against a minority of dissenting creditors would be sensible to operate as an extension of a CVA. In addition, the availability of a moratorium prior to a CVA would give the time and capacity to formulate a plan that would be acceptable to all creditors and we believe would lead to greater use of the CVA procedure.

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

If dissenting creditors would not be worse off under the restructuring than they would have been in a liquidation, then making a restructuring plan binding would make little difference to them. The issue which will be most difficult, and which will need to be carefully implemented, will be determining which creditors can be deemed to have an economic stake and which do not.

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

As stated above we believe that the proposed safeguards including the role of the court will provide sufficient creditors protection against the cram-down of their rights. In addition, we believe that secured creditors whose security has no value given the existence of more senior secured creditors should be prevented from blocking a restructuring plan, and should be treated in a similar way to unsecured 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?

The valuations which are used by the court to ensure the creditors are not prejudiced by the use of a cram-down procedure will be of great importance, and we support the development of a set of consistent bases of valuations which can be used not only in these circumstances, but across a wider range of insolvency processes, in order that creditors can obtain greater information from, and confidence in such valuations. Valuations are however subjective and theoretical exercises and do not always result the forecast outcome so some caution is required here.

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?

As is noted in chapter 10 of the proposals on rescue finance, the structure of UK borrowing is different to many other countries who have more widespread availability of rescue finance. In particular, the customary UK use of floating charges which cover all or significantly all of the assets of the company inhibit the seeking of rescue finance for a troubled business. In practice, companies who are in a position to require a moratorium have few if any unpledged assets, and the value of the pledged security is frequently approached or even exceeded by borrowings against those assets.

Although a negative pledge clause may inhibit further lending in some cases, in practice most lenders who hold a floating charge lend to a greater degree than would otherwise be the case. There is a real risk that should lenders believe that the assets backing their lending may be primed by rescue finance providers, they may factor this into their calculations when making finance available to companies. Consequently there may be a knock on reduction in lending facilities, which may do more harm to troubled businesses.

16) How should charged property be valued to ensure protection for existing charge holders?
If super priority is to be given to providers of rescue finance, then existing security holders must be protected via a prudent valuation of the assets which the existing lender has a charge over, in determining whether there is equity. We suggest that the liquidation valuation basis which is been suggested for creditors in a cram-down could be utilised to provide a prudent basis in determining whether or not there is equity available for rescue finance to be pledged against.

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

By providing for the costs of the moratorium (including trading costs) to be met as an expense, those costs are already being given super-priority. The Government should exercise caution before permitting priority over existing lending, due to the possibility that such lenders may seek to reduce perceived exposure to any payments that may end up being given priority over the repayment of their debt.

Impact on SMEs

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

The SME community are an integral part of the UK economy, and of great importance to it. Due to the interdependence of the business and its owners, in many cases help is only sought at a later stage, after a restructure outside insolvency becomes impossible. In part this is also due to cost, in our opinion the existing small company moratorium available prior to a CVA is underutilised not only because of the inability to bind secured creditors, but also because of the cost of procedure relative to the size of the firm. This adverse factor will be shared by any moratorium process.

In addition, we do not consider that the widening of the pool of expertise to SMEs will necessarily be helpful, as the specialist knowledge and advice provided by insolvency practitioners, and the licensed and regulated nature of their profession provides additional safeguards over those offered by accountants or solicitors who have not obtained additional qualification as an insolvency practitioner. The general lack of SME director expertise in restructuring means they are in particular need of proper advice on all options.
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.

In seeking to enable rescue finance, one source of funding that does not appear to have been considered is the equity of the company. By allowing creditors to take an equity stake in the company in recompense for providing finance to the company, or for accepting a write down of their debt, this may assist in finding a restructuring solution.

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?

X Yes □ No
1. Introduction

(a) Allen & Overy LLP is a global law firm headquartered in London with operations across Europe, the U.S, Asia, Africa and Australasia. Our restructuring practice is a global practice acting on a wide range of domestic and international restructuring and insolvency transactions for debtors, creditors, sponsors, insolvency practitioners and other stakeholders. Our market tends to be large and complex cross-border transactions and we are rarely involved in situations involving small and medium sized enterprises.

(b) We set out below a summary of our comments followed by more detailed responses to the specific questions set in the consultation.

2. Summary comments

(a) We welcome the opportunity to consider the current UK insolvency regime framework, in particular in relation to companies on the verge of financial difficulty. Although the business rescue culture is a well-established part of UK insolvency and restructuring practice and there are some very useful statutory tools available to UK and foreign companies that can fall within the UK’s broad jurisdiction, other jurisdictions, particularly in Europe, are busy updating their restructuring regimes (often mirroring certain elements of the UK regime) and it is clearly important that the UK continually considers how its own regime can be further improved. The existing UK corporate insolvency regime is flexible, effective and internationally well-regarded. We also note that the variety of formal and informal insolvency process in the UK, including contractual/consensual workouts, CVAs, schemes of arrangement and administrations preserve the necessary flexibility for a distressed company to negotiate and implement bespoke arrangements in order to best preserve value for all of its stakeholders. We consider therefore that a strong case needs to be made for any legislative change particularly those of the magnitude set out in the consultation.

(b) The four proposals in the consultation are high level and would represent a material change to the UK restructuring and insolvency regime. The detail of formal legislative proposals will need careful consideration before they can proceed to implementation. The proposals address a range of issues that may arise for companies in financial difficulty, but will not necessarily be relevant in each situation. The problems faced by small and medium sized enterprises in financial difficulty are different from those faced by large businesses and some proposals will be more relevant for one or the other.

(c) For large corporate restructurings we consider that the ability to effect “cross-class” cram-down of out of the money creditors could improve the current regime. However, we don't consider the need for and benefit of the other proposals to be as clear in large corporate restructurings.

(d) The moratorium, supply of essential services and the rescue financing proposals are, to some extent, inter-dependent. The moratorium arguably necessitates the proposals in respect of the supply of essential services and rescue financings. The moratorium proposal should also be considered in the wider context of how finance is provided to companies and how different stakeholders would react to the introduction of a moratorium. In the context of large corporate restructurings we do not consider this proposal to be necessary and, if implemented, would represent a very debtor friendly shift in the legal framework with insufficient protections for creditors.

(e) The proposals regarding the supply of essential services are, in the context of large corporate restructurings, not necessary and, in our view, the existing framework for the supply of essential services (which has only been extended relatively recently) is sufficient. Applying the regime to a
potentially very broad range of suppliers, however big or small, could have a disproportionate effect and very robust protections would be required in order to render the proposal balanced as between the interests of the debtor and its suppliers. In particular, trade suppliers (who are often small and medium sized enterprises not well placed to absorb losses and increased risk) should not be forced to incur further credit risk on a financially distressed company. To the extent this is to be introduced certain contracts will also need to be excluded particularly those contracts relating to the provision of funding or hedging transactions.

(f) The UK has, to some extent, lead the way in promoting a rescue culture for companies in or approaching financial distress. CVAs, schemes of arrangement and administrations all offer companies with a large degree of flexibility to rescue their businesses either pre-insolvency or quickly through an insolvency process.

(g) Schemes of arrangement have developed naturally over time – their use now is far more prevalent and covers far more situations than it would have done even 5 years ago, for example. There is a clear gap in the scheme legislation, however – cross-class cram-down is not possible even for out of the money stakeholders. We therefore consider a new procedure similar to a scheme but with such a mechanism permitted would provide a useful restructuring tool.

(h) The rescue finance proposal raises a number of issues that would need to be worked through before a proposal could be fully considered and we have concerns that adding such a regime to the existing statutory framework could have unintended consequences. In addition, the need for such rescue financing arrangements in the context of large corporate restructurings has not, in our view, been demonstrated so as to justify the potential interference with the rights of secured creditors.

(i) We do have additional concerns that the complexity of the four proposals will not address the problems with the current statutory regime for small and medium sized enterprises in financial difficulty.

(j) Finally, we note that the consultation was issued prior to the outcome in the European Referendum and the UK’s decision to leave the EU. It is too early to tell yet what impact this will have on European legislation such as the European Regulation on Insolvency Proceedings. Until it is known what “exit model” the UK will be pursuing, it would seem premature to adopt a new business rescue tool that is intended to have the benefit of EU recognition.

3. The introduction of a new moratorium to help business rescue

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

General observations

As discussed above, our experience of the UK corporate insolvency regime centres around larger businesses with complex financing arrangements and multiple stakeholders. We question whether the proposed moratorium would benefit such businesses, given the current framework and in particular the rights of lenders to take enforcement action and the risks to lenders that taking enforcement action could result in significant losses for all stakeholders. Security enforcement generally requires an instruction from a significant majority of creditors (typically 66.6% in a bank syndicate and 25% in a bond issue). The broad support required for such enforcement action against large companies often necessitates early dialogue between groups of creditors and a financially distressed company but also reduces the likelihood of action by small groups of hostile creditors. Infringing the rights of secured creditors, particularly in circumstances where management may no longer be trusted to run the business prudently, must be considered very carefully. One potential option would be for secured creditor consent to be obtained before a moratorium could be sought.
Moreover, trade creditors often base their lending decisions on different criteria to high yield bond lenders or syndicated bank lenders and generally lend on shorter contractual terms with greater flexibility to reduce or pull credit lines. Again, the flexibility of trade creditors to pull their credit lines incentivises a financially distressed company to enter into early negotiations with such creditors or to demonstrate that negotiations with its other long-term creditors are progressing. The proposed statutory moratorium risks unintentionally minimising the importance of such early negotiations as the directors and the company have a statutory ‘fallback’ procedure to rely on in the face of threatened creditor action. This position has the potential to incentivise lenders, and in particular trade finance suppliers, to pull lines earlier and more aggressively at the first signs of financial distress in an effort to avoid being ‘caught’ by a potentially lengthy moratorium. This could incentivise a ‘rush to the exit’ on the part of trade creditors in particular and the opportunities for the company to engage in consensual negotiations with creditors (which are often necessarily complex and lengthy) could be greatly reduced. In our experience, in larger business restructurings, the focus is on the capital structure and often trade creditor arrangements are left unaffected.

It is our experience that the process of agreeing contractual standstill arrangements between a company and (certain) of its creditors is in itself proof of positive action being taken by a company in financial distress. Even if a contractual standstill is not signed, de facto standstill arrangements are not unusual in the market and often provide a stable platform from which to negotiate a wider restructuring of the company’s financial indebtedness. A statutory moratorium process would almost certainly involve some degree of ‘stigma’ for the company which would in itself reduce the likelihood of existing financing arrangements continuing following the moratorium period. Along with the risks of a ‘rush to the exit’ outlined above, this would incentivise a company to enter into a moratorium before discussions with (certain) creditors began. This would reduce trust between stakeholders, effectively mandating an exit from the moratorium by way of a more formal process, such as a CVA, scheme of arrangement or administration. Trust with creditors would be further reduced given that a moratorium of this nature inherently prefers shareholders over creditors as the rights of creditors are compromised for a potentially long period while a financially distressed company is enabled to continue trading where it otherwise may not have been able to do so. On these grounds and given the increasing complexity of financing structures, a statutory moratorium mechanism seems to us to be a blunter and more aggressive tool than the existing option to negotiate a contractually-based standstill between (certain) creditors.

Specific considerations

The proposed moratorium needs further detail in relation to the following areas, which will raise difficulties in the context of a large financial restructuring:

1. Protections for set-off, netting and financial collateral will be required in relation to the proposed moratorium.

2. The treatment of creditors with rolling debts (such as those lenders under RCF/working capital facilities) will need to be clarified. Would a rolling debt automatically expire (or be rolled) during the moratorium period? In either situation, the liquidity position of the company could be affected during the moratorium, which in itself would impact the proposed criteria for continuing the moratorium.

3. The new concepts of directors’ liability need to be considered in detail. As discussed below, the current moratorium proposals to reduce potential directors’ liability should be reviewed extremely carefully to avoid potential unintended consequences.

4. As discussed below, the role of the supervisor should be defined carefully and striking the correct balance between the company and creditors will be crucial to the success of the proposed moratorium.
5. The role of the court in the proposed moratorium should be clearly defined, particularly in relation to any tests that must be applied by the court to enter/exit/continue the moratorium. The proposal seeks to balance enough court involvement to police the process adequately and engender confidence among all stakeholders, but while limiting court involvement so as not to make the procedure prohibitively cumbersome and expensive, waste precious costs and stakeholder time. The detail of what the court is bound to consider in relation to the moratorium procedure will affect how well this balance is struck.

6. The eligibility requirements that engage the proposed moratorium should not be unnecessarily restrictive. In particular we suggest the availability of a moratorium should not be limited to UK incorporated companies or EEA incorporated companies with their centre of main interests in an EEA state (assuming of course that these concepts remain relevant following the outcome of the European referendum). We would suggest instead that further consideration is given to the eligibility criteria of the moratorium, perhaps giving the English Court jurisdiction to grant a moratorium based on the ‘sufficient connection test’ which is currently used when approaching schemes of arrangement.

7. There is a separate issue regarding the recognition of the proposed moratorium outside of the UK. In restructurings of the size and complexity envisaged by the proposals there is likely to be some cross border aspect to the business being restructured.

(b) **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?**

The process of filing to court is an efficient means for a company to obtain such wide-ranging relief against its creditors. However, preparing the documentation required for such an application is likely to be an intensive and time consuming process. In practice, we suggest that a company is likely to have consulted at least a subsection of its creditors before applying to court and that this will add to the cost and time required to initiate a moratorium. For larger businesses, we would expect some degree of stakeholders being made aware of a pending application. The option for creditors to challenge the moratorium in a court hearing provides a robust mechanism for challenge but is weighted in favour of the debtor. Creditors would need to expend time and resources challenging any moratorium. For example, a company will need to plan for any potential creditor challenge that may be made in court during the moratorium period. Because the proposed moratorium is so wide-ranging, this will mean that a company is forced to plan a response to all of its creditors. This has the potential to make the preparation for a moratorium application more onerous than a contractual arrangement that targets certain creditors only.

The current proposal allows a company to apply for the relief of a moratorium without giving prior notice to any creditor and does not allow for creditors to challenge the moratorium before it becomes effective and the challenge period is limited to the first 28 days of the moratorium period. For creditors with short-dated instruments or with imminent maturity dates and for those creditors who provide ‘essential supplies’, this proposal drastically reduces certainty of rights in relation to any company in financial or possible financial distress. We see this as potentially problematic, particularly for companies whose financial condition is tied to volatile or cyclical markets, such as commodities.

The proposal as drafted is very debtor friendly.

(c) **Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?**
The proposal states that the company must demonstrate that it ‘is already or imminently will be in financial difficulty, or is insolvent’. While this seems a sensible test for a moratorium, providing a definition in statute for this eligibility will prove extremely difficult. Any attempt to impose a statutory requirement for a valuation, for example, will reduce the speed and efficacy of the moratorium relief and will impose greater costs on companies. Additionally, it will be difficult for a company to prove that it has ‘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.’ If this test remains as drafted then it is likely that companies in the most severe need of the benefit of a moratorium are likely to be unable to satisfy the test because they may have payment defaults outstanding or expect potential payment defaults during the moratorium period. Similarly, while the ‘no creditor worse off’ test is a test seen in other jurisdictions, we query how will the test be framed and at what times and against what comparator are creditors’ rights compared.

The final qualifying condition for the moratorium, that ‘at the outset there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors’ seems to reduce the potential benefits of the moratorium. For directors to reach such a conclusion for large businesses with complex capital structures, some degree of consultation would almost certainly had to have occurred. In such circumstances, those creditors are unlikely to wish to give up rights without having negotiated some form of agreement, much as is the case under the current system. However, because of the ‘no creditor worse off’ and ‘sufficient funds tests’ and because of the wide ranging nature of the moratorium, almost all, if not all, creditors will need to be consulted prior to the moratorium application. This will mean that the negotiation for a moratorium may in fact be more onerous than for a contractual standstill and involve a number of inter-creditor negotiations which would be unnecessary for a contractual standstill.

Finally, the process for the supervisor to monitor the qualifying conditions during the moratorium is likely to be costly and time consuming, particularly in circumstances where a company is in financial distress.

(d) 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?

An integral part of the responsibility of directors is that once a duty becomes, or is likely to become, owed to creditors, the directors must take steps to minimise the potential loss to the company’s creditors. If they cannot demonstrate that this has been done, then they may be required to contribute personally to the company’s assets on an insolvency. The delicate balance of directors’ duties forms a vital part of the current insolvency framework.

The proposed rights and responsibilities for creditors and directors during the moratorium period drastically shifts this balance in favour of the directors at the expense of creditors. Despite the protections offered by the requirement to maintain the conditions for a moratorium, we do not consider the waiver of wrongful trading liabilities to be appropriate on the current proposal. If safeguards around creditor consultation prior to the moratorium being permitted were included, there may be some scope to include at least some changes to the wrongful trading regime, however. On the contrary, this is the exact period in which a director should be the most conscious of his potential liabilities in order to protect the rights of creditors.

(e) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

As discussed above, a three month initial period for a moratorium has the potential to significantly affect the rights of creditors with short-dated instruments or with imminent maturity dates and those creditors who provide ‘essential supplies’. On the other hand, in relation to large companies, at least
a three month period is likely to be required in order to negotiate and implement a restructuring of the company’s financial indebtedness. We suggest that it is likely that more than three months will be required in complex restructurings. The proposals for voting to extend the moratorium require further detailed consideration. In particular, would creditors vote to extend the moratorium based on their outstanding debt and would all creditors vote in a single class? If so, there is a strong risk that minority creditors (who often will include trade suppliers) may be outvoted by institutional creditors holding large amounts of longer-dated debt.

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

We consider that defining the role of the supervisor correctly will be critical to the success of the proposed moratorium. For this reason, additional detail on the supervisor’s role should be made available in order to assess whether the right balance is struck between creditor protection and facilitating and monitoring the moratorium.

We suggest that the supervisor should be independent of both the company and the creditors. However, existing experience in insolvency procedures shows us that supervisors of this kind who are retained initially by the company and its directors and/or the senior creditor, however impartial their conduct, are usually regarded as partisan to the company and its directors and/or the senior creditors. The success of the moratorium procedure will depend upon the independence of the supervisory role and how and when supervisors are able to exercise their powers and discretion in practice.

We think that careful consideration ought to be given to the role of the supervisor and views sought from insolvency practitioners as to how they might achieve its intended purpose. In particular we think that provisions in relation to the supervisor’s request for, and reliance upon, information provided by the directors need to be very robust. The supervisor needs to be able to rely on information provided by the directors, otherwise he cannot adequately perform his role. There also needs to be a safeguard against the directors’ providing only partial or favourable information in order to procure a particular outcome.

The supervisor’s duties will be onerous – and can last for a potentially lengthy period. The duties are likely to be similar to those of the nominee in the Schedule A1 moratorium but with more liability attached because of the likely sums involved. The nature of the insolvency practitioner’s role in the small company CVA is a significant reason why it is so little used. The sums at stake in small company CVAs are simply not worth the potential liability for the insolvency practitioner. With greater sums at stake in a moratorium, the role of the supervisor in the proposed restructuring procedure may be more attractive to insolvency practitioners, but the fee level is likely to reflect the difficulty of the role and potential liability incurred as a result. Therefore the supervisor’s fees is an area that needs detailed consideration.

(g) Do you agree with the proposals for how to treat the costs of the moratorium?

In principle, we believe that this super-priority treatment of moratorium debts and supervisor’s costs is necessary to make the proposed moratorium workable. However, it will also be necessary to define ‘unpaid debts during a moratorium’ carefully to avoid leaving the process open to abuse – allowing some creditors to enter into ‘new debts’ (e.g. bank advances) in the moratorium period to gain priority in a subsequent insolvency. The treatment of liabilities such as dilapidation claims, pension debts and exceptional tax liabilities that could also arise in the moratorium period needs consideration.
In defining the scope of ‘unpaid debts during a moratorium’ it is worth considering the difficulties encountered in applying both the liquidation and administration expenses regime to avoid replicating the same problems.

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

We welcome further opportunities to increase transparency for all stakeholders in a restructuring process - the more information that is available to stakeholders, the more openly the negotiation process can be run. Provided there are appropriate safeguards that the provision of information (and in particular, confidential financial or business information or MNPI) remains at the discretion of the directors of the company and the supervisor, we consider that the opportunity for creditors to make information requests is beneficial to the overall restructuring process. The ability for the creditors to request information should also enhance opportunities for engagement between all creditors and the company and should discourage unequal treatment between creditor groups (subject to existing legal and contractual safeguards).

4. **Helping Businesses Keep Trading through the Restructuring Process**

(a) **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?**

As mentioned in the proposals, any designation of contracts as ‘essential contracts’ would interfere with suppliers’ rights of freedom of contract and their ability to rely on express termination clauses in their freely negotiated contracts. Therefore, any expansion to the definition of ‘essential contracts’ should be carefully considered and clear justifications should be provided for such an expansion. We also suggest that in the vast majority of large-scale restructurings, the ability of a company to designate any of its supply contracts as essential would likely disproportionately benefit the company at the expense of the supplier. For these reasons, we do not think that this option would result in a higher number of large scale business rescues and, as mentioned above, many large business restructurings are effected in the capital structure leaving trade suppliers intact.

We do not think that the case has been made to further expand the definition of essential contracts. In particular, any extension of this part of the existing regime would need to include safeguards relating to suppliers who effectively incurred credit risk with the relevant company. For small suppliers this is of particular concern.

(b) **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?**

One of the criteria for consideration when designating a contract as ‘essential’ is whether the business will still be able to meet its payments as they fall due. The company must also be able to show, as a primary qualifying condition for entering the moratorium, 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. The supervisor must ensure that these conditions continue to exist during the moratorium. Additionally, if a provider of essential supplies considers that the justification of the company for any of the above is not adequate it can apply to the court and the court will be required to determine whether a contract should be deemed as ‘essential’. While the court provides a route for challenge, this will likely be of limited comfort to small suppliers with limited resources.

5. **Developing a Flexible Restructuring Plan**
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?

English law has two procedures that are commonly used to facilitate financial restructurings – the scheme of arrangement under the UK Companies Act 2006 and the Company Voluntary Arrangement under the Insolvency Act 1986. The CVA is an insolvency procedure (and an insolvency proceeding for the purposes of the European Insolvency Regulation), whereas the scheme of arrangement is a corporate procedure that can apply to solvent and insolvent situations (and is not an insolvency proceeding for EIR purposes). Whether there will be any benefits in the CVA being listed as an insolvency proceeding for EIR purposes will depend on the outcome of the UK’s negotiations following the European referendum.

We have, in recent years, been involved in numerous schemes of arrangement to effect pre-insolvency restructurings of a range of what have tended to be sizeable businesses including The Cooperative Bank PLC, German Residential Asset Note Distributor plc, Russian Standard Finance S.A and for these transactions the scheme of arrangement in its current form has the flexibility and the safeguards to be able to deliver the desired results. It is worth noting that, in many of these cases the schemes of arrangement were in respect of foreign issuers who came to the UK to utilise the scheme mechanism to implement their transactions. The pre-insolvency potential of a scheme of arrangement is, in our view, fundamental to the English repertoire of mechanisms to deliver flexible and equitable restructuring solutions in both solvent, near-insolvent and insolvent situations. We do not therefore consider that amending the scheme of arrangement is desirable if doing so would result in the scheme of arrangement becoming an insolvency proceeding for the purposes of the European Insolvency Regulation.

However, we have also undertaken a number of transactions that combine a pre-packaged administration with a scheme of arrangement in order to deal with the lack of cross-class cram-down in a scheme.

It is not clear to us what the 12 month limit for a restructuring plan would be. Most restructurings we are involved in involve a restructuring of the capital structure and financial restructuring while leaving the underlying business unaffected. Accompanying many such restructurings will be a business plan, typically 3 to 5 years in length, on which the future capital and financing structure will be based. We assume that "Restructuring Plan" refers to the capital/financial restructuring and not to the business plan that may underpin such restructuring (even if the business plan includes operational restructurings and disposals). Business plans are, in our view, a commercial matter for management and not for the legislature to interfere with. If this is correct, we suggest that "Restructuring Plan" needs to be defined with appropriate care. In addition, you refer to a 12 month time limit for a restructuring plan. The implementation of the majority of restructurings with which we are involved from launch to completion will occur well within this timeframe, even if the restructured capital.financing structure contains debt and equity obligations that extend well beyond a 12 month period. We therefore consider this time limit to be largely irrelevant for the market in which we operate.

We consider there is scope for a new standalone procedure similar to a scheme. Such procedure would provide for a plan to be proposed by a company acting by its directors or by an administrator of the company and would afford an attractive alternative to a CVA and, in some circumstances a scheme of arrangement. It should therefore constitute an insolvency proceeding for EUIR purposes (assuming that the benefits of this legislation are retained) but should not replace the scheme of arrangement procedure.

Valuation is the key issue in many restructurings and, in our view this is an evidential matter for the court to consider, not a matter for one particular form of valuation to be prescribed over another. While we agree that the minimum consideration to any stakeholder should be what would
recoverable in a liquidation (which broadly reflects current case law in any event) how that valuation is to be determined should be a matter for the debtor and the relevant creditors to determine. Assumptions should be capable of being justified but should not be prescribed - different business and different assets will warrant potentially different assumptions when it comes to valuation and prescribing these in advance could have unintended consequences. Stakeholders are best places to assess and seek advice on their economic interests in a particular asset.

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

The proposed class and voting requirements are broadly aligned with the requirements in a scheme of arrangement which is a long established procedure that has worked well and proved successful in balancing stakeholder interests, with the key difference in this proposal being the ability to cram-down entire dissenting classes. We consider that, a procedure that permits cross-class cram-down, provided there are suitable creditor protections (in respect of which, see below), is worth further consideration although, as mentioned above, think this should be an alternative procedure to a scheme of arrangement and not a replacement or amendment to the current scheme of arrangement procedure.

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

In our experience, prompt access to information for creditors and other stakeholders in a scheme of arrangement is crucial particularly if the proposed scheme timetable is challenging. Access to documentation via a designated scheme website is, in our experience, commonplace but is not necessarily sufficient in all cases particularly cases involving retail investors where additional methods of communication may be appropriate (for example, in mainstream media, or at the point of consumer contact for the customers in question).

See our comments below regarding the role of valuations. The safeguards proposed are broadly similar with the safeguards afforded to creditors in a scheme of arrangement where the courts have a broad discretion to consider class composition, scheme procedure and the fairness of a particular scheme.

The proposal is far more prescriptive and, while we would urge caution on limiting the court’s discretion, the list of criteria appears to be similar to the criteria we would expect a court to apply as a general matter of discretion in any event (as evidenced in the scheme process). There is merit in considering leaving such discretion unamended, rather than seeking to prescribe specific factors.

(d) **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?**

Valuations are a key part of many restructurings and enforcement mechanisms, including disposals effected by an administrator, receiver or mortgagee. In schemes of arrangement, out of the money creditors are often not required to be consulted and it is therefore important to be able to form a view as to where value of a particular business “breaks”. Businesses are different and can be valued differently. No one size fits all is likely to work and we would suggest caution about seeking to prescribe a particular valuation methodology without knowing the background to a particular situation. On balance we would prefer to leave the question of valuation as an evidential matter. Liquidation valuation will not always be the appropriate valuation and in many situations the “most likely alternative” scenario (which could be an administration sale or a solvent wind-down) may form the more appropriate basis for valuation.

6. Rescue Finance
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?

The notion of rescue finance has been considered in the backdrop of insolvency reform in England & Wales for many years. Introducing rescue finance measures is rooted in the idea that it empowers companies to have access to funding when it is needed most and it is hardest to find. While it remains a commendable goal, if such financial empowerment comes at the expense of changing contractual priorities and impacting the security interests of existing secured creditors, the balance to be struck is very fine and one that the Government admits will not be easy to find.

In practice we would expect rescue financing to be used by large businesses but less so by medium sized enterprises and very rarely by small companies. Even for large businesses, in our experience financing is often provided by existing creditors on a consensual basis or by using a scheme of arrangement without the need for specific legislation or the interference with creditor rights. We are not therefore convinced that a rescue finance regime is needed.

We do not consider that large business rescues fail for want of rescue financing and consider that evidence should be collated in this regard to assess what businesses think of the proposal.

For various reasons set out below, we conclude that rescue finance providers should not be granted security in priority to existing secured creditors (including those with negative pledge clauses) primarily because it is very difficult to define precisely in which circumstances this would cause least disruption to the markets. The test set out in the Government proposal on rescue finance is simple and straightforward on paper but its implications are uncertain and unclear in practice. It is very difficult to legislate for rescue finance because it is a dynamic and risky market and there is a risk that the benefit of introducing such measures could be overridden by any unintended consequences.

**General discussion**

*Goal shifting*

Encouraging rescue finance needs to be coupled with an assessment of the viability of the relevant business. Rescue finance should not be available to extend the life of a dying business. At present, this economic assessment has been left to the market i.e. credit providers (existing or new) who undertake the risk analysis before deciding to lend to a distressed company and the legal system does not interfere with this. However, if measures are introduced to assist providers of rescue finance by giving them contractual priority or additional security, this mechanism will need to ensure a proper valuation of the business is undertaken so that the playing field is not unevenly skewed in favour of opportunistic lenders making use of the insolvency regime to benefit at the expense of others.

The presence of a rescue financing as an option could impact stakeholder behaviour.

*Current availability of rescue finance*

Two assumptions that underline the introduction of the Insolvency Service’s proposal are that firstly, there is an established need for rescue finance in the market and secondly, rescue finance is not currently available to businesses and there is a gap in the industry that needs to be filled. We do not feel that current system is necessarily failing to cater for viable businesses which require rescue finance. To the contrary, we have seen deals where one or more existing lenders do take a lead in refinancing or restructuring a business if the business is viable and the lender has considered the economic risk behind the decision. Introducing rescue finance provisions may put undue pressure on existing lenders to either exit the facility early if there is fear that new competing lenders will come
into the picture or force them to consider providing finance in order to avoid competing claims, even if they do not think the business is viable.

**Administrator v debtor in possession**

The proposal does not make a distinction between rescue finance provisions available to a debtor in possession (DIP) vis-à-vis those that will be available to an administrator seeking rescue finance. This distinction is an important one because the nature of the safeguards required in each scenario may differ slightly.

In the US, a company files for DIP status which gives it automatic protection going forward and publicly announces that the company is considering DIP finance. Further, the DIP finance agreement is filed with the court and made publicly available to all interested parties. Consideration must be given to how and when a company is eligible to apply for rescue finance. The dynamics of a company’s directors and shareholders considering rescue finance and bringing in a new lender is very different from an administrator who has effectively been appointed to displace the internal management of the company.

** Opportunistic lenders**

The proposal does not really focus on the identity of the new rescue finance providers. There is no detailed discussion on whether it is envisaged that the existing lenders to the company would play a big role or the company would have access to a whole new set of credit providers relying on the rescue finance measures.

The experience in the US which has a well-established DIP finance industry has been that the existing lenders end up playing a major role in any kind of DIP financing for the company. This is because the existing lender has more information about the company due to its existing relationship and because it does not want competing creditors to come into the picture at this stage.

Further, the US experience also highlights that DIP financing is done on very friendly DIP lender terms and the negotiating position of the company is fairly limited. The US Bankruptcy Code sets out broad parameters for DIP financing and over time, the Bankruptcy Court has established broad guidelines for DIP lenders. However, this has taken several years to develop and is still a dynamic area of law.

While the Insolvency Service recognizes that any new measures which are introduced will require safeguards, these safeguards are aimed at ensuring that rescue finance is only permitted if certain requirements are met. However, there are no parameters on what the rescue finance terms can be and it will depend to a great extent on what the English court allows and what the lender is able to negotiate with the company. One of the lessons that can be taken away from the US experience is that the DIP finance industry has developed to extract as much value as it can from DIP lending because it’s a lucrative business. Therefore, by imposing such a mechanism into the English legal system, the Insolvency Service must be careful not to unintentionally replace the current system of distressed lending with a more competitive and less debtor friendly one which eventually increases the burden on a company in the long run.

**Timing for rescue finance**

On average, it takes anywhere between 1 week to 2 months to implement the first phase of a DIP financing in the US. The proposal will require either approval by the existing creditors or it will be a court driven process and such a process will involve time and money. The company/ the administrator will need to invest in preparing an application for the court or a voting request for the creditors and this will require the valuation and viability analysis of the business, that the existing
secured creditors are adequately protected and there will be on-going negotiations with a new lender/existing lender.

**Role of the court**

The proposal envisages a much bigger role of the courts (similar to the US system) in evaluating whether additional security can be given to rescue finance providers or negative pledge clauses can be overridden. There will be a much greater burden on the courts to make commercial decisions based on evidence put forward and to in effect, assess the viability of the business. The process will involve court scrutiny of the proposal put forth by the company/administrator to ensure that the existing charge holders are being treated fairly. A court hearing may require expert submissions and will require considerable investment by the company/administrator. The court will essentially have to consider whether providing finance to a company is better off than allowing the company to liquidate and that question, is a very difficult one to answer.

**Other factors to consider**

The proposal needs to consider the impact of introducing such measures on and their interaction with the following:

(a) **Working capital finance:** It is important to give working capital creditors of a company confidence to continue their services e.g.: invoice financing, stock financing.

(b) **Consequences on emerging markets like asset backed lending:** The impact of such measures on emerging markets like asset backed lending need to be considered in detail.

(c) **Existing secondary distressed markets:** The distressed secondary debt market has seen enormous growth in the past few years which means that debtors are likely to deal with a changing set of creditors during this phase. These investors are sophisticated players in the economy which valuable experience and at times, aggressive in enforcing their rights.

(d) **Incentives to the administrators:** The proposal does not set out why such measures will encourage an officeholder like the administrator to readily seek the use of rescue finance, which may accessible only on very onerous terms to the company.

**Specific proposals**

**Overriding the consent of secured creditors**

The proposal includes a mechanism whereby if an existing charge holder “unreasonably” refuses to consent to grant security when it has no negative effect on them, the negative pledge clause can be overridden. While the test seems straightforward on paper, it will be difficult for an administrator/nominee to establish when an existing lender is acting unreasonably. The existing charge holder may not be satisfied with the valuation analysis put forth by the borrower or it may be that the borrower is seeking new funds for projects that are considered risky. It is likely that in practice the rescue finance provisions will breach not just the negative pledge provision but various other restrictions that may be places on the company under the existing loan documentation.

**Negative pledge valuation issues**

If negative pledge clauses are to be overridden either with the consent of the creditors or with a court order, the valuation of assets covered under the negative pledge clauses becomes essential. The overriding or such clauses will have an impact on the *in rem* rights of parties to a contract. This will
also impact the LTV cover and the lending terms. It is also essential that the valuation is acceptable to an existing lender to ensure that there is sufficient coverage.

**Test of “adequate protection” of existing charge holders**

This limb of the test is based on the test for DIP financing in the US Bankruptcy Code. One of the many problems with the test is the evidential burden on the company/ the administrator to show that the interests of the existing charge holders is “adequately protected”. There is no set criteria to what would be adequate protection and this depends on the facts. It is the court that will face a difficult question of assessing whether the company has a chance of restructuring or surviving in the long term and balancing this against the interests of the current creditors. The experience in the US has been that the Bankruptcy Court is often unable to satisfy itself that the threshold of adequate protection has been met.

**Criteria for first and second charges**

In addition to the valuation criterion, it is not clear what criteria are required to be satisfied for certain funds to receive the benefit of first charges and certain funds to receive the benefit of second charges on assets.

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

Valuation of charged property is a matter of evidence and the evidential burden will fall on the company/ administrator making the proposal. It is difficult to legislate methods of valuation because this will depend on the underlying business, the nature of the consent process (court driven or not) and whether the valuation is being contested by another creditor. Our suggestion is to not prescribe the methods of valuation that may be adopted but instead for the legislation to set out certain criteria that may be considered while assessing whether the interests of existing charge holders are adequately protected. For example, the criteria could include factors like sufficient equity cushion on a charged asset to show that there is sufficient value for an additional charge holder. However, this should only be a recommended list of helpful aids rather than a prescriptive list.

(f) **Which categories of payments should qualify for super-priority as ‘rescue finance’?**

It is difficult to categorise payments that should qualify for super priority status in absence of a more detailed framework. For various reasons set out in our response to question 15 above, it is important that the question of introducing such rescue finance measures is considered in principle and as a matter of policy but with pragmatic consideration given to how this will develop in practice. The US Bankruptcy Code sets out in great detail the relative priority of payments which are given different rankings depending on whether they meet the relevant criteria. For the purposes of this consultation, we do not consider that going into so much detail would be helpful.
A Review of the Corporate Insolvency Framework
response form


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

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: Heather Buchanan, Director of Policy and Strategy

Organisation (if applicable): APPG on Fair Business Banking

Address: c/o Calum Kerr MP, House of Commons

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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?

Yes, we are very supportive of this and consider it an excellent proposal.

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?

Yes, within the current options available.

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

Yes

3) 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?

Yes. It is critical that directors and guarantors have a clear voice in the moratorium and insolvency

4) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

Yes

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

In principle, yes, but we will need to look at the details of this further.

6) Do you agree with the proposals for how to treat the costs of the moratorium?
In principle, yes, but we will need to look at the details of this further.

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

In principle, yes, but we will need to look at the details of this further.

**Helping Businesses Keep Trading through the Restructuring Process**

8) 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?

Yes, the principles here are sound and continuation would create the stability required for businesses to trade through difficult restructuring negotiations.

9) 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?

Yes

**Developing a Flexible Restructuring Plan**

10) 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?

We would support a standalone procedure

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

Yes, particularly with regard to secured creditors
12) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

Yes.

13) 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?

Yes.

**Rescue Finance**

14) 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?

Yes, an excellent proposal. Any negotiations for rescue finance must include the company directors. We are concerned that the Insolvency Practitioner appears to be in control of the rescue package during the moratorium. Whilst we agree that there needs to be an IP overseeing the process and, if requested, assisting the directors, the moratorium should allow the directors to maintain control and seek viable alternatives.

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

A valuation in which the valuer is accountable to both the creditors and the directors is essential.

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

Any credit that is provided during this 'high risk' time should qualify for super priority.
Impact on SMEs

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

On the whole, the recommendations put forward are welcomed, and will certainly aid business rescue. Given the turmoil experienced by SMEs over the past ten years, there is an urgent need for measures such as those currently being proposed. However, there are other areas that also require attention in order to strengthen the prospects of success, and we will follow up with further detail. In brief, these are:

1) Give guarantors the same status as creditors so that they have a place at the table in the event of administration
2) Create a mechanism in law that allows any interested party, including directors and guarantors, to challenge the basis of an appointment of an IP.
3) Acknowledge the principle that there can be creditor misconduct and create a tool in law that allows an IP to deal with this situation. This has been a particular problem in cases where there has been the mis-sale of a product that has resulted in insolvency, yet the creditor, having been the cause of the failure of the business, still reaps the benefits and protection of insolvency law.
4) Create clear guidance on the assignation of claims. Should an IP not wish to pursue an action there should be an automatic trigger that allows directors/guarantors and shareholders to take on the action at their own risk
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  x

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?

x No
A Review of the Corporate Insolvency Framework
response form


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

Tel: 0207 291 6879
Email: Policy.Unit@insolvency.gsi.gov.uk

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I want my response to be treated as confidential ☐

Comments: The British Bankers’ Association (BBA) welcomes the opportunity to engage with the UK Insolvency Service on their “Review of the Corporate Insolvency Framework – a consultation on options for reform”. The BBA supports the approach taken by the Insolvency Service in consulting with relevant stakeholders on proposals to reform the Corporate Insolvency Framework, and looks forward to engaging further on this matter in future.
The BBA is the leading association for the United Kingdom banking and financial services sector, representing over 200 banks, which are headquartered in 50 countries and have operations in 180 countries worldwide. Our members manage more than £10 trillion in banking assets, employ nearly half a million individuals, contribute some £100 billion to the economy each year and lend some £200 billion to businesses.

The banking industry plays a vital role in providing financing to the real economy and is keen to continue playing their part. As such, our members would like to work with the Insolvency Service to ensure that the UK develops the best possible insolvency framework, to enable viable businesses to remain operational and to ensure that lending to small and medium-sized enterprises is not impacted by unintended consequences of a reformed insolvency framework. As such, we comment on the consultation from the perspective of wanting to facilitate a better outcome for both the consumer and industry.

The BBA raises several concerns with the proposals put forward by the Insolvency Service in this consultation. We are concerned that many of the changes proposed, such as the introduction of a moratorium and the role of the supervisor would lead sub-optimal outcomes for borrowers and potentially harm lender appetite.

Introduction of the moratorium

The BBA is opposed to the introduction of the form of moratorium as proposed in the Insolvency Service’s consultation. We believe that this would unintentionally harm the flexibility that exists within the current UK restructuring and insolvency framework. The current regime allows for informal bilateral negotiations between counterparties, which take place privately, away from the media and unsecured creditor involvement; the involvement of which can often be fatal to the going concern status and overall value. A moratorium process as outlined in the consultation risks ending this arrangement. This would not be a good outcome for business, as lenders would feel less able to lend with confidence, and would likely reduce the amount of funding available.

We do not believe that suitable justification has been provided for why a moratorium would improve the restructuring and insolvency regime in the UK. As we have outlined in our response below, it would likely lead to an increase in costs, a reduction in flexibility and an increase in unnecessary publicity, all to the disadvantage of both lenders and borrowers. If a moratorium is judged to be absolutely necessary, then we refer the Insolvency Service to the World Bank Principles for suggestions on how the terms proposed may see less of a negative impact on businesses as we have outlined in the previous paragraph.

We do not agree with the proposal for directors’ potential liability for wrongful trading to be suspended during any moratorium. Wrongful trading provisions are an essential protection for creditors to deter directors from worsening creditors’ positions by continuing to trade as an insolvent company and we can see no reason for them being suspended during a moratorium.
Potential effects on lending

We are concerned that many of the proposals within the Insolvency Service's consultation may have the unintended consequence of causing adverse effects on lender appetite. The consultation proposals underestimate the likely cost of the processes both individually, and to the economy more generally, whilst also underestimating the risks to creditors in individual cases, as well as the risks of credit tightening and an increased cost of lending.

It is also likely that unnecessary publicity or a lack of confidentiality will lead to loss of customer confidence, and reduced spending will therefore lead to a rapid decrease in revenue. In addition, the proposal that super priority financiers would be able to come in ahead of existing secured lenders would upset the accounting treatment of secured loans for lenders, since there would be no certainty that they could treat the debts as fully or partially secured if another party could disrupt priority. This would only emphasise the risk of credit tightening and lead to an increased cost of lending.

These potential effects on front-line lending in particular are concerning. This would produce the opposite of the Insolvency Service’s intention to “create a business environment that supports growth and employment by ensuring that distressed, yet viable, businesses can be rescued quickly and efficiently”. We do not believe that a one-size fits all approach all is suitable. If any form of moratorium were to be introduced, secured lenders should have prior notice of the moratorium at which time they can either exercise their rights or choose their own moratorium supervisor.

Rescue finance

There is already a market for rescue financing, which works effectively for viable businesses. Funding is typically provided by either existing lenders or, in circumstances where the existing lender is not in a position to provide the required funding, by alternative funders alongside appropriate priority arrangements with the existing lenders. We have not seen any evidence that viable but distressed businesses are failing as a result of an inability to obtain finance.

In any event, we do not support the Insolvency Service’s proposals for rescue finance as currently drafted. The proposals will likely impact on lender appetite if they feel their position is likely to become materially worsened by the provision for rescue finance to take priority against their wishes. This will result in a negative impact on potentially viable businesses, which will see the amount of lending available decline and the cost of lending increase, causing the opposite of Insolvency Service’s intentions.

Role of the supervisor

The BBA does not agree with the proposals for the role of the supervisor as outlined in the consultation, particularly the role envisioned in 7.41 that the supervisor be “a member of the following regulated professions; Insolvency
Practitioner, solicitor or accountant” – we would suggest that at the very least only the former would have the relevant expertise necessary to fulfil such a role.

We are concerned that the role of a moratorium supervisor, as currently proposed, is not sufficiently robust to prevent the misuse of the moratorium process or appropriately protect the interests of creditors and other stakeholders. The appropriate level of controls would give any supervisor additional powers and responsibilities (and associated liabilities) to protect creditors and other stakeholders, and that may result in the supervisor role being similar to that of an administrator or potentially give any supervisor concerns about shadow directorship. Any resultant decrease in lending due to a lack of confidence would harm businesses now unable to access previously available finance.

Processes for SMEs

We believe that the existing process for lending to SMEs is sufficient. The experience of our members is that groups of lenders, including banks, will support viable propositions that are put to them within the construct of the existing restructuring and insolvency market, and therefore the BBA does not accept that a case has been made for significant changes to this system. There does not appear to be any evidence that the suggested solutions for SMEs would allow any businesses to be rescued that are not already rescued via informal arrangements between counterparties or by CVAs, schemes of arrangement or formal insolvency processes. The BBA considers that the Insolvency Service’s proposals may provide solutions not achievable under the existing processes, but only in a very small number of cases, and that the risks associated with the process, such as unprofitable trading continuing during the moratorium process and more deliberate abuse, outweighs any benefits.
Questions

Name: Sam Mannion

Organisation (if applicable): British Bankers’ Association

Address: Pinners Hall, 105-108 Old Broad Street, London, EC2N 1EX

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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?

The BBA does not agree with the proposal to introduce a preliminary moratorium lasting up to three months. A stand-alone moratorium would reduce the flexibility that currently exists within the UK’s corporate insolvency framework with informal bilateral negotiations. We do not feel that the argument has been sufficiently made within the consultation paper as to what the benefits that would flow from such a change are, and therefore why the status quo should be changed. Both the consultation paper and the accompanying Impact Assessment do not address these genuine risks and the potential costs of the moratorium.

The experience of market users under a Company Voluntary Arrangement (CVA) indicates that small companies in particular rarely take up the offer of a moratorium. The anecdotal evidence suggests the reasons for this are the onerous obligations placed upon the insolvency practitioner acting as supervisor. It appears that in order to properly safeguard creditors, the obligation upon the supervisor of the moratorium will be even more extensive, which the Insolvency Service may wish to review and consider.

Furthermore, the minimum costs associated with the moratorium, as identified by the Insolvency Service’s Impact Assessment, of £240,000 mean that the moratorium would only be available to companies of significant size. The costs of £240,000 are predicated upon a “lighter touch” supervision which the BBA considers inadequate to protect creditors’ interest. Our experience is that the small company moratorium in a CVA takes longer than the moratorium route available in an administration and is more costly. Administration however already provides the tools to implement a moratorium and is well-used.

A stand-alone moratorium would encourage publicity, at a possible detriment, rather than the current informal bilateral and flexible negotiations that are good examples of best practice. In particular, we are concerned at the proposals within 7.7, which indicate directors will have the risk of liability for wrongful trading removed if the conditions of the moratorium are met. As there is no proposal for liability to be placed upon supervisors, even if creditors could look to directors for any loss they may suffer, it is highly unlikely that these directors would have the means to meet any liability, and insurance is unlikely to be available.

Whilst we support the intentions of the Insolvency Service to “reduce the costs and risks of restructuring”, an unintended consequence of such a moratorium may be an increase in costs; the Chapter 11 system in the US can often result in very high costs to market users. The repeated references to the court in the consultation highlight this concern. We have concerns about incorporating some elements of the Chapter 11 system piecemeal.
In the event that a stand-alone moratorium is introduced by the Insolvency Service, the BBA recommends that the Insolvency Service consider the following:

- The time period afforded in such a moratorium (please see our answer below).
- The current proposals are open to abuse by debtors and therefore greater control by the supervisor would be preferable.
- That the current administration process of a notice of intention to appoint, with a prescribed time period for holders of a qualifying floating charge to intervene represents best practice.
- The test of financial difficulty, which the BBA do not consider well particularised and should incorporate an objective test.
- That, although court involvement is an essential protection for creditors and other stakeholders, over-reliance on the courts may be counter-productive in terms of access, costs and time delay.

We do agree that it would be unusual not to consult secured creditors prior to applying for a moratorium and would refer to our comments above on Notices of Intention to appoint administrators in that regard. We have additional concerns as to any protections for directors from wrongful trading whilst insolvent during the moratorium and do not consider that this has been well particularised.

The “World Bank Principles of Effective Insolvency and Creditor/Debtor Rights Systems” which is quoted in the Impact Assessment expressly states that systems should “afford timely and proper notice to interested parties in proceedings concerning matters that affect their rights” and that secured creditors should have a specific right to apply for relief from any stay. Both of these protections are missing from the current moratorium proposals.

Rather than acting as an incentive for companies to seek early intervention for difficulties, this would be more likely to lead to the unintended consequence of firms not acting early and using a moratorium period to delay insolvency. We refer the Insolvency Service to the European Commission’s report on “A second chance for entrepreneurs”, as referred to in the Impact Assessment.

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

We do not believe that the process of simply filing to court represents the most efficient means for gaining relief for a business or for creditors to dissolve a moratorium. We are concerned about the debtors’ ability to simply file, seemingly without restriction or prior notification or consent from creditors. We refer the Insolvency Service to our response to question 1 as to the process in administration of filing a notice of intention to appoint administrators, as an example of best practice.

We would also invite the Insolvency Service to review the subjectivity of the intended proposal and suggest that an objective, particularised test of financial difficulty is explored. It is important that the ending of the moratorium be dovetailed with the next phase of the company’s existence, with no potential gaps or hiatus
and that the most efficient way to achieve this and to protect creditors would be a court hearing.

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

The language in 7.2.7 pre-supposes that there have already been discussions between a company and creditors regarding a moratorium ahead of an application to court. This is not a process that is typically followed, and raises the possibility of unintended consequences such as a company reaching an agreement with one creditor ahead of an application to court without consulting other creditors. This process could also potentially lead to creditors taking precipitative action in order to avoid the moratorium.

In addition, it is difficult to conclude from the list of qualifying conditions who exactly decides whether or not these are met. There are potential and obvious conflicts of interest if either creditors or debtors were responsible for establishing whether the qualifying conditions were appropriately met. Although it is not specified in the wording, the BBA assumes that company directors would have this responsibility.

While we support the intention of the Insolvency Service not to leave any creditors in a worse-off position from these changes, we are concerned at the possibility that a moratorium supervisor could be appointed by company directors, placing restrictions on creditors with no additional responsibility on the company directors who will have made insolvency proceedings necessary, which we consider could be open to abuse. We would suggest it unlikely that an Insolvency Practitioner would be willing to sanction transactions, with concerns as to shadow directorships and would invite the Insolvency Service to consider this further.

This proposal therefore absolves directors from the risks of continuing to trade, while creditors continue to bear the risk of losing money. If an administrator runs an insolvent administration, he does (in circumstances where his conduct has fallen below certain levels) at least have the backing of an insurance policy. It is not clear to us what wrongful trading provisions will apply for directors trading while insolvent within the moratorium.

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We refer the Insolvency Service to our answer to question 3. We note that the Insolvency Service’s own Impact Assessment does not make reference to the potentially large amount of turnover (and therefore loss) that can pass through a business, even an SME, in a 90 day period; the Impact Assessment does not include any potential valuations. We have additional concerns as to any rights afforded to creditors to request information at any stage and consider that this may be open to abuse in terms of seeking to obtain a commercial advantage, or publicise an otherwise private arrangement, at a potential detriment.
We are particularly concerned with 7.29 and 7.30 under “essential goods and services”. If a company director argues that a supplier is deemed internally to be “essential” then a court will be in no position to disagree. The BBA considers that the balance has been struck the wrong way in this regard. The only way this position could be overturned would be for a supplier to expend time and resources applying to the court to argue that they do not provide an “essential” service. It is not clear to us how a supplier would realistically be able to go about that argument, and we do not see that these proposed rights and responsibilities would be able to function in practice. The cost of any such arguments to both the company and creditors could be substantial, and the costs estimates in the Impact Assessment are far too low at £4,000 per challenge. We would consider that a minimum cost of £20,000 is more likely.

While we support the Insolvency Service’s intentions to safeguard creditors, deter abuse and increase the chance of business rescue, the proposals put forward could unintentionally lead to a reduction in the number of creditors willing to lend as identified in the Impact Assessment, by reference to the World Bank Principles, which makes specific reference to uncertainty about enforcement of contractual rights leading to credit tightening. It is not clear to us what exact role the Insolvency Service is expecting banks to perform here. We additionally note that the restriction to 28 days included under 7.2.5 does not take into account the fact that many possibilities could occur in the subsequent two months that would change the situation.

In paragraphs 2.8 and 9.2, there is a clear implication that the failure of large numbers of CVAs is because secured creditors cannot be bound against their wishes and/or do not agree to be bound by CVA proposals. Our members’ experience is that there is no connection in the vast majority of CVAs between failure and the inability to bind secured creditors. No evidence has been produced linking the two, either in the proposals or the Impact Assessment. Binding secured creditors into CVA proposals against their wishes would increase the cost of borrowing and tighten available credit, as set out in the World Bank Principles referred to in the Impact Assessment.

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

The BBA refers the Insolvency Service to our response to question 1. We do not support the form of moratorium and hence do not agree with the proposals regarding the duration, extension and cessation of the moratorium.

It is not clear how the cessation would work in practice. The consultation paper indicates that individuals would be prevented from taking enforcement action, including directors. In this instance, if a firm is in the moratorium period and can see that it is not saving the company and restructuring will not be an option, it is not obvious who would have the authority to call on the cessation.
It would appear from our reading of the consultation that the only person with this authority, assuming the decision was not delegated to a court, would be the supervisor. We refer the Insolvency Service to our response to question 6 as to our concerns that any supervisor is an appropriately licensed Insolvency Practitioner.

We consider that any extension ought to only be sanctioned with the appropriate level of unconnected creditor consent, such as in our existing CVA arrangements. We have concerns as to connected parties abusing an extension process and further do not support any concept of secured creditors’ rights being crammed down. We would invite the Insolvency Service to consider the position as to connected and unconnected parties when it comes to particularising consent requirements.

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

The BBA does not agree with the proposals and feels there has not been enough detail put forward in the consultation on the powers of and qualification requirements for a supervisor. In particular we do not support the idea put forward in 7.41 that the supervisor be “a member of the following regulated professions; Insolvency Practitioner, solicitor or accountant”. A supervisor would need to be an Insolvency Practitioner as only they, by their qualifications, are able to demonstrate clearly that they have the relevant expertise to perform this role.

It appears that it is not intended that the supervisor will have any specific liability in relation to their role, which materially reduces creditor protection. The World Bank Principles referred to in our response to question 4 clearly state that insolvency procedures should “provide for...professional expert to investigate, evaluate or develop information that is essential to key decision makers”.

We are, however, concerned at the potential for the supervisor role as described to in effect amount to a “shadow directorship”. Attendance at board meetings, with the appropriate powers, responsibilities and liabilities that would come with the role of supervisor in order to give creditors adequate protection and comfort that the moratorium is not being abused, would mean that the supervisor would in effect become a shadow director. It is not immediately apparent what the purpose of such a shadow director supervisor would be compared to the existing system of administration.

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

We are concerned at the description of “first charge” and the ranking of costs outlined in the consultation. This raises the potential for secured creditors to effectively gain no advantage from their position ahead of unsecured creditors, which in turn reduces the benefits of being secured, thus having an impact on credit pricing and the availability of credit. In order to ensure that creditors are no worse off, the company would need to trade profitably during the moratorium period.
including paying all costs, without using up assets which are either subject to floating charges or “free assets”.

In any case using these assets to fund the moratorium means that in the event that the moratorium fails, these assets will no longer be available to pay dividends to creditors, and thus creditors will be worse off as a result. The creditors most likely to suffer are secured creditors, which will affect the willingness to lend and the cost of credit, as per the Insolvency Service’s Impact Assessment and the World Bank Principles.

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

The BBA believes there is potential benefit in allowing creditors to request information, provided that information provisions are subject to strong safeguards to ensure that market sensitive information is not unduly shared. There is also the potential for an increase in cost if creditors were permitted to request unlimited information, and this would need to be taken into account by the Insolvency Service when considering exemptions.

We recommend that the Insolvency Service examine the INSOL Principles for best practice on how creditors can currently access information, and that this be used as the basis for any requests for information considered by the Insolvency Service.

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?

It is difficult to say what the effects of an essential contract would be as described in the consultation paper. For example, it is hard to say how a company could be compelled to continue delivering goods if their supplies were regarded as being “essential”, and therefore the effect of this criterion on the number of business rescues could be negligible.

It is not clear from the consultation what the Insolvency Service’s intention is for working capital facilities, debtor financing and merchant acquiring facilities, in particular whether there are plans for these to be deemed as “essential” and therefore for people to be bound by the moratorium. We would be extremely concerned at the possibility that lenders may be bound in this way, and would advise the Insolvency Service to clarify that this is not the case.

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?
We refer the Insolvency Service to our response to question 4. We are not convinced that the court is best placed to deem whether or not a supplier is “essential” to a distressed business. It is possible that in such a scenario, company directors would argue that all supplies are essential to the running of their business, and as we stated in our response to question 4 the court may be in no place to disagree. Further, the cost to a supplier of continuing to provide essential supplies may exceed the invoice value recoverable in the moratorium.

**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?

The BBA sees no reason why the existing provisions should be replaced, nor do we see any justification for introducing a third provision which has similar characteristics to existing procedures. We have concerns that the proposed restructuring plan has not been appropriately developed and would recommend the Insolvency Service consider the following:

- A greater focus on shareholders; the position of shareholders with regards to votes, the rights that they have, what they can benchmark their outcome to, and what their outcome from any restructuring should be, as well as mechanisms for potential cram downs.
- Existing case law which confirms that secured creditors cannot be forced to provide rescue finance, which the BBA agree with; we suggest that allowing priority finance to rank ahead of secured creditors’ fixed and floating charge interests would run counter to existing and well-established practice.
- The duration of a restructuring plan; we consider that 12 months may be challenging in more complex cases.
- Appropriate valuation methodology to protect the provision of existing creditors and avoid any unfair cram down.

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

The BBA does not support the imposition of a “cross-class cram down”, or the confirmation of the restructuring plan supported by some classes of creditors in spite of the objections of some other classes of creditors, in all cases. We are concerned at the possibility that a secured class of creditors could be overruled by classes of unsecured creditors, who may not have access to funds but will be allowed to go ahead with a restructuring plan regardless. This is contrary to the World Bank Principles which state that systems should “recognise existing creditor rights and respect the priority of claims…”

13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
Whilst we regard the role of the court in this proposal as being similar to a court’s role in a scheme of arrangement, and have no problem with this, we do not consider the remaining proposed safeguards to be sufficient protection for creditors.

We are concerned at the wording of 9.3.2, that “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”. The BBA does not regard this as a viable condition; it will be impossible to guarantee that all creditors will be no worse off than in liquidation. This therefore cannot be considered as a sufficient safeguard.

Further “liquidation” is not necessarily the right comparator. If the best alternative process to liquidation were to be administration, then this should be the benchmark against which the plan should be measured. Otherwise senior creditors may be disadvantaged and suffer loss for the benefit of a more junior class of creditors who wish to take a chance on a restructuring plan succeeding. This again would be contrary to the World Bank Principles referred to above.

If a company is going to trade during a moratorium period, there remain questions about where they can reasonably expect to obtain the cash necessary to trade from in a way that ensures no creditor is worse off than they would be under liquidation or other process. If a company uses floating charge or “free” assets through the moratorium period and to meet the cost of trading and to pay fees, they would have to be trading during that period in a sufficiently profitable way in order to meet all ongoing costs as well as the additional ongoing costs of the moratorium rather than realising assets.

We recommend that the Insolvency Service make clear whether a company will be required to be cash flow positive or trading profitably. If companies are required to be cash flow positive, suitable steps should be taken to safeguard against the possibility that a company may simple sell all floating charge assets in order to qualify as cash flow positive; if such a company were then to fail regardless, floating charge and unsecured creditors would be put in a worse position. The Insolvency Service’s focus should be on ensuring that a company remains profitable so creditors are not in a worse position than they would otherwise be.

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?

The BBA does not agree that there should be a minimum liquidation valuation basis included in the test for determining the fairness of the described plan; we refer the Insolvency Service to our response to question 13. We do not consider the first fair and equitable condition listed in the consultation as viable, and therefore it is insufficient. We also do not support a cram down being available for all dissenting classes, as detailed in our response to question 12.

**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?

The BBA does not think that rescue finance providers should be granted security in priority to existing charge holders, including those with negative pledge clauses, and we do not believe that – were this to be implemented – it would encourage a greater amount of business rescue. We understand the second question’s intention to mean that a business could be rescued that otherwise would not be under the status quo.

We believe that there is already a vibrant market and suitable amount of rescue finance available to businesses; if a business is unable to access rescue finance in the market at present, it is more likely that they are an unviable business. We regard the existing structure of rescue finance as sufficient; there has been no evidence put forward that granting security and priority is necessary to encourage greater business rescue.

Negative pledges provide a vital protection for secured creditors and borrowers. Without them second ranking security can be granted without suitable “inter-creditor” arrangements (which are required because of the negative pledge), altering the enforcement arrangements between creditors. Inter-creditor agreements mean that RCF and overdraft lenders do not thereby need to close accounts or “rule them off”, to protect themselves under the rule in Clayton’s case.

We are opposed to the appeals process of secured creditors, which is by recourse to the courts and consider that the balance has been struck in the wrong way, and carries time and cost implications. If approved, terms and conditions of lending would fundamentally change. Future lending would be materially impacted, which will be especially pertinent where lenders have traditionally relied on debentures and negative pledge clauses. Covenants would be altered, lending would reduce and we invite the Insolvency Service to consider this carefully.

The experience of our members is that in the vast majority of occasions, where lenders are presented with a viable position, they will look to support that with funding. We would strongly object to the imposition of any priming post-finance loan when existing lenders have not consented.

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

We refer the Insolvency Service to our response to question 14; we do not accept that rescue finance providers should be granted security in priority to existing charge holders. If a property must be valued to ensure protection for existing charge holders, this should be done on the basis of a liquidation analysis; if security is to be granted to any stakeholder it should be done on the basis of a worst-case view of realisations so that existing secured creditors are protected as well as possible and not exposed to a risk that they did not contract for. Otherwise this will
affect the cost and availability of credit, as per the Impact Assessment and the World Bank Principles.

While valuation will always be subjective in nature, there is already a procedure in place to deal with valuation in schemes of arrangement and we believe that there is no reason to diverge from this when considering a liquidation test.

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

The BBA assumes that this relates to super-priority over other costs and expenses of the moratorium and does not refer to secured creditors. If it does refer to secured creditors, then we refer the Insolvency Service to our response to question 16.

**Impact on SMEs**

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

There does not appear to be any evidence that the moratorium would allow any companies to be rescued that are not already rescued informally or by CVAs, schemes or the process of administration. The BBA considers that the moratorium might replace some of these processes, but only in a very small number of cases, and that the risks of the moratorium through unprofitable trading during the moratorium process and more deliberate abuse substantially outweighs any potential benefits, with no actual benefits having been identified by the Insolvency Service’s Impact Assessment.
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.

N/A

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
A Review of the Corporate Insolvency Framework

response form


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

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:
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The Introduction of a Moratorium

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

I agree that the proposal for a preliminary moratorium to allow businesses in distress a breathing space to assess the options available for rescue their business will be most beneficial particularly for the micro and small businesses, although I am disappointed to see that Sole Traders and Unincorporated businesses structure appear not have been factored in the proposals. However, I would take this opportunity to highlight that business distress and difficulty can occur inadvertently and/or by lack of knowledge (particularly among small businesses owners) and in some circumstances debt and financial restructuring is not the only issue the business in distress have to address but also operational restructuring and this should be borne in mind during the preliminary moratorium. Further, the use of the term of a “supervisor/nominee” to oversee a moratorium may cause concern and trigger red flags to creditors (both financial and trade creditors) because of its association to formal insolvency process such nominees in CVAs or supervisors in IVAs. I believe that a “mediator/moderator”, who is not an insolvency practitioner, that can assess and steer the moratorium will be a more creditor friendly term to use. I also believe that not only large businesses will benefit from costs saving in a preliminary moratorium but also small businesses (including sole traders and unincorporated businesses) will also have significant savings and better results from the moratorium to allow the business owners/directors address their business problems and even achieve an informal arrangement and/or full consensual repayment plan with their creditors. Furthermore and in my view the proposals for the moratorium should make allowances to also include (as described under paragraph 7.10) an additional bullet point for the prevention of the enforcement of contractual rights (for example intrusive rights such creditor appointment of “specialists” in Business Reviews which are not independent, is a expense that is charged to the distress business and can be very disruptive as well as foreclosure and/or reductions of credit facilities including overdrafts, factoring, CID and other working capital/operating cash flow financing facilities). Insolvency is a litigious and sometimes contentious process, needless to say expensive, therefore should not be viewed as a turnaround process. I believe the preliminary moratorium would be more effective and would serve its restructuring and turnaround purpose if is separate and independent from the Insolvency Framework with a pause or truce of a minimum of 3 months, accessible to all business in distress and with no interruption from further or potential court actions (and subsequent costs) from creditors to dissolve the preliminary moratorium. In my opinion if
an affected creditor(s) were able to gain court approval to dissolve the moratorium after 28 days of commencement where their collateral or interests are not sufficiently protected or their criteria no longer met, the disgruntled and dissenting creditor(s) will find ways to use their bargaining powers even during the moratorium leaving the preliminary process in unequal footing.

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?

I believe it does not. The restructuring and turnaround process in its holistic form, i.e. finding and understanding the cause of the problem (whether financial and/or operational) and the best suited solution, is a process that very much depends in cooperating and maintaining close working relationship with financial and trade creditors, stakeholders and to extent deployment of commercial common sense. I believe if the distress business wishes to have truce so to have a chance to look for help (or alternative help) it should be an out of court application to moratorium, perhaps in the form of a simple letter from the chosen “mediator” to the creditors, will be, in my view, the most efficient way, transparent and personal approach to engage with creditors and stakeholder as early as possible so to gain the interim relief of at least 3 months for the business to address their problems holistically without the need to register the moratorium in companies house which may cause the credit rating and reputation of the business to be severally affected. Further the proposal as outlined does not make this is accessible to sole traders and unincorporated businesses and allowances for this should be made, therefore and for this type of businesses structures the out of court application via the chosen “mediator” letter will be the most helpful tool for this group of business structures. If the moratorium needs extending after the 3 month period, say because of the complexity of the distress business, then a court application before the registrar would be appropriate to give affected creditors the opportunity to gain court approval to dissolve the moratorium if they feel their collateral or interests are not sufficiently protected or their criteria no longer met or initiate formal insolvency proceedings.

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

I believe it does not provide the right balance. Some Creditors and suppliers that may feel their interest are not protected, particularly in cases of arrears or poor payment history (behaviour generally seen among larger creditors
with bargaining powers and/or secure creditors) are usually the one exerting the pressure in order to seek priority payment or reduce their risk exposure altogether by restricting or foreclosing their facilities. One of the biggest problems facing small businesses (including sole traders and unincorporated businesses) lack of cash reserves and/or access to immediate working capital/operating cash flow particularly in cases where the distress business is also having to chase its own debtors and their bank, for instance, has frozen or reduced their overdraft facility or enforce certain clauses of their terms and conditions. Business owners/Directors can lose control very quickly over a situation particularly when communication and actions are unilateral. In such circumstances the vast majority of micro/small/sole trader and unincorporated businesses will not qualify for the moratorium under the primary condition as proposed, again this will leave the restructuring process and as proposed inaccessible and in an unequal footing particularly if the small business owners and directors believe their business can be and is worth rescuing.

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?

I believe it parts balance. However I take this opportunity to bring to the consultation attention the following; Firstly under the Creditors and Suppliers Rights: Potential court application by a creditor to challenge a moratorium within the first 28 days of the moratorium is (a) the proposal is strikingly similar to Schedule A1 and therefore it might be duplicating the process that already exists under the current Insolvency Framework (i.e. as is the case of CVAs) and (b) is too short of a period for a restructuring plan to be properly formulated or considered particularly when (even at the unincorporated, micro and small business spectrum) business owners and directors are not aware, knowledgeable enough or educated on the options and tools available to them to understand and address appropriately their business problems. As explained before the current Insolvency Framework is already a very litigious, contentious and expensive process and further costs may be incurred in responding to a creditor’s courts applications within the first 28 days of the commencement of the moratorium to challenge the preliminary moratorium particularly in cases where secure creditors particularly in cases where secure creditors or suppliers with bargaining powers are not willing to enter into dialogue because they are protecting their interest or lost confidence on the business owners or directors and subsequently this will defeat the spirit of the restructuring process. In short creditors have to also be commercially reasonable not just seek ways to protect their position by instigating or pushing for Insolvency as chances are that a properly formulated, simplify and transparent restructuring
program will increase chances of a full repayment and commercial continuity than it would otherwise be achieved in a formal insolvency process where the value is lost or significantly eroded and, as I have observed, there is a growing trend in demand and attractiveness for purchasing break up parts of businesses under insolvency process rather than purchasing businesses as going concerns (with potential skeletons hidden in the closet). Secondly under the Directors powers and responsibilities: In recent years particularly after the financial crash and global economic recession, needless to say the rapid or unexpected changes of external and internal circumstances a business face regularly, it is becoming harder and less attractive to be a Director of a company (and indeed a business owner/sole trader) because of the increase personal exposure and particularly when control is lost very quickly when inadvertently things go wrong, because of this I am not keen to see more and new sanctions against Directors and Business Owners but the proposal 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, is a welcome move although I note there are no provisions, again, incentivising Sole Traders and unincorporated businesses and this should also be included in the proposals. The challenge with this point, however, is how many distress businesses will meet the eligibility and qualifying conditions in the first place to benefit from the preliminary moratorium and indeed have access to a rescue framework under the current proposals. Realistically only few will meet those conditions, particularly in terms of reserved cash and stable operating cash flow, again making it inaccessible to all businesses and defeating the spirit of the restructuring and turnaround process.

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

No I do not agree. Further to my response in 2 and comment on 4 above I believe the preliminary moratorium should be a truce or full pause in good faith and accessible to all businesses (including sole traders and unincorporated businesses) and totally Independent from the Insolvency Framework. It should also be a straight forward, simplified, out of court process and perhaps complementary to a pre-action protocol with the chosen mediator assessing and steering the process whilst establishing and encouraging a fully open and cooperative dialogue and guiding the directors/business owners to the right and appropriate commercial and business focused help whilst reminding them of their duties towards their business creditors and stakeholders. Further the restructuring framework proposal as described mirrors and duplicates what is already in existence.
under the Insolvency Framework which as mentioned in 1 above is not a turnaround and restructuring process per se and in my view defeats the spirit of a restructuring process.

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

No I do not agree. An Insolvency Practitioner in short deals with the insolvency and assets of the business for an “equitable” distribution, an accountant deals with financial records of a business and a solicitor deals with the law and protection of certain interests. None of these professions, whilst they are very wordy professions on their own right, do not provide the combined and holistic business and commercial experience (financial, legislative, operational and leadership) needed to assess and steer a turnaround and restructuring process. I strongly believe that the Mediator, as explained before under a standalone Restructuring Framework and independent from Insolvency, should not be an Insolvency Practitioner but should be a Turnaround Focused Specialist natural person preferably member of a qualifying professional self-regulated trade association (such the TMA, EACTP and/or IFT) or a seasoned with solid track record industry specific experience and/or turnaround Independent Director/CEO and capable of following and abiding to the Restructuring Framework. While a Supervisor as described in the proposal (and currently in existent and therefore duplicates what is in the present Insolvency Framework) will need to be an Insolvency Practitioner given the potential transition between a CVA to Administration or Liquidation. In respect of the proposal under paragraph 7.45 whilst the idea of having qualifying independent “officeholders” pre and post moratorium is welcome because it will keep the process independent, firstly the person overseeing a moratorium should not be an “officeholder”, I strongly believe that a Debtor in Possession should be a Debtor in Possession and in control and therefore the person overseeing the moratorium should remain neutral but capable of assessing, steering and guiding the process. If a restructuring plan which is formulated and is accepted outside an insolvency process, a separate and independent Turnaround Interim Director should be considered to be appointed to work with the business/company executing and monitoring the restructuring plan and this person should be adequately indemnify by the business/company under appropriate insurances. If a restructuring plan is only possible or accepted under an Insolvency Framework, for example, Administrative Pre-Packs or CVAs then the person appointed as “Officeholder” should be an Insolvency Practitioner. Secondly, the period proposed between “officeholders” is contrary to the proposals under paragraph 7.37 which will give a separate appointed Insolvency Practitioner after moratorium only 9
months in office, which is not enough time without recurring to court to deal with the formal statutory insolvency process such in the event of an Administration or Liquidation order therefore potentially increasing further costs in the insolvency process.

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

Yes I do agree so long that the costs are proportional and in the spirit of the restructuring process and every option have been explore to achieve the best result other than insolvency, is value for money and not another added layer to insolvency costs.

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

Yes I believe there is some benefit as creditors need to be kept informed as soon as its practical but there should also be information release in stages and controlled and with no interruption from potential court applications to end the moratorium, for example and in the case of SMEs businesses perhaps an initial simple letter from the Mediator with the commencement of moratorium explaining the purpose of the moratorium, together with a copy of his/her CV and explaining what his/her role is, his/her initial assessment from the information provided to him/her by the Director/Business owner, what the moratorium its looking to achieve and, further informing the creditors what and with whom financial and operational consultations/help the Directors/business owners are undertaking together with an outlined timescale of the process. In my view it would also be beneficial if the latest Full set of Year End Accounts/ Financial Reports is also included in the same initial letter. At the end of month 1 Directors via Mediator send letter to Creditors outlining current with year(month)-to-date key financial information, business and operational overview and a 2 month pro-forma of management operational (income and expenditure) accounts, list of creditors (disputed and non-disputed) and any existing interim arrangements with trade creditors (including employees) to keep the business trading. At the end of month 2 Director/Business Owner via Mediator send letter with outline restructuring/turnaround and business plan with comparative figures, business valuation and timescale for implementation together with an invitation for feedback from Creditors.
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?

No I do not agree. I believe the proposals as described duplicates what is currently in practice under the insolvency framework and court intervention would only add the burden of further costs (needless to say delays and disruption) and/or create problem elsewhere like for instance suppliers increasing prices or passing cost elsewhere or tightening their terms and conditions. The preliminary moratorium and the restructuring and turnaround process as a standalone framework should be able, and in the spirit of it, look to find a cooperative commercial workout and interim arrangements with creditors and negotiate certain terms of contract without having to recourse to a court intervention once the Restructuring turnaround plan has been formulated. Also during the process the Debtor in Possession will be able to identify early in the process what are the bare necessities for continuation of trading. The mediator can make this clear to all creditors early in the process and that enforcing contractual rights without giving a proper chance for a turnaround plan to be formulated, implemented and monitored will ultimately trigger an insolvency process. With the right approach Interim payment arrangements and continuation of service can be sought and agreed for the provision of essential supplies. I strongly believe that the cooperation of all creditors and deployment of commercial sense (rather than just knee jerk reaction and creditors seeking to protect their position) will result in 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?

See my comments in 9 above

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?

I believe it could work better and should be included in both restructuring as standalone procedure and as an extension of the insolvency procedure. From experience an informal and close door restructuring plan works better
as a standalone process and with the full cooperation from creditors and stakeholders, however if a more formal restructuring process is to work and in the case that there are group pressing/hostile or dissenting creditors (including secured creditors) which are against the restructuring and turnaround plan, in those circumstances the application of the cram-down mechanism will need to be sought from the court but I believe it should be treated as a separate commercial issue rather than an insolvency matter (unless the restructuring plan is under the insolvency framework such the Administrative Pre-Packs) as indeed contractual issues may arise, for example and as I have observed, in the case of some secured creditors (such providers of CID and Factoring/Invoicing finance) they have additional protection in the form of deed of priority with further personal guarantees (that can be call at any time) and secondary legal charges over property. The application of the cram-down mechanism would also work better if included in the formal insolvency process under the CVAs where companies seek to specifically and formally restructure and reduce their burdensome debts. Again as before this should also be accessible and applicable to sole traders and unincorporated businesses.

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

Yes I do agree with the proposed requirements, although paragraph 9.20 would benefit from further distinctions for instance in a standalone restructuring process the application could be made by the Director/Business Owner and under the insolvency process as is the CVA the application (as currently stands) would be made by the nominee. I am not sure I would agree with the statistics under paragraph 9.22. If indeed we are the 7th highest recovery rate in the world is because of pressure exerted by creditors under enforcement of their contractual rights under their terms and condition or through the debt collection pre-action protocol rather than in the Insolvency process otherwise there would not be 60% failures of CVAs (as reported at paragraph 9.2) or as is the vast cases, reduced or not recovery during Administrations and Liquidations.

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

Yes I do consider the proposed safeguards to be sufficient protection for creditors, so long that the creditors are also transparent about their claims and do not attempt to seek double recovery for example, and as I have observed whilst working with my turnaround projects, creditors assigning late payments and cancellation fees to debt collection agencies, acting on no win no fee or conditional fee arrangements, which can make it confusing for the
small businesses tracing or identifying the primary debt (as it has additional Interests and Recovery costs charges added) and/or may be duplicated.

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?

Yes I do agree and the current business valuation should also be included in the turnaround plan together, and in my opinion this is fundamental, with comparable figures that will also include costs of break up and realisation in the event of formal Insolvency.

**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?

*Financing restructuring projects pre-insolvency is very different from financing restructuring during formal Insolvency such Administration, Pre-Packs or CVA which can be more complex, more difficult and expensive to obtain. From a restructuring view point and totally independent from Insolvency, my experience of working with crowd funders as well as individual private investor/backers on informal restructuring and turnaround projects I found they would work with the distress business on specific arrangements or transactions depending on what is needed and their risk appetite. Usually backers will request a security on property or stock and will accept a subordinate legal charge below the existing and primary or other secured legal charge holders prior this interim or bridging funding is released in stages. In the event where the distress business has a negative value or negative equity in the property or is less than what is likely to be advanced or employed in the turnaround project, backers would prefer and look for additional security from either pledges from existing Directors.Business Owners and/or equity in the business to leverage their risk prior and during the period of the turnaround. Further some alternative private lenders tend to be more flexible in repayment terms but equally, and as a practice, during the turnaround the business financial information and progress is fed regularly to the backers during the project. I have also observed that some turnaround projects once completed have formed better and more transparent, flexible and straight forward commercial relationship with the alternative backers that some business opt to continue working with this type*
of alternative lending to access finance than mainstream business finance. However under the current Insolvency framework, I have observed, that this type of alternative finance are exposed to claw back actions after exiting in the event of Insolvency within a period of 6 years which can be a turn-off to their appetite. What I believe what is needed to encourage more business rescue financing is flexibility and transparency such what sums, repayments and security sought, how long and type of finance is likely to be needed, how the alternative finance funds is particularly used. I have observed that private backers understand that they are senior secure lenders and it will not be unreasonable that the protection that can be offer to this type of alternative backing to be in the same line of priority and treatment as the existing secured charge holders but a with a further guarantee that no adverse action or prosecution or challenge to their charges are made against the backer(s) in the event of Insolvency.

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

I believe and further to my comments on 15 above, property valuation, even on the most thorough and objective valuation methodology cannot be constant or guarantee as is subject to market forces and business cyclicality of demands and needs. Further in the event of insolvency the value is instantly or further eroded because of the prospect of a break-up and flash sale and its related costs. Personally, and more so in the case of SMEs, I am yet to see a secured charge holder fully recovering their full claims from an insolvency process, hence exercising their right of full recovery of their claims and costs through the call of watertight Personal Guarantees given by the Directors/Business Owners over the business.

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

I think it will depend on what the uses of the finance are for and as mentioned in 15 above I think there should be defined and clear distinctions if the finance is provided during a restructuring process pre-insolvency or finance sought for restructuring in an insolvency process (Such Pre-Packs/CVAs). Ultimately it will be up to the lender to weigh up their risk exposure prior granting finance but in the case of a formal insolvency if the existing charge holders are not forthcoming or consent and depending on the lender own policies in place could lead to more expensive borrowing or less financing and a more costly insolvency process due to time and legal cost spent in trying to seek the finance that could qualify for super-priority payment.
Impact on SMEs

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

Whilst the proposal appears to be part of the Insolvency Framework I strongly believe that what is needed is a standalone Restructuring Framework, and completely separate from the Insolvency Framework. What is really needed is a Restructuring and Turnaround Framework that can be treated totally independently from Insolvency as a gateway for all businesses (including sole traders and unincorporated businesses) which purpose will serve twofold, first to enable the distress business to trade whilst negotiate and continue working with existing creditors in good faith and on an open and transparent manner and secondly to understand, learn from their distress experiences and improve entrepreneurship. Restructuring and turnaround in my experience is more than just financial sorting out of debts or selling a business as a going concern, we have that already in the form of the CVA and Administration and Administrative Pre-Packs provisions under the current Insolvency framework, the principle of restructuring and operational turnaround looks at the distressed business holistically to identify the cause of the problem and the external and internal challenges facing business regularly and in the long term, including, but not limited to, operating model, trading environment, organisation and culture, process, strategy, customers, suppliers, pricing, skills. Thus allowing the business owners and directors to not only sort its financial difficulties and learnt from it but also look differently at its operations and the dynamics of the rapidly changing environment in which businesses operate which includes but not limited to the need to seek diversification or innovation and to add value. I am disappointing to read that, yet again, sole traders and unincorporated businesses are excluded or not being taken into consideration in the proposals and this group of business structure should and needs to be included.

What is also needed is a platform to cascade information and tools of turnaround available for SMEs – The government have created a platform for business growth such Business is Great but nothing to educate or cascade information when things go wrong and what tools are available instead SMEs relies on charity such for example Business Debtline and CAB, although their role are extremely important for free advice, information can be limited to just dealing with debts instead of exploring for tools and strategies or seek the adequate advice to help their their business and what to do when control feels is lost or indeed is almost lost.
Furthermore currently under the Draft Pre-Action Protocol for Debt Claims unsecure and trade creditors “should” give 14 days’ notice period to the Debtor to deal with their claim if it’s straight claim and upto 3 months if the claim is complex. But the efforts to strike a balance between Creditors’ claims and debtors have been unwelcome by the Credit Industry given the amount of paperwork that needed to be provided by the creditor\(^1\). Although under the current pre-action protocol the claimant creditor is only limited to the creditor simply writing to the Defendant Debtor with the basis on which their claim is made, a summary of the facts, what the claimant wants from the defendant, and if money, how the amount is calculated\(^2\), this doesn’t stop a Claimant creditor using a Statutory Demand to exert pressure and/or to seek a security after a reminder letter. I strongly believe that a pre-action protocol should also be extended to this type of Insolvency Instruments.


\(^2\) [https://www.justice.gov.uk/courts/procedure-rules/civil/rules/pd_pre-action_conduct#6.1](https://www.justice.gov.uk/courts/procedure-rules/civil/rules/pd_pre-action_conduct#6.1)
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.

My firm is a member of the Federation of Small Businesses and Cambridgeshire Chamber of Commerce and I am yet to see a properly formulate survey on how businesses owners and companies deal with their business when they or their customers are in distress. I believe that an insolvency jargon free survey should be put forward to businesses owners and companies’ member to seek feedback on what business owners and companies, both as a creditor and debtor, need and do when things go wrong.

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
A Review of the Corporate Insolvency Framework response form


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

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: Dr Bolanle Adebola

Organisation (if applicable): University of Reading

Address: Foxhill House, School of Law, University of Reading. RG6 7BA

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<th>Respondent type</th>
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<td>Trade union or staff association</td>
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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?

Yes, the moratorium is necessary to improve the restructuring process. The moratorium as a gateway will help streamline the restructuring process and improve the understanding of non-experts by providing a focal point for commencement.

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?

The proposal to have a filing at the Companies House and the opportunity to challenge is a good way of balancing various interests.

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

The requirement to demonstrate likelihood of reaching a deal with the creditors may just be a box to tick.

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?

Yes, the safeguards appear to be fail.

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

I would recommend that the creditors are given a period of 7-14 days to challenge the extension, instead. That would ensure that the business can continue to operate smoothly while any dissatisfied creditors are given the right to appeal to the court.
6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?  

Yes.

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

Yes.

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

One of the key challenges for stakeholders during the restructuring is access to information. I think that the right to request information is necessary. The supervisor would require the right not to provide information that would jeopardise the success of the restructuring, however. This may be decided on a case by case basis.

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?  

Yes.

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?  

Yes.
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?
   The restructuring plan would be better as a standalone procedure for the sake of clarity.

12) Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?
   The process as explained does not indicate how many classes must approve before a cram down can be triggered. For example, in the US, the Chapter 11 process requires at least one class to approve the plan before a cram down can be triggered. The recent ABI proposals would permit a cramdown in some instances where no class approves. The consultation must clarify its approach.

13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
   The introduction of the APR rule may very well work in some cases but not in others. For example, in the case of a large private company with tiers of creditors. It is possible that the equity holders wish to retain some equity while the junior creditors are unpaid. The junior creditors will perhaps receive no less than they would in a liquidation. Nevertheless, the moment that the equity holders are given a deal that permits them to retain some equity while the junior creditors get nothing, then, they have been treated unfairly. Is it the case, therefore, that the UK approach to the APR can be interpreted to mean that equity holders may be treated better than junior 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?
   It sounds like a good starting point. With the help of the nominee, it may mean that it does not become the only reference point.
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?
In the cases of the largest businesses, this may be a good step. In any event, it should be noted that even in the US where the DIP financing law is clear, only the largest of companies have access to this type of finance. By clarifying the law, it will draw more investors. That of course, will also bring its attendant challenges.

16) How should charged property be valued to ensure protection for existing charge holders?
It will depend on the circumstances of the case. The role of the nominee is very important here.

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?
Yes. Much of the proposals laid out apply to the largest companies. For the SMEs, there are specific challenges which need to be addressed. The 2014 research shows that recidivism figures are high. Almost 1 in every 3 businesses rescued by previously-connected persons fail again. While almost 1 in every 2 businesses rescued through the use of deferred consideration fail, whether rescued by those with or without previous connection to the company. There is research that show that the size of the company is the culprit here. I suggest that the viability report and the viability
statement which were introduced by the Graham review be made mandatory for SMEs. I would say that for all companies but at least for SMEs. The V.Report is to show that the business is viable and the V.Statement to show what operational and perhaps personnel changes will be made going forward. These two reports should be brought under the direct oversight of the supervisor; the aim being to help these businesses develop good plans for the rescued business.

With regard to the use of deferred consideration, the 2014 research shows that businesses that pass the 36 month mark post rescue would survive; most rescues that fail do so within the said 36 months. We see that deferred consideration is extracted from the company within 3 – 12 months post rescue. Deferred consideration is basically debt carried forward by the new company. I would recommend that the supervisor also exercises oversight over the financial structure of the rescued entity. The value to be extracted within the 36 months following the rescue should be commensurate the earning capacity of the rescued entity, if it is to survive.

In sum, for the SMEs, I propose that the challenges that they are facing should be duly considered in the framework that is created. This, in my opinion, requires the use of the viability report, statement and careful attention to the use and repayment of deferred consideration in the 36 month period following the rescue.

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
RESPONSE TO THE REVIEW ON CORPORATE INSOLVENCY

Introduction of a Moratorium

1. We agree with the proposal to introduce a moratorium as long as it is properly supervised by an independent person.

2. We agree that the process of using the Court is the most effective and efficient subject to Court delays.

3. We agree that the proposed eligibility tests and qualifying criteria provide the right level of support and protection for suppliers and creditors subject to the approval of the Court.

4. We consider the proposed rights and responsibilities for creditors and directors to strike the right balance subject to satisfactory supervision.

5. We agree with the proposals regarding the duration, extension and cessation of the moratorium.

6. We agree with the proposals for the powers of and qualification requirements for a supervisor. It is important that such a person is independent of the Company and/or any directors associated with the Company.

7. We agree with the proposals for how to treat the costs of the moratorium.

8. We agree that there is a benefit in allowing creditors to request information subject to the Data Protection Act and any confidentiality provisions. We do not always get sufficient information from insolvency practitioners so this would be useful but would only work if there is some sanction on the supervisor if the information is not provided.

Helping businesses to continue trading through the restructuring process

9. We agree with the criteria for an essential contract. The supply of water is essential but is supplied under a statutory duty and not a contract. We cannot terminate our service so although water is essential we are under a duty to continue supplying irrespective of the Company’s circumstances. We would have a right to cut off the supply for non-payment but would not do so during a moratorium.

10. We would prefer the Court to make a decision.

Developing a flexible restructuring plan

11. We have no strong view on this. A restructuring plan is unlikely to impact too much on us as we will not get any less money if we agree to a restructuring plan. We have no view as to where the plan sits, i.e. stand alone or as part of the existing procedure.
12. We agree with the proposed requirement for making a restructuring plan binding on all creditors despite some dissension.

13. As long as the Court is involved we are comfortable with the proposed safeguards and protection for creditors.

14. No strong views on this.

**Rescue finance**

15. We have no strong views on this.

16. No views on this.

17. No strong views on this.

**Impact on SMEs**

18. No specific views on this.
British Property Federation response to the review of the corporate insolvency framework

Introduction

The British Property Federation (BPF) is pleased to respond to the consultation by the Insolvency Service on the corporate insolvency framework.

The BPF represents the commercial real estate sector – an industry with a market value of £1,662bn which contributed more than £94bn to the economy in 2014. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK’s economic success, provide essential infrastructure, and create great places where people can live, work and relax.

We would be delighted to provide further information on any aspect of our response on request. Please contact Stephanie Pollitt, spollitt@bpf.org.uk, 020 7802 0104.

General comments

1. We are always pleased to see government taking steps to review the insolvency system and understand what could work better and what could be introduced to help promote business rescue. Whilst we have always been supportive of past consultations and have always sought to encourage reform where appropriate, we are disappointed to see that the proposals set out in the consultation on the insolvency framework appear to stifle the current insolvency system.

2. The introduction of a moratorium has, in theory, some merit in helping alleviate the difficulties of a distressed business but we believe this should not be introduced as a new self-standing mechanism, but instead used to bolster existing rescue processes. Administration already benefits from a moratorium process, for example in CVAs but they are only available for small companies. We also believe that a period of 3 months is too long and, with the addition of an extension, would only serve to draw out the process unnecessarily and be prone to abuse. Our view is that the timeframes for CVAs are too short and that the CVA process could be improved with the addition of a moratorium which gives the distressed company a protected window prior to making its proposals. This would also provide an opportunity to canvass the views of stakeholders prior to presentation of proposals in contrast to the existing system where there is no such opportunity. With that in mind, we would be in favour of a shorter moratorium of perhaps, 21 days and which would end with a defined insolvency path such as a CVA.

3. The proposals also favour greater intervention by the courts which again we see as a step backwards. UK courts are already working under great pressure and are time and resource limited. The UK insolvency system relies on out of court processes which ensures that they are dealt with swiftly and efficiently. Having to rely on court availability would remove this element of efficiency.

4. We are disappointed to see that creditors are not adequately protected within the proposals. Government has worked hard in recent years to boost creditor confidence within the insolvency regime including commissioning the Graham review in 2014 and seeing the introduction of a pool of independent experts to review pre-pack administrations. These proposals are at odds with past work and will not help underpin confidence that the insolvency regime is open and transparent.
British Property Federation response to the review of the corporate insolvency framework

5. Our view is that government should be working within the structure of the current insolvency framework rather than seeking to create a new one. Furthermore, given the recent decision for the UK to leave the EU and the associated level of uncertainty within the UK political landscape, we believe that efforts will be better focused on improving the current system making sure it is transparent and robust to help ensure that business rescue is as swift and efficient as possible.

The introduction of a Moratorium

Q.1 Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all business?

6. We agree that where a business is struggling that it should be given the best possible opportunity to seek a resolution to its problems. However, we do not agree that a moratorium as proposed is the right course of action and believe that it would be open to greater abuse to the detriment of creditors including landlords. We have always promoted early engagement between landlords and their tenants and for tenants to seek early advice if they are running into financial difficulty. Landlords have shown themselves to be flexible in their negotiations with their tenants, for example, converting to monthly rents, and remains open to new ideas. They have also shown themselves to be commercial and practical in the face of well packaged CVA proposals, the vast majority of which have been passed with landlord support.

7. If government is set on introducing a moratorium, we would prefer to see a moratorium which promoted open talks between all creditors, including landlords and tenants. This moratorium would be triggered by the company making a statutory declaration that they are, or are about to become, insolvent and would end after a fixed period of 21 days after which either a CVA would be proposed or a notice of intention to appointment an administrator would be served.

Q.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?

8. This proposal would see greater pressure being put on the court system, which is already under significant stress. The large majority of UK insolvencies operate outside of the court system and do so successfully: this proposal therefore would add an unnecessary and burdensome obligation on courts which may struggle to cope with this new duty.

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

Notwithstanding our previous point on the moratorium, we agree that a business must be able to demonstrate it is able to reach a compromise with its creditors and meet its obligations. Again we stress that the moratorium must not be drawn out and must be a prelude to defined action.

Q.4 Do you consider the proposed rights and responsibilities for creditors and directors strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

9. No. Being given a ‘general right’ to apply to court during the first 28 days of the moratorium or that no grace period where creditors could challenge the application for a moratorium be put in place appears counterproductive to business rescue. Furthermore, only companies which are, or about to be, insolvent should be eligible; “financial difficulty” is too low a base. Creditors should be involved at the outset so that all options for rescue can be explored. This proposal effectively excludes creditors from a process which
British Property Federation response to the review of the corporate insolvency framework

they will inherently be affected by in the long term. Additionally, this is again relying too much on the court system and appears to be taking a step back from current practice.

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

10. No. The current proposal of 3 months is far too long and will only seek to drag out the process and lead to abuse, 21 days feels like a more realistic time frame. Furthermore, the ability to further extend the moratorium is unreasonable particular given that there no guidance on how long extensions could last. We do agree that the moratorium should come to an end naturally but that there should be a fixed conclusion as we have highlighted in our answer to question 1.

Q.6 Do you agree with the proposals for the powers and qualification requirements for the supervisor?

11. We agree that there should be a supervisor in place in order to safeguard creditor’s interests but we do not agree that this should be anyone with relevant experience such as accountant or solicitor. The definition of ‘relevant experience’ is far too broad and raises questions such as what would such experience look like and how would different supervisors of differing but relevant experience be distinguished? In our view, the supervisor should be an insolvency practitioner (IP) who has thorough knowledge of the insolvency process, a good understanding of insolvency law and who would also be regulated. It makes perfect sense to us that an IP should have oversight of this process. Ideally, they would be closely involved in advising the company rather than just having an oversight role, and make a statement to creditors that there are reasonable prospects of turning the business around.

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

12. Yes, it is essential that creditors are not put in a worse position during this period than they would be if these costs were incurred during an administration: a first charge is the quid pro quo for the stay on creditor enforcement action. We would, however, note that unless these costs are clearly identifiable this will make it very difficult for IPs to assess the merits of taking on any future administration as office holders. At the very least, all expenses incurred during the moratorium should be priority “expenses of the process”. For consistency, the same should apply during the interim moratorium following service of an intention to appoint an administrator.

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

13. Yes. Creditors should be able to request information in order to be fully briefed on the insolvency and the supervisor should be obliged to provide it. We also agree that this should be extended to all other insolvency procedures including CVAs.

Helping businesses keep trading though the restructuring process

Q.9 Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would continuation of essential supplies result in a higher number of business rescues?

14. We agree that a business needs to be given the best opportunity to bring itself out of distress and that in order to do this; continuation of supply is a contributing factor. However, whilst we agree that suppliers should not be allowed to use insolvency to create a ransom position, we do not consider that suppliers who
British Property Federation response to the review of the corporate insolvency framework

are under no contractual obligation to continue their supply should be forced to do so. A provision that prevents suppliers from increasing their charges in the face of insolvency might therefore be appropriate, although clearly suppliers should be allowed to change any terms of credit given the clear risks of trading with an insolvent company. We are aware that each business is unique and so will have a unique set of suppliers which they need to operate but we are unsure how essential contracts of this nature will be maintained. Again, the courts are being asked to take on additional burdens for which they are not equipped and do not have the time. It is also difficult to ascertain whether the continuation of essential supplies will result in a higher number of business rescues but common sense would denote that if a business is already failing without any change in their supply, this is unlikely to make a huge impact on whether they can successfully be rescued.

Q.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?

15. No. Employing greater reliance on the court system will only result in further delay and greater frustration with the process. This could in turn lead to greater abuse of the system.

Developing a flexible restructuring plan

Q.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?

16. No. The proposals put forward to create a new procedure essentially create a further tier within the insolvency process, making it more complicated and expensive. We believe that the proposal will only delay an inevitable failure and erode any remaining assets. We are aware that existing tools such as CVAs are not perfect, but this is an opportunity to hone and refine them. As such, we firmly believe that government ought to focus its attention on the tools of the existing framework rather than creating a new regime.

17. The consultation states that government feels that CVAs, in their current form, are not fit for purpose for enabling company rescue and we would, to a certain extent agree with this opinion. However, a reform of CVA procedures would be possible without the need to introduce a wholly new process. We do feel that this is achievable and that government should seek to improve it to make it a more viable option for business rescue. The CVA process already provides a framework and it would be best to work within that rather than to create a new one. This could be achieved by giving the insolvency practitioner a greater role in the process with a requirement to provide a statement to creditors that the survival of the business can reasonably be attained by way of the proposal. Finance is often critical for tenants and, as landlords, we would be concerned about any proposal that watered down the rights of secured creditors as this would have an inevitable knock on effect on the terms of debt finance.

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

18. Again, we do not agree that a new restructuring plan is viable. A CVA already provides this binding process through the vote and thus already has this in place.

Q.13 Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
British Property Federation response to the review of
the corporate insolvency framework

19. If a cram down system was introduced we believe it is critical this is overseen by the Court. That said, we do not believe that even this will provide sufficient safeguards to creditors and we remain very concerned about the impact the introduction of such a process will have on commercial interactions, including lending. As stated in the consultation, the UK insolvency regime currently stands at 7th place globally for recovery rates and this may be attributed to the fact that we are not governed by a court system. The consultation appears to be moving backwards by employing greater reliance on the courts and though it is useful to have a plan independently scrutinised, a court procedure is not the way forward.

Q.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?

20. As mentioned, we do not agree with the suggestion of a cram down process. The minimum liquidation valuation basis is fair in principle but we would suggest unworkable in practice. We would note that there would be debates and disputes (involving expert valuers and lawyers) over valuation which would lead to delay and a high level of cost.

Rescue finance

Q.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?

21. No. This will just make it more difficult for all companies to obtain affordable funding in the future.

Q.16 How should charged property should be valued to ensure protection for existing charge?

22. The BPF does not hold a view on this.

Q.17 Which categories of payments should qualify for super-priority as ‘rescue finance’?

The BPF does not hold a view on this

Impact on SMEs

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

23. We do not underestimate the value of SMEs to the UK market but we are aware that they may not have the same level of knowledge or access to expertise when it comes to dealing with insolvencies. It is imperative that SMEs are given these tools within which they can operate successfully but we do not believe that the answer for them lies in the introduction of a new regime. Adding further layers would only create confusion and for those who do not possess the appropriate level of knowledge, decrease the likelihood of rescue. The government undertook an extensive review into pre-pack administrations to understand where the faults and issues could be addressed. We would suggest that the same exercise be carried out for CVAs in order to understand what reforms are needed to make them effective.
A Review of the Corporate Insolvency Framework response form


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

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:
A Review of the Corporate Insolvency Framework: a consultation on options for reform

Questions

Name: David Bryan  
Organisation (if applicable): Bryan, Mansell & Tilley LLP (BM&T)  
Address: 23 Austin Friars, London EC2N 2QP

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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?
A Review of the Corporate Insolvency Framework: a consultation on options for reform

Background and Introduction

BM&T is a long established turnaround and restructuring consultancy. The practice was started in the UK in 1997 as the European arm of US turnaround firm, Glass & Associates, one of the pioneers of such work in the USA both under Chapter 11 of the US Bankruptcy Code and outside it. In 2007 Glass & Associates was sold. The European arm was reformed as BM&T by Alan Tilley and David Bryan in 2008.

Throughout this almost 20 year period we have been involved in working with distressed or troubled businesses and have undertaken over 50 assignments. Alan Tilley helped found the Turnaround Management Association (TMA) UK Chapter in 2001 and subsequently helped fund several other chapters in Europe. He was president of the UK chapter from 2004-2006 and VP International for TMA Global in 2010-2011. David Bryan has been a director of TMA UK since 2010 and a director of TMA Europe since 2011. Alan and David are frequent speakers and authors on turnaround and restructuring and co-authored the Institute of Chartered Accountants (ICAEW) Best Practice Guideline on Turnaround. A copy of this document is available here:


We welcome the Insolvency Service consultation issued in May 2016 to Review the Corporate Insolvency Framework and are pleased to present our response to the various questions raised below.

The Introduction of a Moratorium

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

Yes, we strongly support this. At present, consensual turnaround work is done without any legal framework or protection. This means that if just one
A Review of the Corporate Insolvency Framework: a consultation on options for reform

...creditor chooses to take action against the company then the turnaround effectively fails. A moratorium will give formal protection from such actions and we believe will enhance the likelihood of turnarounds being successful. More businesses will avoid value destructive insolvency with the collateral damage that ensues to jobs and unsecured creditors, particularly in the supply chain. In 2010 an R3 survey suggested that 27% of business failures result from the failure of another business. We believe a greater focus on rescuing viable businesses without the need for an insolvency process will greatly reduce that domino effect.

BM&T partners have been involved with over 50 turnaround assignments and in over 92% of these the businesses have avoided insolvency. These businesses have ranged from revenues of approx. £1.0million to over £1.0billion. In the successful cases the unsecured creditors have suffered no losses although they had to accept their debts being paid over time. Secured creditors have in every case had a deal which gives them full recovery or significantly better recoveries that they would have got in an insolvency.

We strongly believe that in far too many cases, viable businesses move into insolvency without sufficient efforts being made to find and negotiate a turnaround solution. Often this is because management leave it too late to seek help but there is no doubt that the lack of a moratorium type framework and a culture of seeking help is a major contributor. Prompted normally by the secured creditor, the first person company directors usually speak to when in distress are Insolvency Practitioners who propose insolvency procedures as that is what they know and is their business “raison d’être”. Earlier action with more options available will help save many more viable businesses. Indeed, the very existence of a moratorium may encourage earlier intervention and consensual commercially negotiated solutions without even having to resort to a formal moratorium.
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?**

Yes. Assuming this can be kept to a relatively simple and cost effective process this is the easiest way and should give creditors comfort that this is a bona fide process. It is quite right that creditors should have the ability to challenge the moratorium if they feel their interests aren’t protected and this also needs to be a simple and cost effective process. By having to go to court to challenge the moratorium we believe that frivolous challenges are less likely. Also, the existence of checks and balances against unreasonable avoidance of liabilities makes the supervisors task of negotiating a “fair and reasonable” settlement easier.

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

We do agree that a business must have a demonstrable need to enter a moratorium process. However, we are concerned that the proposed definition of “already or imminently will be in financial distress or is insolvent” may lead to companies leaving it too late. There does need to be some liquidity left in the company, as envisaged by paragraph 7.22 and we think the wording may need to be softened to allow for and encourage attempts to rescue a business as soon as it is clear that financial distress is likely.

We fully support the idea that a business going into a moratorium should have to be viable. This will be difficult to define and as paragraph 7.23 says, will be a commercial judgement.

Provided there is a viable business and sufficient liquidity is available or can be made available then creditors should be made no worse off by the moratorium so we believe they are sufficiently protected.
A Review of the Corporate Insolvency Framework: a consultation on options for reform

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?

Yes, the ability of a creditor to challenge the moratorium within 28 days is a good mechanism where there are grounds to believe a moratorium is not appropriate. As per paragraph 7.27 we would expect discussions to have taken place with major creditors prior to entering a moratorium in order to satisfy the requirement that there is a reasonable prospect of negotiating a compromise or arrangement so challenges in court should be the exception rather than the rule.

We do believe there should be some rules around not disposing of assets other than in the ordinary course of business and agree with the proposal in 7.43 that the supervisor should approve any such transactions.

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

The necessary duration of the moratorium is going to depend on the complexity of the business. For a small family business with one lender, three months may be more than enough. For businesses with complex group structures, multi-layer capital structures and cross-border activities, then three months is likely to be nowhere near enough time. We therefore think varying the length of the moratorium by size of business should be considered. Size may not be an exact determinant of complexity but is probably the easiest proxy to keep the rules simple.

We agree that an extension to the moratorium should be put to a vote of the creditors. The proposed threshold for unsecured creditors seems equitable. Consent from all secured creditors could be a problem in complex capital structures and does potentially create opportunities for parties to buy debt with the intention of taking a hold-out position. As the proposals are drafted it would appear possible that a party could frustrate the need to extend a
A Review of the Corporate Insolvency Framework: a consultation on options for reform

moratorium even if they are out of the money and might eventually be crammed down.

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

We agree that a supervisor should be appointed to safeguard creditors interests and make sure the purpose and conditions of the moratorium continue to be met. We believe that the choice of a suitably qualified supervisor should be the choice of the directors and not subject to undue influence by particular creditors, e.g. bank panels and similar arrangements. It is important that supervisors are independent, objective and clearly seen to be acting in the best interests of all stakeholders.

We welcome the proposal that supervisors do not have to be licensed Insolvency Practitioners. There are a large number of highly experienced turnaround practitioners working in the UK with a long history of dealing with consensual restructurings and they are an important resource to ensure the objectives of this proposal are met. They should not be excluded. We also believe the minimum standards and qualifying criteria for a supervisor should be extended to include the Certified Turnaround Professional (CTP) qualification of the European Association of Certified Turnaround Professional. This is a localized version of the American CTP qualification which has long been recognized in the USA for working on Chapter 11 type restructuring processes.

We note that the government wants to make this as cost effective a process as possible. The larger end of the restructuring market is already well catered for and we believe the key to keeping costs low for smaller businesses is to ensure the numerous one person restructuring experts and the small boutique restructuring consultancies are able to undertake this work. Most are very low overhead businesses recognizing that their prospective clients are under severe cash pressure. They are focused on restructuring and with no other services to cross-sell. They are experienced and will be able to
ensure that the supervisor role can be carried out at much lower costs than larger professional service firms with high overheads built into their costs structure.

We note that the Review of Insolvency Practitioner Fees by Elaine Kempson in 2013, section 3.1, identified partner/director level fees ranging from £212 to £800 per hour and Managers from £100 to £460. Most of the turnaround professionals we know outside the larger firms charge at most at the bottom end those ranges with many solo practitioners charging a lot less.

To ensure low cost we believe that supervisors should be subject to low levels of regulation. They are not running the business as this is debtor in possession. Supervisors should not be held personally liable in their role other than for gross negligence to ensure their Professional Indemnity insurance does not become a significant cost that has to be passed on to the debtor. It should be recognized that a supervisor is a professional advisor, advising the directors and not managing the business. However, the concept of “shadow director” exists and turnaround professionals are well versed in acting in full knowledge of directors’ responsibilities and liabilities.

We agree that the supervisor should be satisfied that the eligibility tests are met on commencement of the moratorium and continue to be met. We agree they should be able to attend board meetings and request information. We agree that the supervisor should have to approve any transactions not in the ordinary course and believe that any such transactions should be notified to the creditors.

We are strongly supportive of the proposal in 7.45 that an Insolvency Practitioner acting as a supervisor be prevented from taking a subsequent insolvency appointment were the company to enter formal process. That would be a clear conflict of interest. In a moratorium Insolvency Professionals’ involvement should be restricted to an advisory capacity to the supervisor and upon the supervisor’s instruction. It should be recognized that the directors will be sufficiently appraised of their responsibilities and liabilities by their lawyers.
7) Do you agree with the proposals for how to treat the costs of the moratorium?

We agree that the costs of paying the supervisor be treated the same way as costs in an administration. We believe this will give restructuring professionals the confidence to take on such work and that the need for hefty fee deposits as currently required by many professionals will be mitigated, this helping with much needed liquidity during the moratorium.

We have some reservations about the treatment of debts incurred during the moratorium as this raises the possibility that creditors will be worse off than they were before the moratorium. This is further discussed below in our response to the rescue finance proposals.

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

We support this proposal. Unsecured creditor engagement with insolvency processes is acknowledged as very low in the UK. (See Frisby, S (2006) Report on insolvency outcomes and Office of Fair Trading (2010) Corporate insolvency: in-depth interviews with creditors by Marketing Sciences). We believe the right to ask for reasonable information could be helpful in getting such creditors to be more involved and supportive of the process. Best practice in consensual restructurings is to initiate regular communication with all creditors.

We think there should be exemptions for commercially sensitive or confidential information, disclosure of which would be prejudicial to the debtors’ interests and may be subject to confidentiality agreements, e.g. negotiations to sell some or all of the business. There should also be an exemption for information that is not readily available and would be too time consuming and costly to prepare.
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?

In practice we have not found this to be a great problem in the restructurings that we have been involved with over the years. Maybe that is because the termination due to insolvency clause has not been triggered as there is not a formal process. However, we can envisage that contracts might be written in future to bring moratoriums under the same provisions.

In our experience, most consensual restructurings are carried out on the basis that the creditors positions are frozen where they are at the start of negotiations. Ongoing supplies are normally paid on a cash up front basis and so the creditors position never gets any worse. The alternative for the creditor is an insolvency of their customer so normally the position is accepted.

We think there is merit in incorporating the measures in the proposal to ensure that there is a mechanism for dealing with such situations, especially if ipso facto clauses are amended in suppliers’ standard conditions as a result of moratoriums being introduced. We think the definition of “essential supplies” seems reasonable.

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We support the idea that the courts are only involved to approve which contracts are essential if a supplier challenges. This should help keep the
process simple and avoid excessive legal costs whilst allowing suppliers sufficient safeguards.

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?

In our opinion a restructuring plan would work better as a standalone procedure. A CVA is an insolvency procedure and as such has a certain stigma to creditors, employees and customers. We believe this should be a separate procedure with the “insolvency” word not used at all. All stakeholders need to be aware that this is not an insolvency process but a commercial process, and is in fact intended to avoid insolvency and consequent destruction of value.

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

Yes, we agree. This is a problem that currently impacts larger companies with multi-layer capital structures. Experience in the UK, Europe and even more so in the US is that hold-outs by out of the money creditors or opportunistic hedge funds and buy-out specialists can be a real problem which delay restructurings and significantly add to the costs. Schemes of Arrangement are a useful tool but so expensive that they are only really of benefit to large companies.

In reality the very threat of being able to use such mechanisms should hopefully mean that all but the most contentious are agreed consensually and never go anywhere near a court.
13) **Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?**

Yes, we believe the proposed safeguards are sufficient protection.

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?**

This is a difficult area. Whilst there is an argument that the next best alternative is a better comparator, this is always going to be a complex and judgmental figure. Experience in the US is that it becomes a source of lengthy and potentially costly disagreements. We believe that this proposed legislation should be as low cost and simple as possible and for that reason would reject using the next best alternative.

A possible suggestion is to use a liquidation value but give creditors the right to require the supervisor to seek an independent third party liquidation valuation from a suitably qualified professional.

**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?**

We believe this is likely to prove highly contentious and anything that disturbs the absolute priority of creditors would be a retrograde step.

In our experience most DIP funding comes from existing senior lenders and only where there is some collateral still available. Alternative lenders do have
the option of taking the existing lender(s) out and providing new and increased facilities where sufficient collateral exists but the existing lender is unwilling to increase their commitment. We have worked on a situation where this happened in the last few months. The UK has a very innovative financial sector and we would be inclined to defer consideration of this issue and see how the market responds to the whole moratorium process.

Lastly we are concerned that the availability of super priority funding could be contrary to the stated objective of encouraging debtors to seek early advice while some liquidity is still available.

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

No further response on this section

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

No further response on this section

Impact on SMEs

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

The key issue for SME businesses is cost. There comes a point where a business is simply too small to justify the costs of turnaround advice and assistance. There will always be some businesses that are too small to avail themselves of such help.

It therefore follows that early advice when there is still some liquidity and
keeping the costs to a minimum is crucial to making moratoriums and help available at the smaller end of the market. This needs a commercial rather than a legalistic and highly regulated approach. This needs to be balance with safeguards for creditors. We would reiterate our comments in response to question 6 that low overhead, experienced turnaround professionals with the minimum necessary regulation should be encouraged in order to help small businesses avail themselves of this new framework.

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.

We have worked with the TMA to gather some basic statistics from members that may help with the Impact Assessment. These will be submitted separately.

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
Our ref. GB/PJK/NH

4 July 2016

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

Email: Policy.Unit@insolvency.gsi.gov.uk

Dear Sir/Madam

RESPONSE OF THE CHARTERED INSTITUTE OF CREDIT MANAGEMENT TO: THE INSOLVENCY SERVICE: A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK

The Chartered Institute of Credit Management is the largest professional credit management organisation in Europe. Its members hold important, credit-related appointments throughout industry and commerce, and we feel it appropriate to comment on this consultation.

Please find attached our answers to the questions set out in the consultation.

If we can help in any further way please do not hesitate to contact us.

Yours faithfully

Glen Bullivant FCICM
Chair of Technical Committee

E-mail governance@cicm.com T. +44 (0)1780 722912
A Review of the Corporate Insolvency Framework
response form


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

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Policy Unit
The Insolvency Service
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I want my response to be treated as confidential ☐

Comments:
Questions

Name: Glen Bullivant

Organisation (if applicable): Chartered Institute of Credit Management

Address: The Water Mill, Station Road, South Luffenham, Oakham, LE15 8NB

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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?

The Institute is fundamentally opposed to the introduction of a moratorium available on application by the company's directors. We believe the communication of a moratorium will be interpreted as “effective insolvency” and, as a result, creditors will cease to engage. There are already solutions which allow breathing space, and adding the moratorium concept seems to be driven more by the desire to move our insolvency regime up the World Bank ratings rather than by any genuine need. We believe it will be open to abuse and this will be to the detriment of creditors.

Additionally, we believe that the moratorium is likely to lead to the withdrawal of credit insurance cover and impact on the availability of finance to the business leading to a greater likelihood of failure and insolvency.

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?

While filing at Court offers some protection, we are concerned that the courts will not have the resources nor capacity to deal with moratorium orders effectively. Creditors wishing to dissolve the moratorium will have to expend time and money in taking the matter to court. It is regrettably more likely that creditors will simply consider the business insolvent and fail to engage.

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

No, the proposed eligibility tests and qualifying criteria would provide the right level of protection, but how is the information going to be provided in a form to allow adequate due diligence to take place, and how is the time of the supervisor to do a thorough job going to be funded?

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?

The notification of the moratorium is likely to be damaging and, by the time a creditor goes to court to have it dissolved, it will be too late. Creditors wishing to dissolve the moratorium will have to expend time and money in taking the matter to court. It is regrettably more likely that creditors will simply consider the business insolvent and fail to engage.
5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

No, three months is definitely too long a period and should be shorter. We are opposed to the principle of moratoriums but, if they are to go ahead, we would support the R3 proposal of 21 days. We agree with the extension and cessation proposals.

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

To open the role of supervisor to solicitors or accountants who have no experience of either turn around or insolvency makes no sense. The supervisor role should be filled by qualified insolvency practitioners.

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

We believe unpaid debts incurred during the moratorium should be paid ahead of supervisor's costs.

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

Creditors should have the rights to reasonably request information from the supervisor at any point in the process and this will aid transparency and vigilance.

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?

No, for the directors to be able to create a list of essential suppliers is clearly an opportunity for the system to be abused. It is unreasonable that creditors should have to expend time and resources in requesting and attending a court hearing to challenge their place on the essential suppliers list. It should surely be the responsibility of the company/directors to demonstrate that the supplier is essential and prove that to be the case. Furthermore, there needs to be a guarantee that supplies during the moratorium will be paid for in full. Ideally, the arrangements should require that payment is made in cash and in advance. An alternative would be to remove the veil of incorporation so that directors are personally liable.
A further consideration is the potential impact on a small business that has to buy in raw materials in order to supply the company under the moratorium which may then become redundant if the business ultimately fails. It may also have to do supply the company under the moratorium rather than an alternative customer that is more credit worthy. Both of these scenarios suggest an unintended consequence that will be detrimental to other businesses.

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?

No, see answer to question 9 above.

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?

This proposal carries a significant risk of unintended consequences and the existing procedure, such as a CVA, should be used.

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

No

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

No

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?

Yes
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?

We are concerned that granting super priority could destabilise the market, and we do not believe it would fundamentally encourage business rescue.

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

Based on professional and independent valuation.

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

None

Impact on SMEs

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

No, and we believe the moratorium proposal is more suited to large businesses with complex requirements than to SMEs.

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 □X

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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I want my response to be treated as confidential ☐

Comments:
Questions

Name: John Morton

Organisation (if applicable): Clarke Bell Limited

Address: 3rd Floor, The Pinnacle, &3 King Street, Manchester M2 4NG

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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?
Clarke Bell Limited Response

Clarke Bell Limited is an established insolvency practice. In corporate insolvency it operates primarily in the SME sector. We provide insolvency advice to directors and cost effective formal insolvency procedures when necessary. Our comments are therefore primarily from the perspective of SMEs. In our view the Flexible Restructuring Plan and Rescue Finance are for the benefit of larger enterprises and we have not commented on those two sections of the consultation.

Moratorium

A three month moratorium will provide a breathing space to enable a SME to fully consider their options and decide which is the most appropriate to their circumstance. That should improve both the prospects of any rescue of the company or its underlying business and outcomes for creditors.

Practicality for SME

It is proposed that to enter into a moratorium the company is, or imminently will be, insolvent or in financial difficulty. Also the company must demonstrably have sufficient finance to enable it to pay the costs incurred during the period of moratorium and the debts that are due to be paid during that period. We consider both these requirements will rarely be met in the SME sector and so a moratorium would be unattainable.

Can consideration be given to ‘freezing’ all creditor claims at the time the moratorium was applied for and the assets available to those creditors in an insolvency not been significantly depleted during the moratorium period.

Effectiveness for SME

Can consideration be given to a moratorium also preventing suppliers exercising retention of title clauses to repossess stock held by the company and landlords exercising a distraint over assets held in their property.

Fairness of the moratorium

The creditors that are frozen when the moratorium commences will, in effect, suffer any losses incurred during the moratorium period. The proposal for the moratorium should explicitly explain why the position of the frozen creditors will not deteriorate during the period of the moratorium.

Should a formal insolvency procedure follow on from the moratorium it is proposed the office holder in the subsequent insolvency cannot be the supervisor of the moratorium. This is to ensure that the supervisor is not, or seen to be, influenced by the prospect of a future appointment in providing his advice to the creditors and the company. However, also, should a formal insolvency be required the office
holder will have to duplicate a lot of work completed by the supervisor in order to understand the company affairs and his strategy for progressing the insolvency. This duplication of costs, for SMEs, can be prohibitive. Could consideration be given to allowing the supervisor to accept a subsequent insolvency appointment if consented to by the directors at a board meeting and by a majority of creditors at the meeting that appoint the office holder.

Responsibility for the moratorium

We consider it is correct that the company, acting through its directors, are primarily responsible. However the degree to which the supervisor of the moratorium will be responsible for judging whether the business is viable and that the qualifying conditions are met initially and throughout the moratorium period are unclear. There is a balance to be struck. On one hand assurance should be provided to creditors that the directors’ proposal for the moratorium is reasonable. On the other that the costs of the supervisor (and other liabilities he may inherit) are not prohibitive to prevent SMEs applying for a moratorium or supervisors from providing their service. It is difficult to comment further unless further details of the relationship are provided.

Essential Suppliers

In our experience we have had little, if any, difficulty with essential suppliers. However we also understand where there are such suppliers they could use their monopoly position to ransom preferential treatment. We consider these proposals to be reasonable.

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

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Developing a Flexible Restructuring Plan

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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?
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.

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☐ Yes ☐ No
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Comments:
Questions

Name: Philip Hertz

Organisation (if applicable): Clifford Chance LLP

Address: 10 Upper Bank Street, Canary Wharf, London E14 5JJ

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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?
Yes, see our response to question 1 in relation to the negative impact on the credit market and cost of funding and availability
The Introduction of a Moratorium

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

We note that the moratorium is aimed at large businesses, and is proposed on the basis that it will provide a gateway to rescue to be achieved either on a consensual basis or via a formal process such as a CVA; scheme of arrangement; or on the basis of a new flexible restructuring plan proposed in this consultation. In our experience, for businesses of a significant size, standstill arrangements are often agreed or already operate as part of the existing intercreditor arrangements. We are therefore not convinced that there is a need to introduce a statutory moratorium.

There have also been instances (although quite rare) where the English court has been amenable to grant injunctions against individual creditors, such that they are not able to derail a restructuring (see Vietnam Shipping [2013] EWHC 1146). This points to the fact that the English system is already equipped to deal with recalcitrant creditors, and can already afford companies protection on a case by case basis.

In the consultation it is suggested that by having a statutory moratorium in place, it would in many cases simply act as an incentive for stakeholders to agree to an informal standstill. In our experience, when businesses are faced with distress, significant stakeholders are likely to already be engaged in finding a solution. In such cases providing a distressed debtor with an automatic statutory moratorium may be considered as providing too much time, and risks losing the natural momentum that occurs. In addition, the existence of such a moratorium may make the UK a less attractive place for financial institutions and lenders to extend credit, especially if the dynamics of the current system – which are well understood by lenders – change in favour of the borrower.

At paragraph 1.39 of the Impact Assessment it is recognised that only a small number of businesses are likely to use the preliminary moratorium, it is suggested to be between 10-20 a year. With a cost saving of £2m-60m and £31m as best estimate mid-point range value. While this may be case, we do not believe that the potential negative effects in having the statutory mechanism, which restricts creditor rights, have been fully considered, in particular on the availability and costs of credit, which will have to be factored in as a new risk associated with any statutory moratorium.

Having said that in a small number of recent cases, the breathing space has been achieved by using schemes of arrangement to extend and amend financial arrangements which arguably could have been achieved more cost effectively. With the introduction of this mechanism, any such savings in those cases would appear to be disproportionate to the impact any legislation would have and would in our view be far outweighed by the damage to the credit market.
We do not believe that it would be in the creditors' interests to put the breathing space on a statutory footing. A statutory moratorium already exists in the form of administration, which in practice rarely results in rescue. We do not think that the preliminary moratorium would have any different impact and the moratorium may itself signal the end of the business, likely causing defaults under finance and other key operational contracts. In addition the limitations and uncertainty placed on creditors during this time (without displacing management with the appointment of an independent insolvency practitioner or court intervention) would have an impact on secured lending which would make the cost and ease of access to borrowing for companies more difficult.

For smaller cases, although it is not envisaged in the consultation that the preliminary moratorium will be much used (as there is already a small company moratorium available) it may be attractive to those businesses as it provides for a much longer period of protection than the 28 days (unless extended) under schedule A1 and may be potentially used in cases where it is not appropriate.

Despite the proposals representing a wholesale shift in the statutory framework, to a rescue/debtor favourable regime, the Impact Assessment seems to suggest that the changes for secured creditors at paragraph 1.35 "are largely clarifications of existing law" and are completely misleading. Having the ability as a secured lender to influence and achieve a restructuring on a consensual basis or using a non insolvency process to implement it is completely different from a regime that is statutory in nature and lacks any flexibility that currently exists. Average familiarisation cost of £0.058m seems inadequate for a proposal which would fundamentally change the corporate restructuring landscape – but more importantly there does not appear to be any account in the Impact Assessment of the negative impact it may have on the UK economy and the pre-eminence of the UK as a financial centre. The effectiveness of the UK as a financial centre will be firmly in focus following the result of the European Referendum and will depend upon an insolvency regime that protects freedom of contract and is essentially investor friendly.

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

We are firmly of the view that the most efficient means for gaining relief is to proceed on a consensual basis, and often the most likely chance of a successful rescue being achieved. Even simply using the threat of statutory intervention over agreed creditor rights appears to be misplaced in seeking a rescue to be effectively imposed on creditors.

For cases of a certain size, it would usually be the case that the debtor would seek professional advice, and would only embark upon seeking a moratorium once the majority of its significant creditors are already on board and where there is already a planned exit to facilitate the continuation of the
business. This may not always be the case and we are not persuaded that the safeguards referred to in the consultation would be adequate where a company has no clear plan and/or the creditors are not already engaged (see further below). In certain cases however, where there is already an agreement in principle and the company needs time to facilitate the implementation of the plan, the simple mechanism of filing the requisite documents at court, with the debtor being obliged to provide certain confirmations and declarations, would seem to be an efficient way of achieving this – but even in those instances (as mentioned above) we are not persuaded that the introduction of a statutory moratorium is a proportionate response.

In cases where the existence of recalcitrant creditors make a consensual deal difficult to pursue, having such a significant advantage for the company could also have an adverse impact on those creditors who were willing to come to the table and for example, grant forbearance for a more limited time, but then find themselves with a 3 month statutory moratorium imposed due to the actions of an individual creditor. In addition as mentioned above, we think that the shift in emphasis and dynamic, may potentially trigger earlier formal insolvencies rather than rescue and would also have a serious impact on the availability and costs of credit in the first place. A dramatic example of this can perhaps be found in Italy with the introduction of the concordato preventivo en blanco procedure which was used for perhaps the first time with SEAT PG and enabled the Italian yellow pages company to shield itself behind a moratorium for an extended period with no clear way forward much to the detriment of creditors and ultimately the company. This has lead to several adverse comments about the Italian system, comments which may apply equally here where a company files for a moratorium without clear direction or plan.

In smaller cases where the moratorium is sought and is perhaps more likely to be contested, putting the onus on the creditor to seek to lift the moratorium may make the process very costly and inefficient. It is unclear whether, for example the court would deal with all creditor applications to lift the moratorium generally. Either way the involvement of the court, whilst providing a necessary safeguard for the creditors, may come at a significant cost and time delay which will have a negative impact on any hopes of a restructuring being achieved.

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

See above our general reservations about the need to introduce such a measure in the first place. In relation to the eligibility tests and qualifying criteria – these require much greater detail and lack a certain clarity for us to be in a position to consider them fully.

We note that there is no proposal to restrict the eligibility for a moratorium according to the size of company yet it is clearly acknowledged that it is not
aimed at the SME market, where a small company moratorium (albeit rarely used), already exists. However, the precise exclusions are not entirely clear from the consultation. At paragraph 7.19 it is suggested that those companies which are excluded for eligibility for a small companies moratorium are also "for the most part" to be mirrored here. However, the reference to companies involved in specific financial market transactions has a footnote that specifically refers to paragraph 3 of Schedule A1 – but not paragraphs 4A – J. In our view, if the proposals for a moratorium were to be introduced, protection for the arrangements which currently benefit from a disapplication of s72 IA 1986 and are included in paragraphs 4A to J of Schedule A1 are required in order to avoid potential rating downgrades; limiting access to the capital markets; increasing funding costs; and obliging investors to sell out their positions. We also note that there is no specific reference to the exclusions including transactions that benefit from the Financial Collateral Arrangement Regulations and currently enjoy a disapplication of the effects of insolvency. Such exclusions are necessary to ensure the efficient functioning of the financial markets and also are designed to strengthen financial institutions own capital adequacy requirements.

In terms of the qualifying conditions, likewise they are expressed in very general terms "likely to have sufficient funds to carry on its business" and "the company must satisfactorily demonstrate…there is a reasonable prospect that a compromise can be reached". There is little detail about how this is to be established, and whilst it may be appreciated that this is a commercial judgement on the part of the debtor – it must be recognised that it needs to be sufficiently robust to provide confidence to creditors and other stakeholders (i.e. suppliers) whose continued support will be required.

It is also not clear from the consultation as to whether the conditions of the verification exercise by the supervisor which occurs "on commencement" (but which relies on information likely to have been provided by the directors) have been met and can be tested or challenged, other than in the general challenge available in the first 28 days.

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We are of the view that the balance between the directors and creditors is too much in favour of the directors. In particular the availability of the moratorium, which is to be achieved without any independent oversight or involvement (the role of the supervisor who is selected by the directors only begins at the start of the moratorium) is potentiality open to abuse. It leaves the onus on either the supervisor or individual creditors to challenge the suitability of the moratorium. It is suggested that the government "may" introduce new sanctions to prevent such abuse – but disqualification after the event will be no comfort at all to creditors who may have been exposed to greater credit risks, as they wait for a court hearing to stop the moratorium in
its tracks. While the court may be able to expedite the hearing, as mentioned above this puts the burden on the creditors (who will already be exposed in terms of credit risk) to the cost of making the applications to lift the moratorium. We think that in order to address this issue if such proposal is to be pursued, a majority of secured creditors should be asked to consent and the filing of that consent should be a minimum requirement to the initial imposition of a moratorium in the same way that it is suggested to be a requirement of any extension in terms of the cessation of the moratorium. It is also unclear as to what the position would be in terms of any loss or increased loss if a workout is not achieved and a formal insolvency process ensues.

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

While having the statutory moratorium fixed for an initial 3 month period may provide valuable breathing space for the debtor, given the lack of creditor involvement it may in some cases be too long a period from a creditor's perspective. Creditors would then be reliant on making a challenge in the first 28 days, at their own cost. In terms of the extension, where creditors are in agreement we think that this is appropriate, but we do not consider that having a total moratorium for a period of more than 6 months would be beneficial to either the company or its creditors. It also appears that there will be little risk to the directors in terms of personal liability and the cost of the failed rescue will rank as an expense, diminishing the value of recoveries to unsecured creditors, including preferential creditors (i.e. unpaid employees) and those with the benefit of floating charge security.

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

From the brief details provided in the consultation, it appears that the supervisor will perform a monitoring role only. While we think that the nature of the role may be suited to a turnaround specialist or insolvency practitioner, we are uncertain that other professionals with more general qualifications would be suited to the role – it is unclear what is envisaged by way of "certain minimum standards". No reference is made as to the level of restructuring expertise required, nor is there any reference to the supervisor's duties and to whom they are owed, and if there is a breach, what remedies are to be available. The question also refers to the powers of the supervisor, which appear to be limited, to (i) applying for the discharge of the moratorium when the conditions are no longer met; and (ii) the right to attend meetings; request information and sanction "non ordinary course transactions". The proposals recognise that the CVA is little used at present, and suggests one of the reasons for this is the onerous responsibility being placed on the supervisor – but then this seeks to use a similar approach for the standalone moratorium with the supervisor monitoring the debtor on a continuous basis – and acting, if the qualifying conditions are not met, to terminate the moratorium. This doesn't seem to be a sensible approach.
There may be circumstances where a supervisor is a useful officeholder to employ – for example if recognition of the moratorium is required overseas (Chapter 15 Bankruptcy Code requires there to be a foreign proceeding and foreign officeholder, albeit a director could fulfil the latter requirement.)

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

There is little information about how these costs are to be assessed (if at all) and by whom. As such they have the potential to erode the creditors' interest entirely.

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

We think that the rationale that creditors have access to information to enable them to make informed decisions in relation to a restructuring are sensible. We would however be concerned that dealing with requests for any information (not related to the rescue or its effects on third party interest) could add to the time and costs of the process, and prove to be a distraction from the rescue process. We think the supervisor should be able to exercise his discretion in relation to what is provided and how it is disseminated to creditors in the most time and cost effective way.

Helping Businesses Keep Trading through the Restructuring Process

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

We are not persuaded that the continuation of essential supplies will result in a higher number of rescues and continuation of businesses. It seems to us that if you need to rely solely on a statutory provision imposing the supplies which are essential to your business to continue, this appears to be an unsound basis upon which a business should be continued.

We are of the view that the approach is too favourable towards the debtor, in the same way as the moratorium puts the onus on the creditor to challenge the designation.

Essential to the rescue

Most well run businesses do not indulge in the purchase of non-essential supplies, so unless it is decided that it as part of the rescue, certain aspects of the business are not going to continue, there is a potential that all suppliers will be considered essential and that each supplier would then be obliged to continue with the supply arrangements under the approach provided for in the consultation.
**Alternative supplies**

The suggestion that the debtor must consider whether an alternative supply can be found within a reasonable timeframe, will in most cases, be an easy conclusion to reach, as new suppliers will be put on notice that the debtor is in distress and will be unlikely to wish to take on such risks absent commercial incentives being provided.

**Business to meet payments as they fall due**

While the formal procedures will have some measure of independent assessment, in the preliminary moratorium, the supervisor will be completely dependent on the debtor's assessment. Even in cases where the debtor or officeholder approaches the assessment in an appropriate manner, the business may not always have sufficient funds to meet the payment. Suppliers therefore who have been obliged to continue to supply against their wishes and potentially be exposed to a credit risk that they never wish to accept, will at that stage, have little recourse or hope of recovering compensation for the supplies provided. Is it envisaged for example that the directors or the supervisor provide some guarantee in this respect?

A further imbalance between suppliers and the debtor may manifest itself in the existing rights of those suppliers i.e. for arrears potentially being subject to a later cram down under the restructuring plan – although the consultation anticipates that the supplier of goods or services would need to be in agreement for it to be successful – it may not be possible for the supplier to refuse to supply at the outset unless they are successful in challenging the designation at court. Presumably therefore, if the "essential" supplier can show that he would not support the ongoing business – the chances of rescue cannot be reasonable. If this is the case and it is accepted by the court, then the power to designate essential contracts would seem to be ineffective and a rescue ought not to be able to be pursued.

There is nothing in the consultation that provides for the debtor to reject non-essential contracts, presumably those contracts which are not designated, follow the pre-agreed terms including the ability to terminate but not allowing any enforcement in respect of any arrears?

In terms of the ability to designate any contract as essential, it is unclear as to whether this would apply only to supply contracts for goods and services or whether it is also intended to include other contracts, in particular contracts which provide for finance. We consider that there should be an express exclusion of financial contracts from any threat of designation as an essential contract, this is because the effectiveness of provisions which allow for termination are essential in the context of financial market transactions and in particular have a significant impact on a bank's own capital adequacy requirement.

Generally speaking we are of the view that the designation criterion is too subjective and clearly favours the debtor and this will necessarily put the
supplier at a disadvantage. We note that there is an attempt to redress this balance as the debtor is also to consider whether a supplier can objectively refuse.

Whilst the consultation recognises that preventing the use of ipso facto clauses interferes with the right of the freedom to contract, it would also, given its potentially wide application create a significant amount of uncertainty and unpredictability. Such uncertainty and unpredictability may affect the approach to supply agreements and result in additional cost as the uncertainties are factored in as unquantifiable risks. It is therefore likely that such risks will have an impact on the cost of and availability of credit insurance. In the Impact Assessment at paragraph 1.74 it is recognised that estimating the number of suppliers that will have to pay additional insurance costs is difficult to assess. The best estimate however, seems to be predicated only on the number of cases to which the designation of essential contracts may apply, thought to be between 30-80 cases with a £2.7m best estimate mid point range value. Assessing the cost in this way appears not to recognise that the effects of such provisions may affect all credit insurance and not just those companies which have been subject to a rescue or restructuring.

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?

The supplier’s availability to challenge the designation as non essential does not in our view represent any safeguard at all in relation to an assurance that they are to be paid. Seeking the court’s approval to each contract designated as essential appears to be the only mechanism for having an independent assessment carried out in relation to the business being in a position to meet its payment obligations. We think that suppliers will apply to challenge the designation almost as a matter of course, which will result in a significant amount of litigation and as such have the potential to disrupt the rescue and add to the costs and delay even if the rescue remains feasible.

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?

We are not convinced of the need to introduce a further procedure either as a standalone process or by way of extension to an existing process. In fact the information provided in the consultation as to what a restructuring plan would comprise of, broadly follows the existing scheme of arrangement. One of the key advantages of the scheme is that it is not an insolvency procedure, nor is it included in the insolvency legislation, and as such it does not attract the negative association and potential stigma that may attach to the more formal insolvency procedures. This of course would not be the case with what is envisaged under the consultation as the restructuring plan would be
within the insolvency legislation. We appreciate that given the fact that other jurisdictions are promoting pre-insolvency and restructuring procedures, that stigma may over time become less of an issue; although it could also be said that the administration process was similarly intended to promote rescue and has not in practice had this effect.

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

Notwithstanding our views expressed so far, that we do not necessarily consider that the case has been made out for a further restructuring procedure to be developed, we are in agreement that should such plans be promoted, the introduction of a cross class cram down mechanism may, in some limited cases, be useful. The consultation suggests that where a class is to be crammed down additional minimum thresholds are also to be met. Those thresholds are not entirely clear from the description provided in paragraph 9.20.

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

We think that the proposed safeguard and in particular the conditions to be taken into account are reasonable, save that instead of all creditors being "no worse off than in liquidation", we would suggest that this is broadened to include the most likely alternative to the restructuring, as is currently the approach by the court in the context of a scheme of arrangement. We consider that the safeguards which ensure that the secured creditors are granted absolute priority of the repayment of their debt will be welcome, and suggest that junior creditors do not receive any payment until those senior to them have been satisfied.

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?

No, in the context of schemes of arrangement, there have only been a small number of cases that have been considered (mostly on an obiter basis) by the court in this respect, this tends to suggest that such issues will be the subject of negotiation rather than challenge before the court. Imposing a minimum value, would in our view simply give rise to more litigation on this issue.
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?

We do not consider that the consultation and the supporting Impact Assessment makes a good case for the introduction of rescue finance. In this regard, the current approach to providing finances – either by using funds subject to the floating charge or seeking further funding (usually from existing funders), work sufficiently well in cases where there is a genuine potential to rescue. The introduction of rescue finance to share in the existing security rights will create additional risks for lenders and will also be something that will inevitably result in additional costs and difficulties in companies obtaining credit in the first place. We appreciate that the model proposed follows the mechanism used in Chapter 11 of the US Bankruptcy Code, however the provision of finance in the UK and security rights are in our view not conducive to the same approach. In fact we note in a recent report on Chapter 11, published by the American Bankruptcy Institution in December 2014, that the effectiveness of this aspect of the reorganisation process, in addition to the approach to valuation, was questioned. In addition, seeking to impose new rescue finance on existing secured creditors, even with the safeguards proposed, appears to be thwart not just with practical difficulties – how is the existing charge holder going to be adequately protected? Is there to be a reallocation of assets between the existing and new lenders? What happens if the valuation turns out to be wrong or the value fluctuates? Who bears the risk that the secured creditor has been prejudiced? Where there is no insolvency practitioner is it the debtor or the supervisor who has to satisfy the court that security is required? This is also likely to be a very contentious area, with the potential for significant litigation.

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

We do not consider that the valuation of charged property at the start of the restructuring will provide sufficient protection at all. Especially given our comments in 15 above.

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

It is unclear what is being suggested here. In terms of rescue finance, it appears from paragraph 10.24 that this relates to additional finance, but the detail of those paragraphs do not suggest that the additional finance will get any "super priority". We had understood that super priority would only apply in relation to costs incurred in the rescue process (i.e. not rescue finance) and would be treated in a similar manner to those now treated as an expense in a formal administration regime.
**Impact on SMEs**

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

We do not think that the proposals will necessarily ensure more rescues or better recoveries in the SME market. In fact we think that the potential adverse effects of such proposals being introduced would have a negative effect on the credit market in terms of access to and availability of credit and diminish their role in the UK economy.
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
Dear Sirs

“A Review of the Corporate Insolvency Framework”: Consultation Response

We enclose our response to the “Review of the Corporate Insolvency Framework” consultation (the “Consultation”).

We wish to make a small number of observations concerning the matters the subject of the consultation that are not the subject of specific questions contained in it.

Brexit

Since the date of the Consultation, a majority of the people voting in a referendum have voted for the United Kingdom to leave the EU. While the timing and outcome of negotiations are uncertain, we consider that, if the United Kingdom were to lose the benefit of the reciprocity provided by the EC Regulation on Insolvency Proceedings 2000 (“EC Regulation”), this would cause significant damage to the United Kingdom’s position as a highly regarded jurisdiction for restructuring. The United Kingdom benefits from having all of (a) the legacy Commonwealth co-operation afforded by s426 Insolvency Act 1986, (b) the cross-border collaboration provided by the adoption of the UNCITRAL Model Law and (c) the cross-border collaboration provided by the EC Regulation. The United Kingdom has become a favoured destination for cross-border European restructurings and every effort should be made to protect this position.

Therefore, we would strongly argue that it should be a priority for the UK Government to seek “third country equivalence” for the United Kingdom in connection with the EC Regulation (and all other

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European cross-border insolvency legislation) as part of any exit negotiations. This issue should be given priority over any other changes to insolvency legislation.

**Scope of the Consultation**

We are concerned that there has been insufficient consultation with all stakeholders that could be affected by the proposed changes. In particular, we note that no banks have been directly consulted nor any industry bodies concerned with major infrastructure projects. In this regard, proposals to:

- further restrict security rights enforcement;
- permit restructuring finance with priority to existing secured debt; and
- prevent ipso facto termination of “essential supplies” without limitation as to what those “essential supplies are”,

would constitute fundamental changes to English property and contract law, which should be the subject of further and wider consultation. Part of the reason that the United Kingdom has a highly respected insolvency regime is that changes have been introduced gradually, built on legislation reaching back over 150 years. A move towards a US-style regime should not be introduced without careful consideration of the differences in the historical and legal framework.

**Role of the Courts**

The proposed restructuring tool borrows elements and concepts from the United States’ Chapter 11 and equivalent regimes in other jurisdictions. However, all of these jurisdictions have a far greater degree of court oversight of actions by the insolvent debtor than has historically been the case in the United Kingdom or is proposed in the new regime. The English courts do not, as a general matter, make or approve commercial decisions, nor do they have the funding resources to be able to do so. In the context of insolvency, creditor protection has been provided by ensuring that the officeholder is an officer of the court and an Insolvency Practitioner.

Therefore we consider it essential that any new officeholder (such as the supervisor) is an Insolvency Practitioner and has a proper level of control over the actions of the insolvent debtor.

**Schemes of Arrangement**

The proposals for a new restructuring tool seek to introduce additional insolvency law elements to the laws around schemes of arrangement, when used in connection with an insolvent company. As noted in the Consultation, schemes of arrangement are highly flexible, and respected, restructuring tools and have a high degree of recognition internationally. We would not support any proposal that introduced additional hurdles or regulation to the use of schemes of arrangement.

We would be happy to be involved in any further consultation on these matters.

Yours faithfully

[Signature]

CMS Cameron McKenna LLP
A Review of the Corporate Insolvency Framework response form


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

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: Cara Savar

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Address: Cannon Place, 78 Cannon Street, London, EC4N 6AF

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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?

In principle, and subject to the proposed eligibility and qualifying conditions being met and signed off by an appointed supervisor who is an insolvency practitioner (and thus an officer of the court), yes. An effective preliminary moratorium of the right length would allow a company which is in financial difficulty “breathing space” in which to attempt to agree a rescue or restructuring plan with its creditors as opposed to entering into a formal (and potentially more costly) insolvency process. We would anticipate that the introduction of the preliminary moratorium would replace the need for rolling notices of intention to appoint administrators in order to obtain the interim moratorium as a precursor to administration. Further thought needs to be given to the interaction of these two processes.

However, we do not agree that such a procedure should apply to all types of business: we note that there are some proposed exceptions but in our view these are not sufficiently wide. For example, we do not consider the moratorium should apply to those types of entity to which an exception applies under Sections 72B to 72GA Insolvency Act 1986, or where a special regime applies.

A balance needs to be struck between the rescue of the business and the interests of its creditors. As noted in our covering letter, some of the proposals would have fundamental effects on key points of law and so should be subject to further careful evaluation.

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?

Yes – we consider the “out of court” filing process for the preliminary moratorium as opposed to an “in court” application requiring a hearing to be the most efficient process for gaining relief for a business. However, this process can only be credible where the supervisor is an insolvency practitioner (and thus an officer of the court), who is charged with the responsibility of signing off the directors’ application to court to confirm that the eligibility test and qualifying conditions for the preliminary moratorium have been met by the company.
To the extent that any creditors claiming that their interests are not protected seek to dissolve the moratorium, it is appropriate for such relief to be sought from the court.

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

For the most part, yes. However, if secured creditors’ enforcement rights are to be suspended during a preliminary moratorium, we would suggest that the company reaffirms its obligations/covenants to preserve the secured assets during the preliminary moratorium.

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?

For the most part, yes. However, we make the following comments:

(i) the qualifying conditions and exemptions which apply during the preliminary moratorium could conflict with each other. For example, it is a qualifying condition that the company must be able to meet its current obligations as they fall due and any new obligations that are incurred, but at the same time it is proposed that directors would be protected from any wrongful trading claims under section 214 of the Insolvency Act 1986. If the directors comply with this qualifying condition during the moratorium there is unlikely to be a breach of section 214; if they fail to comply they should be liable to the provisions of section 214;

(ii) for the reasons outlined in (i) above, we consider that the directors should remain potentially liable under section 214 during the period of the moratorium;

(iii) it is proposed that the supervisor’s role will be to ensure that the qualifying conditions continue to be met; and where they are not met the supervisor will make the creditors aware and report to the court. It is also proposed that to ensure that the supervisor has proper oversight he “should be able” to attend board meetings and request information from the directors. We take the view that the supervisor’s powers in this regard need to go further to ensure that the preliminary moratorium is both transparent and effective. In order to achieve this it will be imperative that the supervisor engages fully in the business of
the company during the preliminary moratorium such that there should be no board meetings without the supervisor's attendance nor major decisions made without his/her agreement. Accordingly, it should be obligatory for the supervisor to oversee board meetings and for the directors to provide the supervisor with information he requests within a reasonable time frame. In addition we question whether a supervisor would be prepared to take an appointment without being granted proper control over the actions of the insolvent debtor. We note that in many jurisdictions with a similar regime, the supervisor has joint control of all decisions with the management of the insolvent debtor.

Please see our response to Question 3 above also.

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

In some respects, yes. Where a moratorium has the support of an insolvent debtor’s secured creditors, three months would represent a reasonable period for a restructuring. Where a secured creditor does not support the restructuring process, a three month process would merely permit the insolvent debtor to delay and frustrate the proper commercial aims of the secured creditor.

Further, where a moratorium is followed by an administration and the duration of the administration is required to be reduced proportionately, this could be impractical. An administration that follows on from a moratorium may be extremely short and will likely need to be extended by secured creditors’ consent or the court as appropriate.

It is not entirely clear from the proposals whether the rights of any secured creditors e.g. the right to appoint an administrator, following a termination or cessation of the preliminary moratorium will continue unfettered. We would suggest that the rights of secured creditors should continue unfettered once the preliminary moratorium has been terminated or has ceased. Having already abolished administrative receivership in most circumstances, derogation from such rights would conflict with a secured creditor’s fundamental right to exercise its security rights under English law.

It is proposed that where the company enters a formal insolvency process following a preliminary moratorium the insolvency practitioner who had previously acted as a supervisor would be prevented from taking the appointment. We appreciate that the rationale for this proposal is to ensure that the supervisor acts independently and avoids potential conflicts of interest during the preliminary moratorium. However, on a practical level, this is likely to result in a duplication of cost as the proposed administrator or
liquidator will need to carry out a significant amount of preliminary work before agreeing to take an appointment, and is unlikely to rely on the work carried out by a supervisor.

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

The qualifying criterion for the supervisor to “have relevant expertise in restructuring” is subjective, unclear and insufficient. The supervisor’s role will be critical in protecting not only the interests of the company but interests of creditors, including secured creditors whose rights are to be restricted during the period of the moratorium. This is an area where the skills and experience of an insolvency practitioner will be required. An insolvency practitioner is subject to a professional regulatory regime and is an officer of the court – this gives additional protection that the statutory duties incumbent on the supervisor will be observed. Accordingly, the qualifying criteria for the supervisor should require that the supervisor is a registered insolvency practitioner.

We would suggest that the preliminary moratorium is modelled on the moratorium available in an administration in order to achieve the same level of credibility and transparency of the process.

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

Yes, on the proviso that creditors should be able to monitor the costs incurred during the preliminary moratorium and contest any costs they deem to be extortionate. Creditors should have the right to apply to court to contest any costs they deem inappropriate.

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

We agree that creditors should be allowed to make reasonable requests for information; however the right to request and obtain information needs to be considered in the context of any legal requirements on sharing such information e.g. data protection and confidentiality requirements which may need to be observed, and on a cost/benefit basis to the extent that the information requested is not subject to such requirements.

If the purpose of the preliminary moratorium is to allow the company “breathing space” in which to attempt to agree a rescue or restructuring plan with its creditors within a three month period, dealing with requests for information may prove cumbersome and, therefore, counterproductive to this
process if such requests over burden the supervisor. Accordingly, we agree that the provision of information should be subject to certain exemptions and criteria for “permitted disclosures” should be set out.

In order to ensure transparency of the preliminary moratorium process, creditors should be able to ask the supervisors questions and we suggest that consideration is given to periodical electronic reporting to the creditors by the supervisor. We anticipate that much of the information requested by creditors could be captured in the supervisor’s report.

The more restrictions that are placed on the information to be made available to creditors, the more important it is that the supervisor is an insolvency practitioner subject to a professional regulatory regime and an officer of the court.

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?

The criterion appears to be sufficiently broad to capture what could reasonably be considered to be “essential contracts”. We anticipate that the continuation of essential supplies would certainly improve the probability of a rescue of the business, but we cannot say with any certainty that it will result in a higher number of business rescues. However, we consider that the negative effects of requiring continued supply should be further considered: many complex structures using English companies are currently in place that rely on the traditional rights of termination for insolvency under English law. Any changes to that regime will have far-reaching consequences and it should be considered whether it would be right to exclude its effect on contracts already in place at the time of introduction of any new regime. We appreciate that this would materially delay the benefit of any restructuring regime but it may provide a proper balance between the commercial expectations of the parties at the time they entered into the relevant contract and the desire to achieve a greater number of business rescues.

We make two key observations with regard to the proposals for essential contracts:

(i) the proposals will undoubtedly have wider consequences than simply protecting companies in financial difficulty; the suppliers under contracts which are deemed essential might be affected in
circumstances where they no longer wish to supply the company and, therefore, require to contest the designation of their contract as essential before the court. Should the proposals come into force suppliers will likely seek insurance (at an additional cost to their business) to protect against this risk. Please see our response to Question 10 below also; and

(ii) those suppliers with the benefit of a retention of title clause would have their contractual rights permanently affected as they would be prohibited from getting their goods back in circumstances where the contract is designated to be essential. In this respect, we would suggest that the proposed supervisor or administrator should be under an obligation to provide alternative financial protection for a retention of title creditor.

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?

In the main, yes. However, it should be borne in mind that, to the extent that the automatic designation of contracts as “essential contracts” by the directors/officeholder is contested by a supplier, an affected supplier would need to incur the cost of making an application to court to challenge such designation. Accordingly, suppliers will likely need to seek insurance products (at an additional costs to their business) to protect against this risk.

It is not entirely clear from the proposals, but we anticipate and would welcome confirmation that contracts for the supply of goods and services which are deemed essential to the business will be distinguished from other contracts or licences which may be fundamental to the business e.g. joint venture agreements or operating licences which may lapse on insolvency.

If the definition of “essential contracts” is so wide that it applies not only to supplies (such as paper and car parts, as referenced in the Consultation) but could also apply to the key contracts governing the business of an entity (for example a joint venture agreement or a construction contract for an SPV), further consideration should be given to the exemptions from application of the regime, such as major projects.
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?

We would suggest that the restructuring plan is designed to be a standalone procedure such that the traditional CVA remains an option available to businesses.

We take the view that the restructuring plan should not be an extension of a Scheme of Arrangement as it is critical that a Scheme of Arrangement does not become an insolvency process for the purpose of the EC Regulation (or any equivalent adopted by treaty following Brexit) - we anticipate that the restructuring plan would constitute an insolvency process for the purpose of the EC Regulation (or any equivalent adopted by treaty following Brexit).

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

Yes, on the basis that the court will have the power to reject a plan if it is not fair and equitable, particularly vis-à-vis creditors who are subject to the cram-down mechanism.

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

Yes – please see our response to Question 12 above.

We recognise that any creditors or shareholders who disagree with the court's decision to declare the plan binding on them will have the right to appeal to the court, which will necessitate further costs for the dissenting creditors/shareholders.

On the basis that a Scheme of Arrangement offers more flexibility we question how much the proposed flexible restructuring plan would be used in practice.

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?

Yes, we agree that a minimum liquidation valuation would be appropriate in these circumstances.
Rescue Finance

15) Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. As noted in the Consultation, where secured creditors consider it is in their interests, sufficient funding is usually provided and officeholders have the ability to use floating charge recoveries to repay such funding. The current regime has the effect of protecting the interests of existing creditors as a whole. A rescue finance regime that permits priority security can have the effect of protecting the company and benefitting its new rescue creditors at the expense of existing creditors. In order to promote not only rescue but successful and sustainable rescue, we suggest that the existing secured and unsecured creditors are those best placed to determine whether further funding should be provided or whether it would constitute "throwing good money after bad".

We therefore take the view that an enforced unilateral elevation of a rescue finance provider’s security such that it ranks ahead of or alongside an existing charge holder’s security would undermine English law security concepts in an unnecessary manner and with damaging effects. In the event that this proposal is sanctioned, it will undoubtedly affect the way lenders to businesses assess risk and the cost of credit will increase in order to factor in this risk. This will in turn have a negative cost consequence for all businesses seeking credit. Given the risk to companies from Brexit, we question whether changes that would have an impact on the availability of credit are advisable at the current time.

Considering all of the above points, we take the view that the treatment of rescue finance in the new regime should be analogous to that in an administration, but should be sanctioned by the supervisor (who should be an insolvency practitioner).

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

For the reasons set out in our response to Question 15 above, we oppose the proposals regarding super priority for rescue finance providers and, therefore, make no comment in respect of this question.

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

Please see our response to Question 16 above.
Impact on SMEs

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

The Government could consider promoting the recovery of SMEs, which are in financial difficulty or subject to a preliminary moratorium, restructuring plan, administration or CVA, by granting all or any of the following:

- Corporation tax relief;
- VAT relief;
- Suspension of PAYE and/or employee national insurance contributions; and
- Suspension of business rates.
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.

No.

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
A Review of the Corporate Insolvency Framework response form


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

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: James Wright

Organisation (if applicable): Co-operatives UK

Address: Holyoake House, Hanover Street, Manchester, M60 0AS

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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?

1.1 We agree that a preliminarily moratorium would be beneficial. It will provide more space and incentives for actions aimed at saving potentially viable businesses.

1.2 We anticipate that government plans to introduce this moratorium for UK businesses with an amendment to company law. But for it to be available for all business government will need to take additional steps to provide this moratorium for co-operative and community benefit societies (collectively referred to as ‘societies’). These are mutual businesses registered under the Co-operative and Community Benefit Societies Act (2014), a distinct legal framework that it is too often overlooked and under-maintained. Failure to make such a provision will add to existing disparities between the company and society legal frameworks.

1.3 Thought should also be given to building societies and friendly societies, which also have distinct legal frameworks. Credit unions have a legal framework which is in part attached to that of co-operative and community benefit societies.

1.4 There is no logical reason for not applying a preliminary moratorium to societies and other mutuals. It would be in the interests of good government to ensure that it is applied across all legal forms.

1.5 Responsibility for the Co-operative and Community Benefit Societies Act sits with HM Treasury, not the Department for Business Innovation and Skills (BIS), so some cross departmental collaboration is likely to be required.

1.6 Section 118 of the Co-operative and Community Benefit Societies Act (‘Power to apply provisions about company arrangements and administration’) gives HM Treasury the power to apply new insolvency provisions for companies to societies. Meanwhile Section 134 of the Co-operative and Community Benefit Societies Act (‘Power to amend this Act to assimilate to company law’) gives HM Treasury a more general power to assimilate useful changes government makes to company law. We believe these sections provide government with a straightforward means of applying a moratorium to societies through secondary legislation.¹

1.7 The Insolvency Service, BIS and HM Treasury should work together to ensure a preliminary moratorium is provided for under the Co-operative and Community Benefit Societies Act.

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?

4.1 Government should note that while the preliminary moratorium should certainly be provided for co-operative and community benefit societies, these businesses make use of a special form of equity capital that will require specific attention.

4.2 Societies issue something called ‘withdrawable share capital’ which provides equity for the business but can under normal circumstances be withdrawn by shareholders at par value. The right to withdrawal is not absolute and a society can impose restrictions and how and when capital is withdrawn, including a total suspension of withdrawal rights.

4.3 Society directors have a duty to act in the interests of the society and its members, and in practice this includes taking the decision to limit or suspend withdrawals if needs be. It would clearly damage the interests of creditors and the viability of the business if a board failed to take such action and the triggering of the preliminary moratorium acted as a signal for shareholders to withdraw their capital en mass.

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?

8.1 While the interests of creditors are clearly vital in the insolvency process, the interests of the members of co-operatives should also be considered. Members democratically own and control the business and derive benefits from its activities. Crucially members’ primary stake in their co-operative is not financial, so they must be considered differently to shareholders in a company.

8.2 Thus supervisors should also be required to make information available to the members of a co-operative or community benefit society.

**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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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?

There is growing interest in the UK in enhancing the role of employee and management buyouts in recovery strategies. It is widely accepted that employee buyouts are most likely to be effective in SMEs. Thus we suggest that the insolvency tools available should be calibrated so as to improve the chances of a successful employee or management buyout for SMEs in particular. This will require employees to be recognised as an important stakeholder group in insolvency processes; to be kept informed and to be given opportunities to play an active role in restructuring and rescue.
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 ☒

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☑ Yes        ☐ No
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Comments:

Achieving a top 5 ranking in the World bank ratings is not the only appropriate driver for change to the current UK insolvency regime, which as the Right Honourable Minister ("the Minister") acknowledges, "is already highly regarded". To balance the view expressed in the Executive Summary (that many of the basic insolvency procedures have remained largely unchanged since 2004), the UK insolvency regime has been the subject of recent and significant change over the
past six years, with the introduction of measures designed to speed up processes, reduce costs, improve transparency and to better inform creditors and equip them to exercise control over fees and costs.

We agree that some elements of the proposed reforms might, in principle if not substance, be desirable; a moratorium for example. However, we do not consider that any of the proposed reforms are either necessary or, given the current political and economic instability in the aftermath of the decision to leave the EU, appropriate at this time. In particular:

1. There are already, as the paper recognises, a number of mechanisms through which a distressed entity can seek to restructure its debts, with or without the shelter of a moratorium, notably consensual informal restructuring work outs, Schemes of Arrangements (‘Scheme/s’), Administrations and Company Voluntary Arrangements.

2. Where these processes “fail” (i.e. the outcome is closure/wind down rather than rescue) the cause of that failure is not simply attributable to shortcomings in the restructuring mechanism employed or lack of available funding. Rather it is more likely to be a reflection that the distressed entity was no longer viable. Similar views were expressed in the 2009 BIS Consultation on Encouraging Company Rescue.

3. We consider it unlikely that the introduction of additional rescue tools will in itself facilitate business rescue. Rather, a more holistic approach is needed to also look at why business leaders and managers facing distressed situations will typically fail to act in time to enable the business to be rescued, particularly in the SME sector. Measures could then be considered to encourage them, whether by incentive (such as is suggested at paragraph 7.34) or sanction (for failing to act in time to permit a rescue, such as may happen in France/Germany), to act earlier in recognition of debt problems, and whilst they still have the support of lenders/key stakeholders. This will generally mean, whilst there is still available headroom for any additional lending/security for those willing to continue to support the distressed business.

4. We consider it essential therefore that if new rescue tools are to be introduced that there are effective checks and balances to filter out unviable businesses that might otherwise seek to unnecessarily prolong their life only to fail in the near future.

5. We consider that any proposals concerned with altering the priority rights of secured lenders should be the subject of further consultation with those providers not least to assess the potential detrimental impact on the capital
market for raising funds both as regards availability and cost of lending, specifically to the SME sector.

Questions

Name: Nick Edwards

Organisation (if applicable): Deloitte LLP

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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?

We are supportive in principle of the introduction of a moratorium which should be accessible by all corporate debtors facing insolvency or financial crisis, regardless of size, other than excepted financial institutions. However, this must provide a fair balance between supporting the debtor and having adequate protection for the various stakeholders.

There are already a number of mechanisms through which a distressed entity can shelter behind a moratorium while it formulates a restructuring or exit strategy. Each of these have their own advantages and disadvantages:

- The Schedule A1 moratorium: Provides extensive protection but is little used. This is in part because it is limited to small companies and also, in our view, because it carries disproportionate risk of personal liability for the insolvency office holder in the form of the paragraph 27 provisions.
- Consensual restructuring through informal (i.e. non statutory) creditor work outs. These tend to focus on the restructure of secured debt and be restricted to larger business entities, seeking only to restructure on a consensual basis with sophisticated creditor groups. Cost potentially rules this out as an option for SMEs. Such workouts often utilise a combination of a Scheme and/or CVA to implement any such restructuring (we note neither process offers a moratorium) and the negotiations are often reliant on consensual standstill agreements with lenders. While these work in practice they lack the certainty of an automatic or statutory stay without which they will have little relevance outside of a restructuring amongst lenders/shareholder groups or specific constituencies, such as landlords.
- Filing a notice of intention to appoint (“NIA”) an administrator under paragraph 26 Schedule B1 has the effect of creating a stay of up to ten days, which can be extended on application. It can be used by a company of any size provided it is or is likely to be insolvent. However, it is generally a gateway to administration, the aim of which is rarely to save the business but rather to achieve better outcomes for some or all creditors.
- Schemes: Have the added flexibility of sitting outside formal insolvency procedures but can be both costly and complex with heavy court involvement, which effectively price this procedure out for all but the largest entities. There is no automatic stay, the absence of which may
precipitate or trigger a formal insolvency appointment (CVA or administration). However these procedures are predominantly used for cross border entity structures where various other jurisdiction insolvency law protections are also obtained.

Overall we agree there is scope for a new moratorium process but note the following concerns and observations:

• There is currently insufficient detail to provide anything other than high level comment. If a new moratorium is to be developed it will require more substantive proposals and a further consultation.

• It may be more beneficial for the primary purpose of the moratorium to be the delivery of already formulated or at least part formulated proposals rather than to provision of a breathing space in which to explore options (as is suggested at paragraph 7.10). It is our view that in all but the most extreme of instances (say where there has been a catastrophic event impacting an entity’s business/value) the application for a moratorium should in addition to the matters set out in this paper, be accompanied by a statement of proposals which have been reviewed and ‘supported’ by an insolvency practitioner, the latter acting as “nominee”. This would also align to a shorter period of say 21 or 28 days, extendable on application by a further 21/28 days for the moratorium. It would in addition ensure that the debtor company was able to provide immediate and clear information to the stakeholders, effectively a “scheme – lite” explanatory statement.

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?

Yes. The filing provides clarity for the debtor by fixing the point from which the clock starts to run in terms of length of moratorium and evidencing formal entry into the process.

Filing will also provide creditors with a forum through which objections (subject to meeting criteria) can be aired and if necessary court intervention triggered, including an ability to bring the moratorium to an end.

Where, as is suggested, the court is merely a filing repository at first instance (i.e. will not, as in Chapter 11 proceedings, review or have the power of veto), consideration would need to be given to safeguards against abuse of process. We have suggested one such measure in our response to Q1 (that the application must be accompanied by proposals that have been reviewed and “supported” by the IP appointed to act as nominee). In their paper “A Moratorium for Businesses;
A Review of the Corporate Insolvency Framework: a consultation on options for reform

Improving business and job rescue in the UK “ published in April this year

R3 have suggested that the applicant directors should be required to make a statutory declaration (thus mirroring notice of intention to appoint an administrator under paragraph 26 Schedule B1) as part of their application, which would expose the directors to punitive sanctions if the process was abused and with which we concur.

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

We agree that there should be eligibility criteria/conditions.

However, the proposal at 7.21 to 7.24 is not sufficiently developed to enable a view to be formed other than we agree that there should be evidence of ability to fund/pay as it goes for the period of the moratorium. As to other conditions, these would need to include some form of insolvency/near insolvency statement, and be supported by further measures such as inclusion of a proposal document, independent scrutiny of the proposals by a nominee and sanctions for those who make false/misleading applications.

There would need to be sufficient measures so as to provide the requisite degree of assurance to creditors that there was a reasonable assumption of the stated objective being achieved (as set out in the proposal document) which should in turn reduce the likelihood of court applications to challenge the moratorium as provided for at paragraphs 7.25 to 7.27.

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We agree that the moratorium should be immediately binding to provide the necessary breathing space in which the debtor can conduct negotiations/options for the restructuring without fear of creditor intervention or supply chain collapse.

We do however consider that further talks should be held with BBA and other lending bodies to discuss whether consent/agreement of secured lenders should be made a condition of application. Alternatively, a Qualifying Floating Charge Holder could be given 5 days’ notice, as in the NIA provisions.
The general right to apply to court (subject to qualifying criteria) would provide sufficient opportunity for creditor challenge and would potentially incentivise the applicant directors to provide timely and transparent information (such as we suggest in the form of a “scheme – lite” explanatory statement – see Q1 response) with notice of the moratorium. We do not agree that the right to challenge should be restricted as is suggested at paragraph 7.25. Creditors should be able to challenge the moratorium at any point as circumstances may change (such as creditor agreement over a restructuring plan) giving valid reasons for a challenge.

Although there are circumstances where it would be helpful to obtain ongoing “essential supplies”, there are numerous legal, commercial and practical difficulties in implementing this. The proposals are currently not sufficiently detailed and there will be complex situations where an objective judgement of a suppliers’ obligation to supply is difficult to reach, for example:

- Where a supplier has ceased to supply a number of days, weeks or months before a moratorium, can that supplier still be nominated as a designated supplier?

- Where a supplier has production difficulties or working capital restrictions which prevent supply, can that supplier still be nominated as a designated supplier? A warehouse fire may, for example be easy to assess objectively, whereas a conveniently lost ‘widget’ which prevents supply much less so.

- Where the supplier’s own supply chain fails to perform, or if supply lead times have been ‘uninvested’ due to concerns over the customer’s credit-worthiness, can that supplier still be nominated as a designated supplier? This is unlikely to be capable of being fixed in the moratorium period.

- Where the supplier has credit insurance for pre moratorium debts are credit insurers going to also be forced to continue lines to suppliers and agree not to benefit from any post moratorium cash flows for goods or services provided post moratorium?

- In addition, the current proposals provide the directors with the ability to define essential suppliers without any independent or objective scrutiny.

- Is it fair to force a supplier to lose more profitable custom if a choice has to be made, where before a moratorium no such enforcement was in place, with matters being decided on a commercial basis?
There will be many difficulties in addition to those outlined above, all of which point to the likelihood that the essential supplier proposals as they stand, would, in practice, prove unworkable.

We believe that there are a number of alternative options for securing business continuity for distressed debtors, which we feel should be explored, such as:

a) a blanket statutory ban on termination with onus on the debtor company to opt out of any contracts before expiration of a statutory time frame; failing which the contracts will be automatically adopted including historic debt (this we realise has cash flow implications);

b) Making it a condition of filing for a moratorium that the proposals (see our response to Q1) identify designated essential suppliers, provide details of the debtor company’s ability to meet payments for the duration of the moratorium and any period envisaged as necessary, and provide confirmation from the nominee that the supply is essential and that it is reasonable to assume that the payments can be met.

c) The R3 proposal that designated suppliers of essential goods/services should be able to refuse unless the directors personally guarantee payment for the period of the moratorium or pay on pro forma invoice basis (see our further comments on this below).

In all of these cases we would also suggest that the process of identifying essential suppliers should be subject to the scrutiny and approval of the incumbent licensed practitioner rather than left in the hands of the debtor and the courts.

We are not clear on the intended sanction or penalty for failure to provide a designated essential supply nor how this might be enforced without involving court/legal process, both of which take time and money and do not deliver the objective of continuing the business.

We agree with the proposal at 7.33 to limit the frequency with which a moratorium can be obtained and note that this would not otherwise rule out an alternative process such as administration within the ‘prohibited’ period.

With respect to the proposals to incentivise directors to use the moratorium process by relieving them from liability under various heads such as wrongful trading, we question whether this is appropriate.
5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

No. See response to 1 above. We consider a 21/28 day period should suffice and strike the right balance between providing a breathing space for the debtor and recognising creditor rights. A longer period would require additional safeguards to protect creditors’ interests and that would entail greater levels of compliance and monitoring and thus increase cost of process. If the objective is to facilitate rescue the process needs to be quick and not unduly complex or formulaic. We also question whether funding for longer periods would be available or whether, should directors be required to guarantee payment to designated suppliers (see Q5 response), directors would be prepared to accept personal liability for a longer trading period.

We do not agree with the proposals for extension. The focus should be on rescue not preparation for creditor meetings. We agree with the R3 proposals for extension, in that this should be limited to a further 21/28 days and made by the directors’ application to the court and supported by witness statement from the supervisor. This latter approach provides an acceptable degree of oversight (independent scrutiny by a regulated IP and subject to court discretion in the form of a refusal if the case to extend is not made). It is essential that adequate provision for notice is developed.

As to cessation we broadly agree with the proposals outlined in 7.38/9 save for the time period referred to.

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

We consider that the nominee/supervisor should be a licenced insolvency practitioner.

The nominee/supervisor should be independent of the debtor company and have had no prior material relationships with same and should not take follow on insolvency appointments as set out at paragraph 7.45

The role of the nominee should be to provide assistance to the company and, similar to a CVA (and also now important in Schemes), provide an opinion as to whether there is a reasonable prospect of avoiding loss/minimising loss/obtaining a better outcome by use of the moratorium rather than other alternatives.
The nominee would become supervisor on filing of the application and would be required to support any application to extend the period of the moratorium. The supervisor should have adequate powers including power to file notice terminating the moratorium on any ground including failure on the part of the debtor company to keep the nominee informed or to meet the eligibility criteria.

Provided the length of the moratorium is restricted to 21/28 days, there should be no need to impose any reporting obligation on the supervisor, other than to issue notice of extension/termination/end of the moratorium. Stakeholders should receive full information to include copy application/summary proposals and copy of the nominee’s opinion at the outset, thus obviating the need for later reports.

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

Yes.

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

We have suggested already that in all but exceptional cases (sudden catastrophic business loss) that there is a mandatory and timely provision of detailed information in the form of proposals and nominee opinion on same. If such measures were adopted this should obviate the need for a statutory right to information such as is suggested here.

However, if such a measure was to be adopted, some clarity would be needed regarding what information might reasonably be requested. Would for example, a designated supplier be entitled to ask to see cash flow projections and underlying assumptions to satisfy that the debtor can pay its way? Or would the nominee opinion suffice?

We are not aware of any need or demand for the proposed extension of such a provision to all insolvency processes. There are already ample measures in place to maximise provision of salient information to stakeholders.

**Helping Businesses Keep Trading through the Restructuring Process**

9) Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?
We support the concept of essential supplies but consider that the definition and any sanctions need to be tightly defined, see our response to Q4 above.

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?

No. If this is a court driven process it will prove too slow, too expensive and unfairly prejudicial to “innocent” third parties deemed to be essential suppliers.

Please see our response to Q4 above which outlines alternative propositions such as that proposed by R3, namely to extend the remit of section 233 and section 372 IA 86 such that the debtors’ business will be supplied provided either the IP or, if a moratorium, the directors, consent to personally guarantee or pay in advance for the continued supply.

**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?

As outlined in our opening comment, we question whether this is needed.

An effective way of delivering this objective could be to enable CVA’s to bind secured creditors subject to the support of 75% by value being in favour (>50% being unconnected)

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

Yes, this is superficially at least, attractive, although it is essentially a re-formulation of the scheme, albeit bringing it into the insolvency regime. In addition, the process as outlined will likely suffer from the same ‘drawbacks’ of a scheme – heavy on time, legal and court involvement and heavy on cost. Thus, if we have a process (the scheme) that works already, do we need this proposal?

We are thus attracted to the proposal but not convinced that it is needed given existing tools. We would perhaps rather see a cram down mechanism being bolted on to the CVA process.

We are also concerned that there are wider implications for UK lending which need further consideration.
13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

Given our comments above at Q 11 and Q12, we are not certain that there is a need for a restructuring plan and thus not able to comment on this question in any detail.

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 cramdowned down onto dissenting classes?

There will generally be a need for at least two bases of valuation so as to enable each constituency to assess their options. Whether break up (ex situ)/liquidation value should be the back stop valuation will depend on the circumstances of the case, it may for example be more appropriate to provide a fair value comparative?

**Rescue Finance**

15) Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. This question is perhaps better directed at the lending community as the proposed measures would likely have far wider implications for lending to UK businesses, not least in relation to requirements under Basel III (e.g. confirmation that a bank holds first ranking security could be impacted by such proposals). Negative comments were received in the BIS Consultation on Encouraging Company Rescue 2009 and these comments are still pertinent. We would note that any proposal that may impact lender security rights in the future may have damaging implications for the willingness of lenders to provide funding to businesses.

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

No comment.

17) Which categories of payments should qualify for super-priority as ‘rescue finance’?
As has been said already it is rare that a viable business will fail for lack of funding, meaning that current lenders/charge holders will generally continue to support a viable business. Conversely, where further support is refused, the decision to do so is typically based on sound commercial judgment that the business/debt is no longer viable/sustainable.

Where that support is not forthcoming and the IP is satisfied that there is no risk to the existing charge holder, we are concerned that the proposals as they stand could result in any headroom being lost in mounting costs if charge holders challenge the IP decision. We would ask that in place of the measures outlined that consideration be given to powers such as afforded to an administrator under paragraphs 70 to 72 could be extended to the IP/nominee.

**Impact on SMEs**

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

There is an inherent tension between restructuring or restarting. The former as we have seen is likely to be facilitated through (and thus ‘tainted by’) an insolvency process such as administration or a CVA and will likely result in years of uncertainty if not eventual failure as the business struggles to go forward, rebuilding bridges with key suppliers whilst making reparation for historic debt. It is not surprising then that restarting through liquidation or a pre-packaged sale are often the preferred route for debt alleviation.

We question whether a moratorium process would impact the SME sector, where typically intervention is taken later in the distress curve, when the business has exhausted all options (including its owner’s own pockets) and is no longer viable. The question is perhaps how to encourage earlier intervention to open up a wider range of options?
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
A Review of the Corporate Insolvency Framework response form


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

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: Helen Smithson

Organisation (if applicable): Ernst & Young LLP

Address: 1 More London Place, London, SE1 2AF

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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?

*We agree with the proposal in principle, subject to safeguards to prevent abuse. It would be necessary for the courts to be sufficiently resourced in order to deal with potentially complex applications and challenges.*

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

*We are concerned that the lack of a court hearing, or indeed any form of judicial review, could lead to significant abuse of the process.*

*We are also concerned that it could be difficult, in practice, to check if a company had entered into a moratorium in the previous 12 months. We suggest that it would be necessary to create a central register, covering all the courts where moratorium applications could be filed, and for the court staff to be responsible for checking the register before accepting a moratorium filing.*

*We suggest, as an additional safeguard, that directors should be personally liable for any debts incurred during a moratorium which has been improperly obtained.*

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

*No – for the reasons set out below.*

*In order to be able to apply for a moratorium, the company must demonstrate that it is already, or imminently will be, in financial difficulty or is insolvent. However, it must also be able to show that it has sufficient funds to carry on its business during the moratorium and be able to meet current and new obligations as they fall due. It could be difficult to meet the eligibility criteria if the company is insolvent or imminently so. We suggest that a better test would be one of prospective insolvency.*

*It is not clear from the consultation document to what extent the company would be required to carry on its business during the moratorium period. Could it close a branch or a business unit, for example?*
It is also not clear to us what “current obligations” would include. For example, would loan or other finance or interest payments falling due in the moratorium period have to be paid? Employees’ claims could also cause difficulty. Would all wages and salaries falling due in the moratorium period have to be paid, even if they related to a pre moratorium period? Similarly, if wages and salaries were overdue at the date of the moratorium would the company be empowered to pay the arrears in order to retain the goodwill and services of the employees?

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?

It is not clear whether creditors would have to be given notice of intention to apply for a moratorium. Under the proposals, once a moratorium is obtained, creditors have 28 days in which to challenge it. We question whether 28 days, without any previous notice, is sufficient time for a creditor to gather the information necessary for an application and to obtain a court hearing.

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

We agree with a 3 month duration, with the possibility of extension. Any shorter period than 3 months would, in most cases, not allow sufficient time for a plan to be developed.

Extension of the moratorium should not require the agreement of all secured creditors. This could allow a minority secured creditor – perhaps one which is ‘out of the money’ – a disproportionate level of influence during the restructuring negotiations. We suggest that the majority should be 75% in value of total debts held by secured creditors.

If the proposed restructuring is only of finance debt, it should not be necessary to obtain the approval of non-financial unsecured creditors to an extension of the moratorium.

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

No.
We see the role of the moratorium supervisor as a highly specialised one, akin to that of a moratorium supervisor under Schedule A1 of the Insolvency Act 1986. We suggest that the role should be undertaken by a properly regulated professional experienced in restructuring, particularly as the only scrutiny of the application for the moratorium would be undertaken by the supervisor.

If the role were to be widened to bring in other professionals, a common system of regulation would have to be developed to cover all those undertaking the role.

It is also not clear what would constitute “relevant expertise in restructuring”.

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

Yes.

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

We are not convinced that there is a benefit. We note that the consultation document does not propose that a moratorium supervisor should send a report to creditors. Instead, it is proposed that the supervisor will respond to requests from creditors for information. We are concerned about the costs which could be incurred in dealing with requests, particularly if the scope of the information which can be requested is wide. There is also the risk of duplication of effort, if more than one creditor requests the same or similar information at different times.

In any event, we believe that there would have to be safeguards to ensure that the supervisor could decline to supply the information on any of the following grounds:

- Confidentiality
- Disclosure could prejudice the outcome of the process
- The request was frivolous or unreasonable
- In the opinion of the supervisor, the costs of complying with the request would be excessive, having regard to the relative importance of the information.

Helping Businesses Keep Trading through the Restructuring Process
9) Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?

We broadly agree with the criteria under consideration. In principle, we believe that it could be helpful to extend the current categories of essential supplies, however there will be practical issues to be addressed. We comment on these below.

We see an important difference between the position of utility and IT services suppliers, who can continue to supply relatively easily, and suppliers of other forms of services or goods who may not be in a position to continue to supply – for example, because of the withdrawal of their credit insurance. There may also be cases where the supplier has suffered cash flow problems because of the company’s difficulties. It may be necessary to build in safeguards for suppliers, for example by requiring the business which is restructuring to pay for continued essential supplies on a cash on delivery basis or within a specified period of time – for example 14 days.

We believe that supplier confidence, both the company’s ability to pay for ongoing supplies promptly and in the restructuring plan, will be key to the success of any new essential supplier provisions.

It is not clear from the proposals what sanctions would be available to the company or the office holder in the event that a supplier refused to supply after the court had determined the supply to be essential.

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We are concerned that the proposals would place additional strain on court resources and that legal costs incurred in challenging decisions could be substantial.

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?

We are concerned that the proposals provide for significant court involvement. We believe that this will make the process costly and therefore restrict the ability of SMEs to access it.
We would prefer to see modifications to the CVA procedure (i) to provide a moratorium for companies of all sizes and (ii) to create a single class for non-secured creditors and a second class for all secured creditors, with a CVA proposal having to secure the approval of 75% in value of those eligible to vote in each class.

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

Yes – but please see our answer to question 11 above.

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

We believe that the safeguards could be potentially be very costly to apply.

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?

We have reservations about this. There may be occasions when a liquidation basis is inappropriate and we are concerned that if it is mandated it may give rise to significant challenges to court. Given that the aim of the process is to achieve a restructuring of the company which will enhance value there may be classes of creditor that would be “in the money” as a result, but they would be considered to be receiving only what would be payable in a liquidation. This could result in the “impaired classes” being treated unfairly as the wrong test in determining the value of their interest in the restructuring plan would be applied

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?

We are concerned that any proposals which provide for over-reaching senior secured creditors, including overriding negative pledges, could adversely affect future lending. It could also make lenders more inclined to seek personal guarantees from directors.

We assume that any proposals in this area will not affect security which has already been granted.
16) How should charged property be valued to ensure protection for existing charge holders?

*Not applicable – please see our answer to question 15 above.*

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

*We are not convinced that super-priority is necessary or desirable*

**Impact on SMEs**

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

*Any restructuring plan should be developed in such a way that it can be accessed at low cost by SMEs. As we have previously stated, we would prefer to see the CVA process modified rather than a new procedure be introduced. Please see our suggestion in answer to question 11 as to how the CVA procedure might be modified to make it more effective for SMEs.*
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.

None

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 ☐

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☐ Yes ☐ No
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London
SW1P 2HT

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Comments:
Questions

Name: Jukka-Pekka Joensuu and Tyrone Courtman

Organisation (if applicable): EUROPEAN ASSOCIATION OF TURNAROUND PROFESSIONALS (EACTP)

Address: C/o PKF Cooper Parry, Sky View, Argosy Road, East Midlands Airport, Castle Donington, Derby DE74 2SA, UK

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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?**

   Yes.

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?**

   Yes.

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

   Yes.

   However, we are concerned with one of the proposed eligibility tests, being that “the company must demonstrate that it is already or imminently will be in financial distress or is insolvent”, may lead to companies leaving it too late before seeking to implement the preliminary moratorium. Companies need to be persuaded to seek help sooner rather than later if the prospective benefits of a turnaround are to be given the best chance of being realized.

   Further, continuing liquidity is critical to any turnaround, as envisaged by paragraph 7.22 We consider a more appropriate criteria may simply be “for the company to demonstrate that financial difficulty or insolvency is in all probability likely”.

   As regards the proposed qualifying condition set out at 7.23 we believe it is critical for the company to be able to demonstrate, as part of its application for a moratorium, that there is a realistic prospect that a compromise or arrangement can be agreed with its creditors. Presumably there will be an obligation on the Supervisor to express such a view independent of the company’s Directors?
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?**

Yes, but we would comment as follows;

The preliminary moratorium will provide an immediate stay on creditor enforcement actions. A widespread promotion to all creditors of the moratorium should be avoided and should be limited only to those wishing to exercise enforcement actions, after which they can then make an application to court to challenge the moratorium, if they are able to demonstrate that the moratorium is wholly prejudicial to them.

Directors prospective liability for wrongful trading should continue during the preliminary moratorium. They should be obliged to take every reasonable step to ensure that the position of creditors is not adversely prejudiced during the period for which the moratorium is in force, and making adequate provision to achieve this should form part of their and the Supervisors assessment both of the company’s viability whilst the moratorium is in force and of the efficacy of the restructuring that is anticipated to be implemented during that time.

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

Yes, but we would comment as follows;

In the event of the company entering administration after the moratorium, we do not see why the period of the administration should be adversely prejudiced (reduced by the preliminary moratorium timeframe) by the failed moratorium actions of the incumbent directors.

As regards an extension. Consent from all secured creditors could be problematic in complex capital structures and does create opportunities for parties to buy debt with the intention of taking a
ransom position. As drafted it appears a charge holder could frustrate an extension even if they have no monetary interest and/or might eventually be crammed down.

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

Yes, but we would comment as follows;

We believe the choice of supervisor should be the choice of the company’s directors or shareholders and be independent of creditors, e.g. secured creditors. It is critically important for the supervisors to be independent, objective and for him to act in the best interests of the company.

We welcome the proposal that supervisors do not have to be licensed Insolvency Practitioners, but recognize the importance of them meeting certain minimum standards and qualifying criteria; having relevant expertise in restructuring and be a member of a regulated professional body.

There are a number of highly experienced turnaround practitioners working in the UK with a history of dealing with consensual restructurings and they are an important resource to ensure the objectives of this proposal are met.

We believe the minimum standards and qualifying criteria for a supervisor should be extended to include the Certified Turnaround Professional (CTP) qualification of the European Association of Certified Turnaround Professionals. This is a UK/European version of the American CTP qualification which has long been recognized in the USA for working on Chapter 11 type restructuring processes.

We believe its members, many of whom operate on their own account, provided they are appropriately insured, could offer at least the same level of expertise and assurance at a cost which is considerably less than some of the larger business advisory practices operating in this arena.
Supervisors ought to be held to account for concluding as part of its application for a moratorium, that there is a realistic prospect that a compromise or arrangement can be agreed with its creditors, of its viability during the preliminary moratorium and to ensuring that the qualifying conditions continue to be met.

Further, it should be recognized that a supervisor is a professional advisor, advising the directors and not managing the business. However, the concept of “shadow director” exists and turnaround professionals are well versed in acting in full knowledge of directors’ responsibilities and liabilities.

We are strongly supportive of the proposal in 7.45 that an Insolvency Practitioner acting as a supervisor be prevented from taking a subsequent formal insolvency appointment were the company to enter formal process. That would be a clear conflict of interest.

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

Yes, but we would comment as follows;

We agree that the costs of paying the supervisor be treated the same way as costs in an administration, and that any unpaid supervisor’s costs be treated as a first charge if the company proceeds to enter a formal insolvency process after the moratorium has ended.

The supervisor’s remuneration will be agreed by Creditors, and to the extent Creditors are repaid in full, its Directors.

We do not consider it is appropriate for any unpaid preliminary moratorium debts to be treated as a first charge if the company proceeds to enter a formal insolvency process, albeit such claims may give rise to a wrongful trading claim against the company’s Directors by a subsequently appointed Administrator or Liquidator.
8) **Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?**

Yes, although best practice in consensual restructurings tends to initiate regular communication with all creditors in any event.

Exemptions will be required for commercially sensitive or confidential information, disclosure of which would be prejudicial to the debtors’ interests and may be subject to confidentiality agreements, e.g. negotiations to sell some or all of the business. And also there should exemption for information that is not readily available and be too time consuming and costly to prepare.

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**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?**

Yes, but would comment as follows;

Would it not be easier in practice to simply outlaw the refusal by any former supplier to a company the subject of a preliminary moratorium or administration or Liquidation on anything but the same terms as the company enjoyed previously, except in so far as the timing of any payments to be made in respect of those new supplies.

This would avoid having to consider what is essential and provided the suppliers have a right to challenge the supply request in Court, should provide adequate protection for suppliers if such a continuity is considered to be so adversely prejudicial to their interest in doing so?

We believe such continuity of supply regulations would result in a
greater number of business recues.

Furthermore, termination clauses in contracts should be limited to maintaining the status quo (i.e. reimbursement of consequential losses) had the contract continued, not to enabling suppliers to profiteer from a company’s failure.

This is particularly prevalent within the provision of Asset Based Lending (“ABL”), where the company’s demise can provide more profits for the supplier than its survival. In such situations many ABL’s are motivated for the company to fail.

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?

Yes, but subject to our comments in response to question 9.

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?

In our opinion a restructuring plan would work better as a standalone procedure, albeit such a preliminary moratorium could be utilized to provide protection as a for runner to a CVA being agreed with Creditors.

A CVA is an insolvency procedure and as such has a certain stigma to creditors, employees and customers. We believe this should be a separate procedure with the “insolvency” word not used at all. All stakeholders need to be aware that this is not an “Insolvency” process but a “Commercial” process, and is in fact intended to avoid insolvency and destruction of enterprise value.
12) **Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?**

Yes.

This is a problem that currently impacts larger companies with multi-layer capital structures. Experience in the UK, Europe and even more so in the US is that hold-outs by out of the money creditors or opportunist hedge funds and buy-out specialists can be a real problem which delay restructurings and significantly add to costs. Schemes of Arrangement are a useful tool but are expensive.

In reality the threat of such mechanisms should mean that all but the most contentious are agreed consensually and never have a need to go anywhere near a court.

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

Yes.

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?**

Yes, but we would comment as follows;

Where a plan is being crammed down onto dissenting classes, then the evaluation of the minimum liquidation valuation should be provided by a Licensed Insolvency Practitioner independent of the company’s Directors and its Supervisor.
**Rescue Finance**

15) *Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?*

No. We would comment as follows;

In our experience most DIP funding comes from existing senior lenders and only where there is some collateral still available. Alternatively, alternative lenders do have the option of replacing the existing lender(s) and providing new and increased facilities where sufficient collateral exists but where the existing lender was unwilling to do so.

We are concerned that the availability of super priority funding could be contrary to the stated objective of encouraging debtors to seek early advice while some liquidity is still available.

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

At its open market value, i.e. assuming a disposal within a 3-6 months’ time frame

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

No comment

**Impact on SMEs**

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

Promoting the critical importance of seeking professional support early when financial distress is anticipated.

Promoting a mechanism that provides access to professional advice that is affordable.

Unfortunately, there will always be some businesses that are too small to avail themselves of such help.

We would reiterate our comments in response to question 6 that professionally accredited experienced turnaround professionals be encouraged to help small businesses avail themselves of this new framework.
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
Dear sir/madam

Review of the Corporate Insolvency Framework Consultation Response Form

We write in response to the above consultation and welcome the opportunity to be able to share our opinions in respect of the proposals tendered for the reform of the current UK Insolvency Framework to allow preventative measures enabling viable businesses to be rescued.

Introduction and Background of EACTP

The European Association of Certified Turnaround Professionals (EACTP) is an independent organisation, which has established the first European-wide accreditation programme for all turnaround professionals to provide an industry standard of quality in the practice of turnaround and restructuring.

We currently have certified members from Eire, Denmark, Finland, France, Germany, Greece, Italy, The Netherlands, Poland, Romania, Serbia, Spain, Sweden, Switzerland and the UK.

Our organisation have 29 certified members practicing in the UK alone.

Our pioneering programme aims to promote high standards in turnaround management by delivering a respected pan-European certification scheme based on the Turnaround Management Association (TMA) Global Certified Turnaround Professional (CTP) programme.

Leading turnaround professionals from across the continent sit on the EACTP’s board and committees to set strict admission criteria and oversee the stringent certification process. This ensures that only those practitioners able to demonstrate relevant academic qualifications, skills, experience at a significant and substantive level, and continuing practice may be entitled to become and remain members. Furthermore all associates and members are required as a condition of their continuing membership and certification of the EACTP to conduct a minimum of 15hrs of structured Continuing Professional Development (CPD) training per annum and must comply with the fundamental principles set out in the our Code of Ethics.

Cont/d…
Our members are professionals involved in turnaround management, including lawyers, bankers, accountants, insolvency practitioners, managers and independent directors.

We hope you find our response below useful, and we would be very happy to be of assistance in formulating strategies on implementation or to give you more information on issues raised in this response or about our more details about our association.

Yours sincerely

Tyrone Courtman

Jukka-Pekka Joensuu

Enclosure: A Review of the Corporate Insolvency Framework Response Form
Response from the Faculty of Advocates

To the CONSULTATION on the Review of the Corporate Insolvency Framework

Question 1

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

Response

The question raises a general issue of policy, on which it is not appropriate for us to express a view. Accordingly, we confine our response to these matters on which we feel qualified to comment.

First, we are aware, from the perspective of companies which are registered in Scotland, that there have been very few, if perhaps any, moratoria under Schedule A1 to the Insolvency Act 1986 (“Schedule A1” and “the Insolvency Act”).

In addition, it is not clear to us what are to be the statutory grounds on which a creditor would have the right to apply to the Court for an order terminating the moratorium. The intended grounds may be those which are set out in paragraph 40(2) of Schedule A1 and which can lead to an order being made terminating the moratorium. Alternatively, the grounds could be the much wider ones which are set out in paragraph 26 of Schedule A1. In any case, the grounds must be stated more precisely than the criteria which are mentioned in paragraph 7.12, namely “where [the creditors’] collateral or interests are not sufficiently protected”.

Question 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 businesses aren’t protected?*
Response

We agree that the filing with the court is more consistent with the scheme of the moratorium which is envisaged. Any court hearing would, as suggested, involve cost and delay. It is also difficult to see what the court’s function would be in any hearing.

Question 3

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

Response

As regards the eligibility tests, we agree with the principle which is proposed. The appropriate wording is that in paragraph 11(a) of Schedule B1 to the Insolvency Act (“Schedule B1”), which is one of the tests for the making of an administration order.

As regards the qualifying criteria, we doubt whether the first is realistic, although it does reflect paragraph 24(1)(b) of Schedule A1. A large number of companies which would seek a moratorium, perhaps the majority, have cash flow difficulties which would make it impossible to meet all the liabilities, such as bank repayments, which became payable during the moratorium.

The second criterion will also have to be drafted with some care, being presumably based broadly on paragraphs 3 and 11(b) of Schedule B1 and the formulations “likely” (para 3(1)(b)), “reasonably practicable” (para 3(3)(a)) and “reasonably likely” (para 11(b)).

Question 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?*

Response

This question also raises a general issue of policy, on which it is not appropriate for us to express a view.

We add that it is difficult to see how the criterion of “unfair prejudice” which is mentioned in paragraph 7.26 would apply in relation to any creditor’s challenge, as opposed to disputing the qualifying conditions had not been satisfied.

In addition, we doubt, on a very practical level, how quickly the Scottish Courts, even the Court of Session, would be able to dispose of any challenge by a creditor.
For completeness, we doubt also whether the description at paragraph 7.25 of the effect of paragraph 44 of Schedule B1 is quite accurate in referring to a challenge “prior to the granting of the preliminary moratorium”.

**Question 5**

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

**Response**

This question also raises general issues of policy, on which it is not appropriate for us to express a view.

We comment only that a requirement of consent from all secured creditors, regardless of the amounts secured, seems unduly restrictive. It might be useful to include an alternative way of extending a moratorium, namely a court order.

In addition, it is difficult to see how a scheme of arrangement (“a Scheme”), under part 26 of the Companies Act 2006, could be negotiated and then sanctioned by a court, all within three months.

For completeness, we doubt whether it is appropriate, in effect, to add the period of the moratorium to the one-year period of an administration.

**Question 6**

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

**Response**

Three points.

First, it is not clear to us what is meant in paragraph 7.41 by “relevant experience”, leaving aside the future relevance of the further reference in the footnote to an EU national.

Secondly, we do not immediately understand why the term “nominee” is not to be used, as it is in Schedule A1.

Finally, we assume, in any event, that the proposal envisages the consent from, and statement of, the supervisor being required, as under paragraph 7(1)(d) of Schedule A1.
Question 7

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

Response

We agree that the proposal is necessary.

Question 8

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

Response

We see significant practical issues arising from this proposal.

In particular, we are not clear as to what is envisaged by the references in paragraph 7.48 to “reasonably request” and “in accordance with any legal requirements”.

It might also be appropriate to impose a requirement that only one or more creditors with a specified minimum indebtedness can request information.

Question 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?

Response

We are not qualified to give a meaningful answer to the sub-question in the third sentence.

As regards the sub-questions in the first and second sentences, we see very significant practical difficulties in the suggested criteria and indeed in any other criteria.

On the one hand, any criteria would require to be precise in order to be workable.

On the other, the use of the emphatic word “essential” imposes a very strict test which may be satisfied only by few companies.

That consideration may explain what appears to be an inconsistency between, on the one hand, the reference to essential and that in paragraph 8.10 to “absolutely necessary” and, on the other, the reference in paragraph 8.10 to the contribution of the rescue plan.

In a similar way, the discussion in paragraph 8.14 of the meaning of essential seems to us to be inconsistent with the natural meaning of that word.
Finally, the reference in paragraph 8.15 to the supplier objectively justifying a refusal to supply confirms the difficulties of drafting a workable test or set of criteria.

**Question 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?*

**Response**

As in reply to Question 4, we doubt, on a very practical level, how quickly the Scottish Courts, even the Court of Session, would be able to dispose of any challenge by a supplier.

We refer again in the context of this question to the reference in paragraph 8.15 to the supplier objectively justifying a refusal to supply. Tests that are appropriate for regulated utility suppliers may not be appropriate for suppliers of other services who may themselves be SMEs. In any event, we are of the view that, in order to give sufficient protection to the reasonable commercial interests of a supplier, the test, or set of considerations, would need to refer also to the supplier’s usual business terms and also business practice, for example in allocating resources of materials and production between orders.

**Question 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?*

**Response**

We consider that there is no clear answer. On the one hand, there are disadvantages in having too many insolvency processes. On the other, there are disadvantages in making any existing insolvency process even more complicated than it already is.

Beyond that, what is proposed seems to us to be closer to a Scheme than to a CVA. Indeed, we understand that only the moratorium and the matters which are described in paragraphs 9.19 and 9.20 distinguish the proposal from a Scheme and justify the introduction of a new process. Beyond those differences, the procedure which is described in paragraphs 9.17 and 9.18 is, in effect, that which is required for a Scheme. In addition, Schemes can, and sometimes do, involve a “cram down”.

In addition, we wonder whether the proposal takes fully into account that a Scheme does not require to be approved by a class which has no longer any economic interest in the company (see eg *Re Oceanic Ltd* [1939] Ch 41 at 47).

Finally, we observe that the establishment of any new process involves costs as companies and practitioners require to try to operate it in practice.
Question 12

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

Response

This question also raises a general issue of policy, on which it is not appropriate for us to express a view.

As regards the practical implications of what is proposed, our overall response is that the details are insufficient to enable us to raise more than general matters.

Subject to that overall point, we agree that issues of class have caused problems in Schemes. However, the Courts have adopted a pragmatic approach to classes, at least those of unsecured creditors.

In addition, we do not follow the detail in paragraph 9.20. Presumably, the expression “each remaining class” means the classes of prior-ranking creditors and 50 per cent refers to the number of creditors.

It is also difficult to envisage a court ever exercising the power to which paragraph 9.21 refers.

In addition, we do not fully understand how the cram down is actually to work, particularly when the rescue plan is to last for only 12 months. In that context, we mention again that a Scheme does not require to be approved by a class which has no longer any economic interest in the company.

Finally, we do not see understand why the comparison in paragraph 19.10 is only liquidation rather than liquidation or administration.

Question 13

Do you consider that the proposed safeguards, including the role of the Court, to be sufficient protection for creditors?

Response

We refer to the points in the previous response.

In addition, we observe that the considerations which are set out in paragraph 9.29 are those which apply to the sanction of a Scheme.
Question 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 creditors?

Response

We doubt whether this proposal is appropriate, far less necessary. The minimum liquidation basis may be of little practical use when the alternative to the plan is administration or, and more generally, some other valuation basis is more appropriate in the particular circumstances.

Question 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?

Response

This question also raises it its first sentence a general issue of policy, on which it is not appropriate for us to express a view. As regards the second sentence, we are not qualified to do so.

We merely query what are the perceived changes in market conditions since 2009, to which paragraph 2.10 refers. We are not aware of any potential providers of “rescue finance” who would differ from existing lenders, particularly banks. The basis of the belief in paragraph 10.10 is not stated.

For completeness, there is, in our view, a significant difference between two matters which are covered in the question. The overriding of negative pledges in limited circumstances is different from, and narrower than, permitting new securities to have a “super priority”. The former change could be introduced without the latter.

Question 16

How should charged property be valued to ensure protection of existing charge holders?

Response

We observe that no valuation bases are suggested. In principle, the securities should be valued prudently on a basis which is appropriate in the circumstances of the company, which might be “a going concern basis” and perhaps subject to an additional percentage representing prudence.
Question 17

Which categories of payment should qualify as for “super priority” as “rescue finance”?

Response

We agree that there is no reason in principle to limit the categories of funding or credit, albeit that it would in all probability comprise that which was provided by financial institutions.

We should also comment on the suggestion in paragraph 10.26 that the court should not have a power to modify the proposed terms. We see no basis for that suggestion. That power would no doubt be rarely exercised, but that seems an insufficient reason to exclude a power which could be usefully exercised.

Question 18

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

Response

In so far as we might be qualified to give any response to this question, we cannot suggest any such measures.
Dear Mr Blaney,

A Review of the Corporate Insolvency Framework

FSB is the UK’s leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. FSB is non-party political, and is the largest organisation representing small and medium sized businesses in the UK. Small businesses make up 99.3 per cent of all businesses in the UK, and make a huge contribution to the UK economy. They contribute 51 per cent of the GDP and employ 58 per cent of the private sector workforce.

We welcome the opportunity to respond to this consultation on corporate insolvency reform.

The existing insolvency framework

An insolvency regime is a vital part of the wider legal framework which underpins and enables economic activity. Specifically, the insolvency framework facilitates the process of creative destruction by regulating the death of businesses, the maintenance of assets and value in such circumstances, and the upholding of property rights. Therefore, an insolvency system has to balance the need to facilitate the winding up of businesses that are no longer viable in the least disruptive way possible and the returning to creditors of assets on the one hand, with the potential benefits that might accrue from trying to rescue businesses where there is a good chance that they can go on to thrive. The current corporate insolvency regime in the UK, on the whole, works well in both regards. The UK’s framework is long established and widely respected based on a mixture of statute and common law principles. FSB does not want to see these key advantages diluted.

That is not to suggest there are not ways in which the current framework cannot be improved. The UK’s insolvency framework could be improved. It could:

- Be made more transparent with greater fairness for smaller unsecured creditors; and
- Deal more effectively with directors that act negligently or improperly. Such behaviour causes considerable problems, not only for those small businesses directly affected by such behaviour but it reduces the levels of trust between businesses, increasing the costs
of doing business and negatively impacts the reputation of business among the public more widely.

The proposals in the consultation

FSB considers that the proposals in the consultation are not measures which will enhance the existing insolvency framework in the ways that it needs to be improved. Little evidence has been offered about the extent of the failure of the current framework overall, to rescue sufficient businesses. It is not clear why the new ‘moratorium’ system or the introduction of other an expanded ‘essential supplier’ category and a ‘cram down’ mechanism will deliver better outcomes i.e. be more effective at rescuing businesses than the current arrangements.

The current domestic framework offers a number of opportunities for businesses who are insolvent to be rescued or for assets to be re-deployed in productive ways, while managing to avoid many of the problems of a US-style Chapter 11 system, which proposals like a ‘moratorium’ seem to be moving the UK towards. Recently, the European Commission also proposed reforms which would, in effect, do something similar. This is not a shift FSB supports. Moving in this direction creates a number of risks, which could result in the UK regime’s strengths being watered down for little demonstrable gain elsewhere.

FSB considers that, at best, the proposals fail to deal with the most significant problems that negatively impact small businesses the most. At worst, they could make things more problematic for small businesses.

The main focus of the consultation is on establishing a ‘moratorium’ system. It is not evident as to why a new ‘moratorium’ system is needed when one is already available for Company Voluntary Agreements (CVA) and which is infrequently used. The benefits of a new ‘moratorium’ system have not been demonstrated.

One of the biggest issues for small businesses is late payment and the abusive imposition of post facto credit terms (i.e. unilateral extensions mid contract term). Late payment has a significant impact on the cash-flow of small businesses. If a customer is already behind in their payment schedule, permitting it further time will be of little help to the creditor small business. As a result, a ‘moratorium’ may just end up delaying the inevitable while putting creditor small businesses in more difficult situations. Delays in returning monies owed as a result of a ‘moratorium’ could result in more small creditor businesses suffering to a greater degree than they already do. The wider economic implications could be more insolvencies rather than less from the spill-over effect through the supply chain.

In addition, the costs of the ‘moratorium’ will come out of the remaining assets in the business, further reducing the potential returns to creditors, if the attempted rescue fails. This could further compound the risks to the financial position of creditor businesses already created by the ‘moratorium’.
If the Government is determined to move ahead with the plan for a ‘moratorium’, no matter the risks, then the period which it can be in place for must be as short as possible. This will at least contain some of the risks (described above) associated with the policy.

Widening the category of ‘essential supplier’ is also fraught with risk. If small businesses have to continue supplying a larger business but which may still go out of business in the end, the financial position of those small business suppliers is more precarious, not less. This is not just a risk for one small business. An insolvent larger business in particular is likely to have numerous small business suppliers. In such circumstances the dangers of a domino effect are real. One result will no doubt be the need to increase the risk premium in suppliers’ pricing to take account of the new uncertainties such a law change would create.

A third significant risk for small businesses in the proposals come from the suggested creation of binding rescue plans and the introduction of a ‘cram-down’ mechanism. Implementing such measures are likely to put small business creditors (and unsecured ones in particular) in even more vulnerable positions. As with the ‘moratorium’ and the proposal for a wider ‘essential supplier’ list, the cumulative impact on small business creditors could be substantial, reducing rather than increasing the chances of receiving any assets back and putting creditor businesses in financial difficulty and. Rescue plans need to be supported by creditors and their development should be done through consent. It is only through such an approach that the negative spill-overs for creditor businesses can be avoided because each creditor is best placed to know if a rescue of the debtor business is likely to result in the best outcome for their own business. More widely, compulsion risks creating further distrust of the insolvency system among small businesses and increase levels of dis-engagement, which are already high. This would be a perverse consequence, when the objective should be to increase engagement where possible and practical.

Many small businesses do not encounter liquidations of ‘viable businesses’ who have been precipitated into insolvency by the acts of others or uncontrollable / unforeseeable circumstances. Rather, for most small businesses the reasons for the insolvency of a debtor (customer) business are more often perceived to be director greed, incompetence and in some circumstances criminal behaviour. In many of these types of cases, the directors and employees are readily able to work elsewhere and it is often planned that they do so, sometimes via a closely related ‘phoenix company’. Insolvencies that are a result of these kinds of actions should not be subject of delays as a result of the measures proposed in the consultation document. Neither should small creditors be forced to effectively collude in such actions. In such circumstances creditors need to be able to move quickly to preserve assets and secure material that might lead to civil responsibility on the part of the insolvent company’s directors. Consequently, a further result of the proposals in the consultation could be more directors not being held accountable for the consequences of their actions.

Finally, the suggestion in the consultation of greater involvement of the courts is counter-productive. They are likely to increase costs and potentially strain relations between parties rather than ease them. Procedures which involve creditor consensus rather than the cost of
court involvement are preferable, and such procedures inevitably increase insolvency practitioner costs as well.

Effective reform

The problems with the current insolvency framework are not found in its inability to rescue ailing businesses but in the system’s:

- Lack of transparency;
- Cost and chequered performance in returning assets to unsecured creditors in particular (which is related to cost); and
- Inability to deal effectively with negligent or malfeasant directors.¹

The Government should focus its reform agenda on these aspects. Useful measures that would improve the framework in all of these areas include the following.

Transparency and costs

- A simplified fee structure e.g. fixed fees for the statutory aspects of the insolvency process;
- Building on the recent changes with ‘front-page’ disclosure of costs to ensure true transparency around costs and fees. This should include an overall estimate of what creditors can expect as a return from the insolvency e.g. ‘nothing’, a ‘small return’, a ‘larger return’ etc. This kind of information upfront is what creditors want to know. It will help incentivise creditor involvement if there is the prospect of a return. It should also involve full itemised disclosure of costs. This does not have to be intimidating or confusing for small creditors. It can be presented in an understandable format, such as that used by Australian practitioners;²
- Clear industry guidance on how to allocate costs especially in grey areas e.g. where jobs might ordinarily be done by juniors or office administrators but for unexpected reasons may have to be done by partners;
- Creditors meetings should be re-instated as a standard part of the insolvency process.

A further way of reducing the costs of insolvencies and enabling more returns to creditors would be to reduce the charges on compulsory liquidations and bankruptcies. How any shortfall in funds for the Insolvency Service might be made up would have to be thoroughly thought through. Therefore a review should be undertaken of such levies and whether alternative sources of income might be found e.g. other charges or general taxation, which could help share the burden.

¹ While the term directors is used in this submission as a short-hand, The term ‘director’ in this context is being used as short-hand to not only encompass directors of companies but negligent and malfeasant sole traders and partners in general partnerships too.

²Fully itemised disclosure should use the cost information that IPs already have to calculate within their practice in order to identify how much they will need to charge for a ‘job’. This should mean minimal additional administrative burden on IPs.
Protecting unsecured creditors

- The Insolvency Service should examine the case for a ‘third party debt right’. Such a right should (perhaps similar to the Contracts [Rights of Third Parties] Act right) be available in insolvency situations. It would help small contractors further down the supply chain to seek a proportionate payment direct from the paying client who has received the benefit of their work or goods provision often without having paid for them. There would be some complexities to be looked at in detail, and it may mean some exceptions to a general rule, which would need to be identified. Such a measure would help avoid knock on insolvencies in the supply chain;

- A review of the law on retention of title in insolvency situations, to see whether it might be strengthened, for example, to further help small creditors retain control over goods supplied to a business that had subsequently become insolvent which have not been paid for;

- More education targeted at small business owners about using credit control mechanisms and terms and conditions more effectively to better protect themselves. This is the kind of advice and information that could be made available jointly through the Insolvency Service and the Small Business Commissioner.

Negligent/ malfeasant directors and director disqualification

Despite recent changes there remain ‘gaps’ in the effectiveness of the armoury of legal measures available to those trying to tackle negligent and malfeasant directors and reduce incidents of wrongful trading:

- The authorities who usually take disqualification action against directors are under-resourced. They also tend to concentrate on the larger cases. Smaller company directors, who are sometimes serial director/liquidators and so-called ‘phoenix merchants’, tend to be tackled less effectively. FSB considers that the Insolvency Service would be benefit from more funding to help them take more action against such people;

- Creditors should be able to bring disqualification action against negligent/ malfeasant directors using a simplified or streamlined procedure which, if successful, would potentially trigger the compensation power under Section 110 of Small Business Enterprise and Employment Act (SBEEA). Such an approach would lead to more successful disqualifications and to valuable compensation for SMEs;

- Section 118 of the SBEEA 2015 created a right for causes of actions against directors to be assigned to creditors who might wish to fund and have control of such action. However, for this to be effective the assignee needs the authority, through a simple procedure, to access the key documentation held by the IP on which they can base any legal action. If this disclosure right is not put in place then Section 118 will be difficult for creditors to utilise;

- Further, even if a director is found guilty they can ‘hide’ behind court rules because the liquidator is not party to the evidence the director has submitted on their net worth, because the liquidator is not ‘the victim’ even though the liquidator is responsible for the victim and the creditors of the liquidated company. Therefore changes to the rules in this
regard would further improve the position of those ‘wronged’ and enable more returns to creditors;

- The Insolvency Service, BIS and the Ministry of Justice should work together to identify ways of reducing the ‘barriers’ to bringing actions against negligent/malfeasant directors by IPs. These barriers include liquidators being held liable if a court action fails. The removal of the exemption from the Jackson restrictions on no-win, no-fee (which previously created a cost effective way of going after negligent or malfeasant directors) has created a significant barrier to bringing such actions;
- Create a rebuttable presumption of trading while insolvent when there are already one or more unsatisfied judgments against a company. That would help tackle the common problem of some businesses trading with minimal assets after they have been subject to such a judgment. The evidential burden of proving wrongful trading to establish director’s personal liability would likely be considerably lessened by such a change with the result that more judgments would be settled or more directors held to account.

We would be happy to talk in more detail about the points made in this response, if you would find that helpful. If you have any questions about this response please contact my colleague Richard Hyde on the following email address: Richard.hyde@fsb.org.uk

Yours sincerely,

Martin McTague
Policy Director
Federation of Small Businesses
FINANCE & LEASING ASSOCIATION RESPONSE TO THE INSOLVENCY SERVICE CONSULTATION: ‘A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK: A CONSULTATION ON THE OPTIONS FOR REFORM’

July 2016

1. The Finance & Leasing Association (FLA) represents UK providers of asset finance (leasing and hire purchase). Our members include specialist subsidiaries of banks of all sizes, independent asset finance businesses, and captive finance companies owned by equipment manufacturers. FLA members are a vital source of new finance for SMEs and we believe that SMEs' needs are generally well met by asset finance providers. In 2015, FLA members were provided £29 billion of finance to the business sector and public services, representing almost 32% of UK investment, equipment and purchased software in the UK.

General Comments

2. The FLA believes that the UK insolvency framework should seek to promote enterprise and create a business environment that supports growth and employment where possible. Whilst we support the Government’s objectives, we also believe that the needs of SMEs should not be prioritised at the expense of other stakeholders such as creditors or suppliers – many of whom will also be SMEs. We therefore call on the Insolvency Service to ensure there is a balanced consideration of the needs of each stakeholder when assessing the merit of these proposals.

3. In instances where a customer is in default on their agreement an asset finance provider may take actions to mitigate their losses or recover an asset. Restricting the opportunities or unnecessarily delaying the ability of an asset finance firm in instances where a firm is in financial distress could make businesses lending less attractive for asset finance providers as it would increase the risk profile of some businesses. We believe this would act against the Government’s objective of promoting business finance.

4. We support the Government’s desire to assist companies that find themselves in difficult circumstances, but we are concerned that the proposals put forward in this paper may have unintended consequences. Whilst, the introduction of a three month moratorium provides companies with the opportunity to readjust their business models to a more sustainable footing, it could also lead to further damage to a company’s financial position and cause further detriment to its suppliers, employees and creditors.

5. As noted above, FLA members are a vital source of new finance for SMEs. Our members are concerned that these proposals would weaken their ability to recover either the asset or any outstanding payments. This will affect their credit assessments of these businesses, which in turn may lead to a reduction in lending to businesses or an increase in the cost of credit where it is provided because asset finance funders would factor in the increased risk when assessing whether to provide finance and at what price.
6. In summary, although we welcome the Insolvency Service’s review of the insolvency framework, we do not believe that these proposals will have a material impact on the ability of firms in difficulties to continue trading. We would be happy to discuss this further with the Insolvency Service.

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A Review of the Corporate Insolvency Framework response form


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

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: David Dunckley
Organisation (if applicable): Grant Thornton UK LLP
Address: 30 Finsbury Square, London, EC4P 2YU

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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?

We recognise the importance to the Government of seeking to make the United Kingdom the best place in the world to do business. We also recognise the importance of there being a moratorium available in appropriate circumstances.

However, there are already two moratorium procedures established within the UK insolvency regime, namely:

* Small company pre-CVA moratorium
* The moratorium associated with the administration regime

In our view there is merit in developing these existing moratorium procedures in order that they may better assist the Government in achieving its overall aim, rather than creating a further parallel procedure.

Nevertheless, our answers to the subsequent questions in this consultation of necessity address the detail of the proposed additional moratorium procedure.

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?

Yes

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

Paragraph 7.23 states that the company "must satisfactorily demonstrate that … there is a reasonable prospect that a compromise or arrangement can be agreed". We agree that this is essential to prevent misuse of the moratorium to buy protection with no clear plan as to what is to happen next.

Paragraph 7.34 refers to directors being incentivised to make use of the moratorium to "develop a rescue plan".

We believe that there is a contradiction between the visions of these two paragraphs as to what is intended as the qualifying criterion for the start of a moratorium.

If the rescue plan must be largely formulated before the start of the moratorium, then we are not clear what the new moratorium adds as compared to a schedule A1 moratorium
(potentially 28 days plus 2 months) when a CVA is being proposed, or as compared to the interim moratorium associated with an application for an administration order or notice of intention to appoint administrators.

If the rescue plan has not been largely formulated before the start of the moratorium, then either the moratorium will not happen because the supervisor cannot be satisfied that the entry criteria are met, or alternatively the moratorium will be open to misuse by directors denying reality or hoping that "something will turn up".

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We comment in answer to question 3) above regarding the apparent confusion as to the degree to which the rescue plan must be developed prior to the moratorium. There is a difficulty in allowing the plan to be developed within the moratorium whilst expecting professional buy-in from the outset and avoiding misuse.

We comment further on the concept of essential supplies in answer to question 9) below.

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

If at the outset there has to be a sufficient plan to demonstrate the feasibility of a rescue, the initial duration of three months is possibly excessive. However, given that there will be no need to utilise the full period in all cases, it is better to be generous rather than not, so as to minimise the need for extensions in cases where the initial timescale in fact proves to be insufficient.

The need for the consent of all secured creditors to an extension is to repeat a problem that is already present in relation to the extension of administrations. It is simply not realistic to expect a large number of secured creditors all to engage within a deadline. Certain banks are notoriously institutionally slow. Secured creditors who are clearly "out of the money" can be expected not to bother to reply and secured creditors who are not regulated institutions may object out of malice. A sensible middle position would be for the secured creditors to be invited to approve and the test is that none object within a specified timescale. Regrettably this suggestion was rejected in the redrafting of the Insolvency Rules.

Paragraph 7.24 understandably requires the supervisor to terminate the moratorium if he thinks the company no longer meets the qualifying criteria. This repeats the problems inherent in schedule A1 as to (1) whether the supervisor is to monitor superficially and cheaply, or thoroughly and expensively and (2) exposing him to attack
from two sides, either that he terminated the moratorium without sufficient cause, or that he failed to terminate it when he should have done.

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

We think that opening the role of supervisor to any solicitor or accountant would be too wide. Insolvency and restructuring are specialisms in their own right. We note the suggested requirement for "relevant expertise", but without knowing how this is to be defined and assessed, we cannot comment further.

We note that insolvency licensing was introduced for compelling reasons in the mid-1980s at a time when the mood of government was to sweep away professional restrictions rather than to create new ones.

The protection of creditors through insolvency licensing is weakened at peril to creditors in relation to individual cases and with possible macro-level adverse impacts on the economy. Market distortions can be expected to result from the creation of a cadre of professionals with access to only one sector of the insolvency toolkit (as would have been the case also had the legislation for "authorised persons" to handle only voluntary arrangements ever been brought into force; happily, wiser counsel prevailed so that this primary legislation was never brought into force and now has recently been repealed).

Companies Act schemes of arrangement operate successfully without any licensing requirements, but these are in practice only used by large companies who can be relied upon to choose their professionals carefully.

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

Yes

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

Given the initial duration of a moratorium not exceeding three months and the need to enable creditors to vote on an informed basis, we do not see the need to formalise the requirements as to the flow of information.

In relation to current insolvency procedures (generally of significantly longer duration), the suggestion in paragraph 7.49 that periodic collective reporting be replaced with (or
in addition to) an actual duty to report to creditors individually on demand strikes us as a recipe for cost escalation, delay in progressing cases as resources are diverted to this new duty, an opportunity for the vexatious questioner to cause distraction to the disbenefit of the collective and quite probably a new liability risk for the office holder with a new duty of care to give appropriate answers on which the questioner can rely.

**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?

The second part of this question answers itself to the extent that the withdrawal of essential supplies will necessarily prevent the rescue of a business, although of course the mere continuation of essential supplies is of itself a continuation of a status quo ante and not a step in restructuring as such.

As regards the ability to legislate in respect of essential supplies we do not see that this is possible other than where there is a continuing supply contract, whose termination or variation by reason of the insolvency may be prevented by legislation. If the essential supplies are obtained under discrete purchase contracts for each batch, we doubt that legislation can properly compel the supplier to enter into further contracts on the same terms or at all.

We favour the approach that legislation should not try to define too closely what is an essential supply as this is likely to be impractical and / or to have unintended consequences. We think that the approach of leaving this to the directors / supervisor is correct, with the filing of a notice in court concentrating minds that this is a serious step only to be taken where justified rather than too widely.

10) Do you consider that the Court's role in the process and a supplier's ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We cannot see that a creditor would in practice avail themselves of the right to challenge their designation as essential, other than on the basis that they are not satisfied as to the certainty of payment for continuing supplies.

If the creditor's concern is an absence of belief that they will be paid for continuing supplies, then given the fact of the customer's insolvency it may be insufficient compensation for the credit risk merely that the customer should pay on time for further supplies. Furthermore, the supplier may find that credit insurers and/or invoice
discounters withdraw support, putting the supplier in a particularly invidious position. It seems not unreasonable that the customer could be required to pay on delivery, even though this will inevitably have an adverse cash flow impact on the customer.

Given that the requirement for essential supplies is likely to run from day one of the moratorium and that they are by definition essential, the courts will need to be resourced to deal with a challenge as a matter of extreme urgency.

**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?

We are not clear why the proposals contained in this consultation might be expected to be any more effective than a CVA with the benefit of a schedule A1 moratorium being available to all companies without size restriction.

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

Yes, provided that the 75% by value majority requirement is retained (as is proposed). A binding departure from contract and expectation merits a sterner test than the basic 50%.

What is suggested here appears merely to need amendments to be made to the existing scheme of arrangement legislation to require prior court approval of the classes and to allow cram-down of out-of-the-money classes. Court involvement in the former is potentially an unnecessary burden. Court approval of the latter is probably essential to ensure acceptance. We do not see any justification in legislating for a parallel procedure rather than adjusting that which already exists.

It is probable that the process will continue to be attractive only to large companies (we use the description loosely rather than in any technical sense) because of the cost implications of the positive involvement of the court.

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

Yes

As a point of detail, we do not understand the need to impose a time limit of 12 months on the restructuring plan. The debtor company itself is unlikely to want a prolonged process, but if particular circumstances make that appropriate we see no reason to impose this constraint on that which the company may propose, the creditors may agree to, and the court may confirm.

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?

Yes, although the measure of the minimum liquidation valuation will be a matter of professional judgement, so whilst the theoretical principle appears correct, its practical application will not be free of contention.

**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?**

The fundamental concept of security is undermined if it can be over-ridden in the very situation where the lender might be looking to rely on it.

It has always been the case that a chargeholder can consent to the creation of a superior security where commercial circumstances are such that the lender considers this appropriate. If legislation is to intervene, it can presumably only be to force a relegation on the original lender in circumstances where the original lender does not consider that to be a sensible commercial decision. It may on occasion override an original lender who is merely being obtuse, but the widespread price to pay for an occasional (and debatable) win will be that lending to the business sector is made less attractive and so more expensive, or less readily available at all.

Possibly negative pledge clauses might be legislated to be ineffective in relation to the creation of new charges of inferior ranking, but further research may be necessary to understand any impact this might have on the price and availability of business finance.

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

Ultimately the value of charged property can only be determined by exposure to the market. In the situation being considered in this consultation such exposure is not intended and neither would there be time for that. On the contrary, time pressures may require a rapid valuation to be undertaken. Valuers can take very different views, particularly of commercial property and may offer a range rather than alighting on a fixed sum. The variability of view occurs within any definition of the basis of valuation and not merely as between different bases; the consultation paper appears only to envisage the latter.

The suggestion that a valuation might replace the physical property undermines the principle that the secured creditor can enforce at a time of their choosing. As with our answer to Q15 above this idea must impact adversely on the willingness of lenders to lend into the business sector.

Given that the intention of the rescue process is that the company should continue as a going concern, it seems only proper to the lender that the valuation should be made on a going concern basis. If the rescue succeeds, when the alternative would have been a shut down, then the extra value attributable to the lender (1) reflects the reality of what
There will be situations where the value of security will be higher on a shutdown of the business than upon a rescue, for example a factory on a long lease where a shutdown presents the opportunity to replace the factory with housing. The legislation must be flexible enough to protect the secured lender's interest in this situation. There is also a bigger economic question as to whether the business should survive, or whether the release of the land for a higher value use is the optimum macro-economic outcome.

It is not clear whether it is intended that if the rescue process completes successfully, the security would be restored to its original status without the restriction of the valuation that would have been the entitlement had the rescue process failed.

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

The project to update the Insolvency Rules grappled with the possibility of defining administration expenses as a matter of legislation rather than relying on common law principles to distinguish a provable debt from an expense payable. This idea was abandoned in the face of drafting difficulties and the risk of unintended consequences. We think that any attempt to define 'rescue finance' is likely to run into similar difficulties.

Impact on SMEs

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

We make no suggestions at this stage.
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?

X Yes □ No
A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK

ICAEW welcomes the opportunity to comment on the Review of the Corporate Insolvency Framework published by The Insolvency Service on 25 May, a copy of which is available from this link.

This ICAEW response of 6 July 2016 reflects consultation with the ICAEW Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW licence holders.
ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW’s regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 145,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
MAJOR POINTS

1. We agree that the UK insolvency regime might benefit from new procedures of the kind outlined in the consultation. However, these would be significant changes and it is important that the detail is considered carefully and more detailed proposals developed and subjected to consultation before any decision is taken to proceed; some of the suggestions included in the proposal would not, in our view, be workable.

2. While giving businesses a breathing space may result in more failing businesses being saved, any reduction in creditor rights may make it more difficult for businesses to obtain finance in the first place and a number of elements of these proposals may alter commercial behaviours in ways that could be difficult to predict. Similarly, it is possible that essential suppliers could be small businesses whose own solvency might depend upon being paid all amounts owed and for whom the burdens of applying to court might be disproportionate. The government will need to assess the relative advantages and disadvantages taking into account comments from the affected sectors, including the banking sector.

3. With regard to the moratorium, further analysis is required as to why the current CVA regime is perceived to have been unsuccessful to avoid the proposed moratorium regime suffering a similar fate. In particular, we believe that the responsibilities (and associated liabilities) for insolvency practitioners deter use of the existing regime. If the moratorium is intended to allow directors greater freedom to continue to operate the business during the moratorium period, then it is important that they are accountable for their actions.

4. There are proposals to give creditors rights to request information at any time during the new moratorium regime and, perhaps, to extend this right to existing insolvency processes. We do not believe that this is a good idea and it is not clear what purpose it is intended to serve. It could add substantially to the costs of the process and distract supervisors from saving the business (or otherwise performing their statutory duties). There may be other implications, for instance regarding confidentiality and inequality of information between creditors (with possible risks related to insider dealing).

5. From the outline contained in the paper, it appears that the skills and experience required of a supervisor for a moratorium will be similar to those required in existing insolvency proceedings. We therefore believe that those performing the role should be similarly qualified and experienced. This means, in practice, that they should be insolvency practitioners. We understand that government wishes to reduce regulatory requirements and believes that costs could be reduced by reducing standards. However, we believe that the price to be paid through risk of mistakes being made by insufficiently expert advisors is too high, particularly in a context where creditor rights are being affected.

6. We understand the desire of the UK government to improve the UK’s standing in World Bank statistical rankings and it is sensible to consider whether practices from other countries might usefully be adopted in the UK. However, there are risks in making comparisons on individual issues because the effectiveness of a regime in any jurisdiction needs to be judged as a whole in the context of the underlying policy objectives for that jurisdiction. We believe that government should focus on areas where UK practitioners and businesses believe the UK regime has weaknesses with an eye on practical realities such as costs and potential for abuse, particularly as regards small businesses that are failing.

7. We would like to more information provided on HMRC’s role in the existing regime, in particular the degree to which it considers whether a business might be rescued before petitioning for insolvency and its record in participating in restructuring plans.
RESPONSES TO SPECIFIC QUESTIONS

The introduction of a new moratorium to help business rescue

Q1. Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?

8. A moratorium regime may be useful in certain circumstances but we think that further consideration is required regarding its scope and we hope that, if the proposal is to be taken forward, government will consult again on the basis of more detailed proposals. We have commented below on the specific questions raised but many other questions will need addressing depending upon how the proposals are developed, for instance on the role of the courts (and their ability and willingness to perform the functions attributed to them), the respective responsibilities (and liabilities) of supervisors and directors and the impact of freezing of debts, for instance on employees.

9. Many issues of detail will require further consideration, for instance,
   - please see introductory comments, particularly regarding creditor requests for information [paragraph 7.9 of the consultation paper];
   - the idea that arrears will be frozen and ongoing costs met [7.11] will be relatively straightforward for many simple businesses, but various scenarios may need to be considered for more complex businesses, such as margin calls for foreign exchange contracts (which can impact companies that would not be excluded from the regime as proposed).

Q2. 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?

10. Yes, but one of the strengths of the UK regime is the balance it draws between court and out of court processes and the role of skilled and regulated insolvency practitioners. This aspect of the proposals requires more development. If supervisors are not to be regulated persons, then greater court supervision may be required to minimise risks of abuse by directors and unfair prejudice of creditors. If supervisors are to be regulated (i.e., in practice, insolvency practitioners), then the role will need to be well defined. The costs of court processes should not be underestimated and, if government is concerned about World Bank rankings, the potential impact of proposals such as this on this element of the rankings should be taken into account.

11. We suggest that more consideration is required as to what should be included in the court filing, including whether the supervisor should already have been appointed and involved. If the process is too easy, there is a risk that directors will simply file because they have nothing to lose (but court fees) in order to delay taking decisions that would otherwise need to be made and to avoid risks of wrongful trading. Directors should remain accountable.

12. Creditors should be able to apply to court at any time during the moratorium, not just during the first 28 days. Circumstances may change during this time and a court could be expected to take into account whether an application should more appropriately have been made earlier in the process and the effect of any delay on restructuring plans. Creditors should be able to apply not only on grounds of unfair prejudice or suspected misfeasance, but also if they have the required majority to block any eventual restructuring plan.[7.25]

Q3. Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

13. Yes, although if the regime is intended for use by medium sized or large businesses (or would in practice be most useful for these businesses), it might be clearer to limit it to them (and reform the CVA regime if appropriate, for small companies). The criteria that financial difficulty must at least be ‘imminent’ [7.18] is somewhat at odds with suggestions in the paper that the moratorium
will be flexible and allow businesses to ‘explore options and develop a restructuring plan’ [7.7] and ‘financial difficulty’ will need further definition.

Q4. 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?

14. Yes, but if, as the paper suggests would be expected, debtors consult secured lenders before the moratorium, it is possible that secured lenders might exercise their rights straight away or seek to influence the process (for instance by insisting on a limited choice of supervisor). Is it intended that secured lenders should not be able to do this?

Q5. Do you agree with the Government’s proposals regarding the duration, extension and cessation of a moratorium?

15. We are not convinced that the proposed duration would be suitable for all cases. For small businesses, it seems excessively long as it should be relatively quick and easy to determine whether or not the business is viable and to adopt a restructuring plan (e.g. through a CVA or administration). However, for very large complex businesses (particularly where a scheme of arrangement is contemplated) the period would often be too short.

16. We do not believe that the test for creditor approval of an extension should be ‘all’ secured creditors. [7.36] Rather we suggest it should be the same majority as required for passing the restructuring plan, otherwise a single secured creditor might be in a position to undermine a restructuring plan that would otherwise proceed. There will also need to be a connected party restriction so that only unconnected parties pass it.

17. We do not agree that the length of the moratorium should be deducted from the period of administration. It would be an unnecessary complication and it seems perverse to reduce the initial administration period when the 12 month period was only introduced by the Enterprise Act 2002. In practice, even the 12 month period can be problematic, not least because of delays within HMRC and applying for extensions adds to work and cost.

Q6. Do you agree with the proposals for the powers of and qualification requirements for a supervisor?

18. We do not agree with the qualification requirements. Please note that accountancy is not a regulated activity as such in the UK. There are various professional accounting bodies, so that it would be necessary for government to designate bodies that it thought appropriate in this context if it were to proceed on this basis (assuming that it would not want unqualified accountants, i.e. not members of professional bodies, to perform the role). We would, however, advise against this. So far as we can see from the current proposals, in practice, the supervisor will need to have the knowledge, skill and experience of an insolvency practitioner, which involves both accounting and relevant legal knowledge and ability, and we can see no reason why supervisors should not be required to be insolvency practitioners. The JIC examination is not restricted to accountants or solicitors and there is a large pool of practitioners and a competitive market. The Solicitors Regulatory Authority has recently ceased authorising insolvency practitioners due to lack of demand and we cannot see on what basis all solicitors as a class would be qualified to provide this function. [7.41]

19. Requiring the supervisor to sanction transactions not in the ordinary course will require careful consideration. It is a potentially onerous role and it might be necessary to absolve the supervisor from any personal liability. This regime is based on the premise that the debtor remains in control and that means that director responsibility for conduct of the business should be preserved. [43]

20. We agree that it is important to be clear on the issue of independence [7.45]. One advantage of requiring that the supervisor should not act as the insolvency practitioner after the moratorium is to avoid any public perception (or misperception) that the ultimate outcome was pre-planned
and the moratorium process was not used as intended. On the other hand the supervisor will be familiar with the business and issues so that it would typically be more cost effective for the supervisor to continue. Creditors, particularly secured creditors, might expect to have a say on this issue. It is for government to reconcile these conflicting drivers, but if it ultimately decides that supervisors should be able to continue in the interests of efficiency, then it should be prepared to justify its position to the public.

21. The above comments on the role of the supervisor are based on our understanding of the proposals and the limited amount of detail contained in them. If it is a priority for government that non-insolvency practitioners should be able to perform the role, then it might be necessary to consider the scope of the role and the possible impact of a moratorium on any following insolvency processes further in that context.

Q7. Do you agree with the proposals for how to treat the costs of the moratorium?
22. Yes

Q8. Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

23. We do not agree with this proposal – see our introductory comments. Instead, we suggest that there could be a mechanism for standard reporting at fixed stages in the process to all creditors, for instance 7 days after appointment, at the conclusion of the process and to support any requested extension. It should, however, be noted that the preparation of reports and information involves time and cost. [7.47-7.49]

Helping Businesses Keep Trading through the Restructuring Process

Q9. 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?

24. We agree that some additional safeguards might be appropriate to prevent suppliers taking unfair advantage of a business that is seeking to restructure, but the proposals in the current form may be too favourable to the debtor and open to abuse by debtor businesses. It is possible that provisions of this kind might influence wider commercial practices in ways not currently anticipated (e.g. with suppliers seeking to avoid the prospect of being essential suppliers). [8] It is not clear how the provisions would be enforced against non-UK suppliers.

Q10. 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?

25. The proposed court process is weighted in favour of the debtor and we are concerned that the regime as a whole does not sufficiently protect the interest of suppliers, given the costs of making court applications.

26. It is not clear whether the regime would include requirements for personal guarantees by office holders or others and we suggest that any proposals for increasing liability of insolvency practitioners should be the subject of further consultation.

Developing a Flexible Restructuring Plan

Q11. 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?

27. We suggest that the plan be introduced as a separate stand-alone plan rather than as an extension of CVAs, although we think further analysis should be undertaken as to why the CVA moratorium is so little used to inform consideration of these proposals. [9]
Q12. Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissent from some creditors?

28. Yes, we believe that a cram down regime would be useful where it is possible to assess the liquidation outcome for junior creditors, but the detail will require careful consideration and it is likely that the regime would only be appropriate for use in larger more complex cases, which are likely to be relatively rare. Safeguards should be included to prevent use in other cases. The following are our initial thoughts on the points noted:

- Cram down should apply also to shareholders
- The plan should cover preferential creditors as well as secured creditors [9.10]

Q13. Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

29. Broadly speaking, we agree that the role envisaged by the courts is appropriate in this context, but, as noted above, greater court involvement involves greater cost and the proposed process is, in practice, likely to be appropriate only for larger, more complex business restructurings. If the proposal is taken forward, we believe that provisions will be needed to restrict use of the regime to appropriate cases and to provide safeguards against potential abuse, in order to protect creditors.

30. We agree that those involved in financial markets as noted should be excluded. [9.23].

31. We suggest that majorities should be of those present and voting, as is currently the case. [9.24]

32. A restructuring plan is typically designed to result in permanent change and it would be helpful for more detail to be given regarding the 12 month time limit in paragraph 9.29.

Q14. 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?

33. Yes, there needs to be a clear, not marginal, benefit if creditors are to be forced to accept a plan. We agreed that a liquidation value is the appropriate test as it is necessary to show that no creditor will be worse off than in a liquidation.[9.35]

Rescue Finance

Q15. 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?

34. The priorities of creditors may affect not only business rescue but also the willingness of creditors to extend credit to solvent businesses, and it is important that government considers the evidence and views provided by a range of finance providers carefully. We do not comment further at this stage, save to note that if the priority of costs of administration may be affected, the potential impact on the willingness of insolvency practitioners to accept appointments should be taken into account.

Q16. How should charged property be valued to ensure protection for existing charge holders?

35. No comment.

Q17. Which categories of payments should qualify for super-priority as ‘rescue finance’?

36. No comment.
Impact on SMEs

Q18. Are there any other specific measures for promoting SME recovery that should be considered?

37. As noted earlier, we do not agree that a larger pool of advisors is required. If the new regime results in increasing demand, then it is open to members of the regulated professions to take the necessary exam and become insolvency practitioners.

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.

38. We do not have additional comments at this stage, but would be happy to participate in further consultations and discussions with government as the proposals are developed further.
RESPONSE TO
A REVIEW OF THE
CORPORATE INSOLVENCY FRAMEWORK

INSOLVENCY SERVICE
Introduction

The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 21,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK. We have an in-depth knowledge and expertise of insolvency law and procedure.

ICAS’s Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.

ICAS is pleased to have the opportunity to submit its views in response to the Review of the Corporate Insolvency Framework issued by the Insolvency Service. We shall be pleased to discuss in further detail with the Insolvency Service any of the matters raised within this response.

Executive Summary

ICAS believes that in order to provide a vibrant economy and to support economic growth that businesses which suffer financial distress through factors largely out with their control and which would otherwise be viable deserve an opportunity to be restructured.

In the foreword to the consultation, The Rt Hon Sajid Javid, Secretary of State, Department for Business, Innovation and Skills said “…sometimes, insolvency is unavoidable. And should the worst happen to a business, we have a duty to give it [the company] the best possible chance to restructure its debts…” While the sentiments behind this statement are entirely correct, it must also be recognised that in some situations the most appropriate response is not to restructure the company. A distinction is required between viable businesses which are in temporary financial distress and non-viable businesses as a result of changing markets, economic conditions or incompetent management. For non-viable businesses, it is paramount that the company creditors, its employees, and its customers are protected as far as is possible.

Many of the proposals within the consultation are broadly welcomed. Further discussion will however be required with stakeholders to ensure that the detail behind any of the proposals taken forward do not result in unintended consequences and will deal with many of the practical concerns which we raise in our detailed comments.

A number of themes have arisen during our consideration of each of the consultation proposals under consideration. These include:

- Whether the existing court structure in the UK would adequately support the proposed framework. The proposals would require the court system to be accessible, quick to react and with sufficient skills, knowledge and experience in insolvency, commercial, employment law amongst other areas to be effective. The UK court system is already under considerable strain and adding a further layer of complexity in relation to insolvency proceedings would require further resources. Consideration should be given to whether it is now appropriate to create separate insolvency courts in the UK to ensure there is access to appropriately resourced and skilled judiciary which is able to react quickly to matters requiring a decision.

- Detailed discussions with UK bank and lenders will be required to understand their likely attitude to lending structures, security requirements against lending and the availability of finance were the proposals to be proceeded with. In particular, we are concerned that the proposals may result in a contraction of available credit lending and increase
in the cost of borrowing, particularly to the SME market which would restrict economic growth in the UK.

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

9 It is essential that any process which involves corporate restructuring or insolvency retains confidence of the relevant stakeholders. This relies on skilled and knowledgeable professionals who are appropriately trained and qualified to deal with such matters and backed up by a robust regulatory system. We therefore believe that any new restructuring regimes must be supervised only by insolvency practitioners.

10 A number of the proposals within the consultation are available or similar to procedures within CVAs. The consultation document highlights at paragraph 9.2 that the majority of CVAs fail. It is unclear from the consultation how the proposals will substantially change the underlying cause of failures seen within CVAs and hence how the proposals if implemented are likely to result in an increased number of rescued businesses.

11 We would suggest that in order to promote business rescue amendments could be made to existing legislation without the need to introduce substantially new proposals. In particular, we would suggest that the moratorium provisions which apply to CVA’s could be extended to be available all companies. In addition, condition a) of paragraph 3(1) of Schedule B1 to the Insolvency Act 1986 (objective of administration) could be amended to refer to the ‘business of the company’.

Detailed Comments

12 Our detailed responses to the questions posed within the Consultation document are set out in Appendix 1

6 July 2016

Direct contact for further information:

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Appendix 1 – Responses to questions posed in the Consultation

The Introduction of a Moratorium

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

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

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

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

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

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

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

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

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

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

We also note the proposed restrictions set out in in paragraph 7.20. We consider that the scope may warrant a wider application to prohibit those behind serial company failures from benefiting.
from the moratorium. For example, the scope could be extended to include companies who in the previous 12 months have bought the business of a company in administration.

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

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

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

4 Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

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

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

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

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

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

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

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

The process of formulating restructuring plans can take anywhere between a few weeks and many months. This is dependent on many factors such as the availability of management
information within the company, its readiness and resource availability to dedicate to the restructure, the attitude of funders and credit availability, and many more factors specific to each individual restructure arrangement. We therefore consider that the proposed maximum moratorium period (without court sanction of an extension) of 3 months provides an appropriate balance to allow the majority of companies to benefit from the moratorium without overburdening the court where further time would be required.

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

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

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

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

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

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

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

Without such statutory protection, there is a significant risk that unqualified persons providing accountancy services could be appointed as supervisors when they do not have the necessary competence or integrity to conduct this work with the appropriate due, care, skill and diligence. There is a risk that those who are not members of a professional body could utilise these provisions to facilitate the removal of assets during the period of the moratorium. In addition to the immediate detrimental effect on creditors, this would pose a significant risk to
the trust in the UK restructuring system and profession which in turn is likely to result in increased lending costs and potentially restrictions on credit lending as lenders factor these risks into lending criteria.

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

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

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

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

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

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

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

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

Helping Businesses Keep Trading through the Restructuring Process

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

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

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

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

Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

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

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

**Developing a Flexible Restructuring Plan**

Would a restructuring plan including these provisions work better as a standalone procedure or as an extension of an existing procedure, such as a CVA?

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

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

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

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

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

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

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

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

14 Do you agree that there should be a minimum liquidation valuation basis included in the test for determining the fairness of a plan which is being cram down onto dissenting classes?

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

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

Rescue Finance

15 Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. We are concerned that such provisions would substantially undermine core business finance models and as a result could significantly restrict finance availability, increase finance pricing and result in additional securities being required on lending, particularly in the SME market. This would have a significant impact on the ability of the UK economy to grow in the longer term.

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

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

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

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

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

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

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

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

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

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

Please acknowledge this reply ☒

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

☒ Yes ☐ No
A Review of the Corporate Insolvency Framework response form


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

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:** Technical Committee, Insolvency Lawyers’ Association  
**Organisation (if applicable):** Insolvency Lawyers’ Association  
**Address:** Valiant House, 4-10 Heneage Lane, London EC3A 5DQ

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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?

The availability of a preliminary moratorium could be a potentially useful option, perhaps particularly in operating company restructurings, as opposed to balance sheet restructurings, where standstills are typically negotiated, and may perhaps serve more as a negotiating tool than a frequently used procedure. This is however subject to a number of qualifications, the first being that (as we think may already have been acknowledged) the use of “single gateway” terminology is misleading, as it suggests that the preliminary moratorium would be the default option, which we do not think should be the case.

We comment below in further detail on the costs aspects and the need for greater detail in order to make the proposal a workable one, in particular with regard to the role of the supervisor and the proposals for the provision of information to creditors.

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

We appreciate that allowing the moratorium to commence simply by filing an application at court would minimise costs. It should be recognised however that the possibility of abuse could affect confidence in the procedure, and directors themselves may consider it preferable in a given case to seek a court order confirming that the qualifying criteria have been met (and contracts designated as such are agreed to be “essential”). An option to make an application to the court rather than merely filing would not of course preclude challenge by creditors (if the hearing was on an ex parte basis), but the existence of a court order may dissuade creditors from seeking to impugn the procedure. We strongly believe that an application to court route must be available, in parallel with an out of court filing route. In particular, the proposal in its current form precludes cases where there is a winding-up petition. We consider that there would be benefits in removing that exclusion: if it remains, a single unsecured creditor with an unsecured debt could prevent a company from utilising the moratorium simply by presenting a winding-up petition. A court application for a restructuring moratorium would then provide a forum at which the issue of an outstanding winding-up petition could be dealt with at the same time. Providing an option to make a court application would also be useful if (although in current circumstances this is very uncertain) there were issues regarding the ability of a company to make use of an English law
procedure (which the proposal is silent on), or a need to obtain cross-border recognition (the likelihood of “essential” contracts having cross-border features cannot be ignored), where the existence of a court order may carry more weight in other jurisdictions in which recognition is sought.

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

We are concerned that the proposal lacks sufficient detail. The requirement that the company is insolvent or in financial difficulty, or will “imminently” be in such difficulty, may mean that, by the time the moratorium becomes available, it is unable to meet the qualifying condition that it has sufficient funds to carry on business during the moratorium, meeting current obligations as and when they fall due as well as any new obligations that are incurred. It is also not clear to us whether the intention is to require all financing obligations to be met during the moratorium period. We would query the usefulness of a moratorium if the company is required to meet current obligations as they fall due where the debt sought to be restructured arises under finance rather than trade arrangements, and believe that this would significantly limit the usefulness of the proposed restructuring moratorium procedure as a whole. In practice, a company with both finance and trade creditors may look to agree a standstill with its finance creditors by reference to the terms of the existing documentation and utilise the moratorium to protect it from actions by unsecured creditors. Equally, the proposals do not address the situation where some level of forbearance has already been agreed in relation to some of the company’s obligations. Would the company have to demonstrate that it had funds available to meet the amounts in question, even if the creditor had agreed to a suspension or a deferral? That would seem to risk frustrating the purpose of the moratorium.

The proposals appear to envisage that the ability of the company to demonstrate at the outset that there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors will require the company to have sought views from some key stakeholders at least. It is not clear to us beyond that precisely how the applicant will be expected to demonstrate that the condition is satisfied (for example, would the outline terms of a compromise or arrangement be required?) and what evidence of stakeholder in principle support would be required?

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We have commented below on the proposals relating to essential goods and services.
In relation to creditor rights, we consider that the proposal places too much of an onus on the creditor to challenge the inappropriate use of the moratorium, with the attendant costs and time delays, for creditors who might already be out of pocket.

In relation to directors’ powers and responsibilities, we disagree with the wrongful trading waiver. We would hope that once sufficiently clarified and detailed in legislation, the required eligibility tests and qualifying conditions should be such that a director who is able to confirm that they have been (and will continue to be) met during the moratorium period is unlikely to be guilty of conduct falling within the wrongful trading provisions. However, to legislate for a blanket disapplication of those provisions could provide scope for abuse and send the wrong message. One solution suggested by some members of the Technical Committee might be to have a less categorical disapplication, so that only those directors who reasonably consider that the moratorium criteria have been and will continue to be, met should be able to rely on the disapplication. This would allow advisers to provide some reassurance to directors whilst limiting the scope for abuse. On the other hand, whilst arguably sufficient protection is already provided for in the defence available pursuant to s214(3), other members consider that any disapplication is unnecessary, and a partial disapplication would add undesirable complications. This difference of opinion amongst practitioners underlines the need for the full details of the proposal to be carefully and holistically considered. In addition, on a separate point, careful thought will need to be given to how the moratorium duration interacts with the clawback period for antecedent transactions, given the effect an initial moratorium period of three months would have on the ability to challenge a transaction under the antecedent transaction provisions of the Insolvency Act 1986 (in particular with an unconnected party, where the relevant period is six months), and the possibility that an extension of the moratorium would effectively preclude a challenge. The issue could be addressed by requiring court approval for certain transactions.

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

We are concerned that whilst the restructuring moratorium appears to be primarily aimed at large scale restructurings, the proposals in their current form could make the moratorium unworkable in such restructurings. An initial duration of three months may not be (and would probably not be) sufficient to enable a fully developed plan which is likely to be approved to be finalised, particularly in the context of large corporate restructurings with complex debt profiles. Similarly, a requirement for all secured lenders to consent to an extension would probably be unworkable in many cases – in our view a requirement for majority lender consent would provide a suitable balance between workability and the interests of creditors. We recognise however that a shorter period may be appropriate for SMEs, and that...
in that arena, it may be appropriate for all secured lenders to give their consent to an extension. Any implementation of the proposals would need to provide flexibility to reflect the complexities and breadth of creditor interests at different ends of the market. Finally, we find the proposed reduction of the 12 month limit for a subsequent administration difficult to justify, not least because it is envisaged that a different office holder would oversee that subsequent process, who would need to become fully acquainted with the company’s affairs and formulate a proposal for the conduct and aim of the administration. As the legislation currently acknowledges that 12 months is the minimum period in which this can sensibly take place, we see no reason for imposing unrealistically tight time limits.

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

We comment below in further detail on the proposed qualification requirements for supervisors of the restructuring moratorium. Our main concern however is that it is not clear to what ends the supervisor would be required to “meet certain minimum standards and qualifying criteria; [and to ] have relevant experience”. The role of the supervisor will be key to the success of the procedure, and achieving the appropriate balance between on the one hand creditor confidence in the procedure by appropriate safeguards, and on the other hand ensuring the role is neither too onerous (both in defined functions and exposure) or costly, needs careful consideration. As set out in the proposals, the anticipated functions of the supervisor are not entirely clear: the role appears to be the primary source of oversight, of the initiation and conduct of the process but this does not seem to be aligned with the limited involvement in the business that the consultation envisages. The proposal envisages that the supervisor would (a) need to be satisfied that the company is eligible for the moratorium ab initio (basing their assessment on evidence requested from and prepared by the directors) and (b) ensure that the qualifying conditions continue to be met during the moratorium (making the creditors and the court aware if they are not). The proposal also envisages that the supervisor should be able to attend board meetings, request information (as to which see our comments below) and should sanction transactions not in the ordinary course of business.

This brief exposition of the anticipated role of the supervisor does not however specify whether the supervisor incurs personal liability in carrying out his role, and if so, for what, and to whom. It is crucial that the liabilities and responsibilities of the supervisor be very carefully delineated and that his duties be owed to the company and to the court alone.

In the absence of clarity on the precise status of the supervisor, and who is intended to rely on his acts, deciding what his professional qualifications should be strikes us as premature. Once the profession has that clarity, further consideration should be given to the potential pool from which supervisors might be drawn, which might take into account the fact that the procedure is intended as an initial alternative to administration and that the costs of engaging an insolvency practitioner may be high (and as the
supervisor would not be able to be appointed in any subsequent administration, the potential costs of a second insolvency practitioner will be an important factor to consider).

We do not agree in any event that, in the short period of the moratorium, significant transactions outside the ordinary course of business should be a matter left solely to the directors and the supervisor. And, if this is not dealt with by a clearer definition of the role of the supervisor, an equivalent to s 127 Insolvency Act 1986 might usefully be considered to address this.

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

We agree with the general proposition that the costs of the supervisor and costs incurred during and as part of the process should in principle be an expense of the process, with appropriate protection and priority, although this begs the question what would fall within such costs.

In addition, the proposal as formulated does not give any indication as to whether, how, and by who, it is intended that the costs of the supervisor (and other costs) could be subject to scrutiny. We accept that any kind of formal creditors' committee would not be a sensible approach in the context of a short moratorium. But the proposal does not provide any forum in which these matters might be raised and ultimately controlled.

The issue of costs of the supervisor, and their priority, needs to be considered in tandem with the role, duties, and liabilities of the supervisor. As we indicate in our response to the previous question, the proposal lacks meaningful detail in this regard.

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

The proposal is that creditors will have a right to reasonably request information from the supervisor at any point in the new moratorium process, and that the Government is considering extending this provision to all insolvency procedures to “improve transparency”.

Our response focuses on the provision of information during the new moratorium process, although the comments may be equally applicable to existing procedures (but these should be subject to further analysis and consultation).
The new moratorium period is intended to be relatively brief, and to be initiated at a time of financial distress. The proposal envisages the possibility of different outcomes (a consensual restructuring or a formal process).

We would be concerned that, if creditors were to have free rein to request “information”, the efforts and resources of the company could needlessly (and perhaps deliberately) be diverted away from the very purpose of the moratorium and the ultimate aim. Additionally, the proposal ignores judicial commentary which recognises that limits can and should be imposed on requests for information which would needlessly divert time and resources.

Whilst seeking to introduce a general “reasonable” requirement, the proposal does not sufficiently robustly address key issues of what information could properly be requested (or appear to appreciate that – possibly sensitive and confidential - information might be requested for collateral improper purposes), nor does the proposal address the costs implications of complying with multiple requests, in particular whether the (subjective) interests of “transparency” for a small number of creditor outweighs the (entirely objective) interests of the general body of creditors, with comparable exposures, in minimising costs and delays in the process.

A better approach in our view would be for the legislation to provide instead for the company to be required to provide a defined information pack which is relevant to creditors who will be affected by the moratorium and an ultimate restructuring. Further thought would need to be given to what such an information pack should include, and would need to reflect what information it is reasonable to expect the directors to provide, and at what stage of the process.

We have commented above on the role and duties of the supervisor. The proposal is that requests for information would be made to the supervisor. However, there is no suggestion that the supervisor would have access to that information (or have the staff to deal with numerous requests), making it difficult or impossible for him to respond. Requiring the supervisor to be responsible for the accuracy of its information would be a potentially very onerous obligation. Again we would stress that it is key that the role and functions of the supervisor be very clearly defined.

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?

Taking the second limb of this question first, individual members of the Technical Committee have anecdotal evidence of situations where the continuation of supplies was important to the restructuring of a trading business. However in the absence of a wider and comprehensive survey and analysis, we have no firm empirical evidence to support (or not) the proposition.
Turning to the first limb, whilst we appreciate that using the term “essential” may at first glance be sensible (as the same term is used in s 233 Insolvency Act 1986), we consider however that it is not the most appropriate term in this context. The particular goods or services might be of a generic nature, and a particular contract to provide them might then not, objectively, be considered to be “essential” would be preferable in our view for this to be a matter for the directors, to determine that the particular goods and service, and the particular contract to supply them, are important for the restructuring (and that accordingly the relevant supplier should be paid for the supply). On a similar semantic point, the use of the word “contract” could inadvertently limit the scope of the provision, as it risks excluding situations (which are common), such as supplies under framework agreements, or cases where specific purchase orders (each constituting individual contracts) are historically how the company and the supplier trade; in the latter scenario, would the trading history be construed for these purposes as a “supply contract” which can be designated as essential? It will be important to capture in detailed drafting all common arrangements under which companies procure the provision to them of goods and services. Legislation would also need to address how to capture contracts along the supply chain, and a clear understanding of how the interim arrangements might impact on the terms of suppliers’ credit insurance (and how that impact might be avoided). In addition certain types of contracts, such as those for the provision of finance and hedging arrangements should be excluded. In brief the current proposals are in our view both complex and unclear and it is difficult to see how they will work in practice in an efficient manner.

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We have doubts whether the requirement for a supplier to make a court application to argue that it is not in fact a supplier under an “essential contract”, with the associated costs and timing issues, will be very attractive, particularly for suppliers which are themselves SMEs. Having said that, if the designation as an essential supplier ensures that supplies will be paid for in full, the expectation might be that such challenges would be rare. There may however be situations where the timing, rather than the fact, of being designated an essential supplier is prejudicial to the supplier, or, that, whilst not disputing that the contract is “essential”, the supplier has concerns that payment on existing credit terms might be jeopardised, or that existing credit terms for example are, in the circumstances, unfairly prejudicial (leaving it unable to meet its own obligations to third parties and possibly at risk of insolvency).
The proposal envisages that the court will, in the event of a dispute, determine whether a contract is or is not “essential”. We can see that in practice this could give rise to a significant amount of litigation.

Although there is no specific question relating to paragraphs 8.17 to 8.19 (incl) of the consultation document, we note that it is envisaged that an essential supplier would have a right to veto a plan and that the restructuring proposal would need to make provision for the continuance of essential supplies (presumably by the same essential supplier). If the essential supplier has been paid in full for supplies during the restructuring moratorium period, it is not obvious to us why he should then have a right to veto a proposal on the basis of pre-moratorium debt, and this could undermine the new cram-down power. The financial position of the company and the requirements of its business post-proposal may also mean that a particular essential supplier would not be the best option in the future. Again, we see no reason why the company should effectively be tied to a supplier after a proposal has been agreed by the requisite majority of creditors.

**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?

Our preference would be for current procedures (CVAs and schemes) to be retained as separate procedures, with the new restructuring plan procedure (largely based on the existing scheme provisions) being included in the Insolvency Act 1986 as a new procedure. We have made a general comment in our cover letter on the currently uncertain issues regarding jurisdiction and recognition.

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

Broadly, yes. The availability of the new proposal may be helpful in certain complex circumstances where classes of creditors are not already bound by inter creditor arrangements and junior creditors have some economic interests which may give them a hold out position which prevents the restructuring. Alternatively, a cram down mechanism may be useful in cases where the continuation of a legal entity, as opposed to the business, is required for other reasons (for example as in the My Travel case referred to in the consultation document) However, the detail of the procedure needs careful consideration, not least in relation to valuation, as to which see our comments below.

13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
Again subject to the fundamental question of the approach to valuation, we note that, were the restructuring plan provisions to be based on the current provisions relating to schemes, the developed body of jurisprudence relating to schemes would apply to, and guide, the interpretation of the new restructuring plan provisions. There would remain however fundamental differences, for example the 12 month time limit and strict order of priority. A preferable solution would be for the procedures to be identical, with the addition for the new restructuring plan of provisions for cross-class cram down by reference to a clear valuation methodology. This is not simply a question of making sure the scheme jurisprudence would apply (although that would be of undoubted benefit), we are also concerned, for instance, that the 12 month time limit and strict order of priority rule would make the new procedure insufficiently flexible and risk losing one of the key attractions of schemes.

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?

The issue of valuation is arguably the most complex and difficult aspect of this part of the consultation. The consultation paper acknowledges (in para 9.35 – which we would observe seems to us to conflict with para 9.34) that “valuation in a restructuring can be particularly contentious”. However the suggestion that the default option would be a “liquidation valuation”, leaving “flexibility for the use of other methods of valuation where appropriate” [9.35) does not suggest to us that there has been a consistent analysis of the various valuation methodologies available or the potential for lengthy disputes over valuation methodology. We strongly believe that in the absence of robust empirical evidence, drawing on the experience of other jurisdictions, it would be unwise to make any hasty legislative decision (even more so in light of our comments in our covering letter). Further consideration also needs to be given to the separate positions of SMEs and of large corporates.

In any event, we do not consider that a “liquidation” valuation would (save in very limited, rare, circumstances) be appropriate, if what is meant by “liquidation” is break up values, as the assumption of the plan would be that the business is viable as a going concern. A better starting point would be a counter-factual approach (going concern basis) or perhaps some other basis, with an initial counter-factual assessment. In the absence of rigorous data it is difficult to be definite.

We are also concerned that the question of whether one approach to valuation is appropriate or not (and if the latter, what is the appropriate alternative) is assumed to be a matter left to the court (and we note without specifying which court). The introduction into the legislation of a new cram-down process requires there to be certainty in how and when it can be implemented, and any lack of clarity regarding valuation methodology in particular would we fear invite disaffected creditors to dispute the chosen basis, prejudicing both the specific plan as well as the attractiveness, to companies and creditors, of the new procedure generally.
To the extent that the courts may be required to rule on the actual valuations arrived at, based on the applicable methodology, in any given case, it will be important, again for reasons of consistency and certainty, for there to be clear guidance to nominees in establishing values, and common standards. This might best be dealt with by a Statement of Insolvency Practice.

Our principal concern is that it would not be helpful for any new restructuring procedure to potentially give rise to a plethora of litigation.

**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?

This part of the proposal was less developed than the other elements [and as a consequence we feel unable to provide a detailed response. The idea of overriding negative pledge clauses and subordinating existing security requires a great deal of consideration, as does the applicable valuation to use when applying safeguards, which is absolutely key. Furthermore (perhaps because of the low interest rate and high liquidity environment that has underpinned the recent financial crisis) we are not particularly aware of a need for introducing legislation on this issue, or what the barriers to entry to the market for established US DIP finance firms really are. We are aware that a need for DIP Finance might arise in future perhaps (a) if we approach another recession but with higher interest rates and/or with lower availability of distress investment funds and/or (b) to use in conjunction with the new restructuring plan contemplated in this consultation, but possibly without the same ability in practice to provide expense priority restructuring plan proceeding funding. We do not consider that the case for introduction of rescue finance at the present time has been made out. In any event, the potential impact these provisions could have on the availability and cost of originating credit, and on the dynamics of restructurings needs to be carefully assessed. Some members of the Technical Committee are particularly concerned how the proposal would work in practice. The cost to SMEs of this type of funding is expensive, and it cannot be ignored that some funders operate less ethically than others and can seek to take advantage of a distressed situation. We also believe that thought needs to be given to whether the introduction of this measure might lead to a change in normal commercial lending terms during the course of a company’s life as the lending risk may be assessed as higher at the outset.
16) How should charged property be valued to ensure protection for existing charge holders?

A snapshot valuation of the charged property, which may turn out to be wrong, will offer little protection for existing chargeholders.

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

Without limiting our general comments above, this should be limited to new finance in the period of the moratorium.

**Impact on SMEs**

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

This is a very wide question. Generally speaking, there are are real concerns that the current CVA framework may be inadequate, although the lack of success in this regard may simply be attributable to economics rather than the absence of a suitable proceeding. It does work in certain circumstances, for example where there is a need for landlord cram down (and then only because of current market conditions) but for a standard SME business, it is commonly the case that in the absence of an upfront lump sum investment into the CVA it is highly likely to fail as trading forecasts are often too ambitious and infrequently achieved. As a result, CVAs are rarely considered for SME businesses, with the option of administration or liquidation being the only one (with consequent impact on rescue rates for SMEs).
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
A Review of the Corporate Insolvency Framework response form


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

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): Insolvency Practitioners Association

Address: Valiant House, 4-10 Heneage Lane, London, EC3A 5DQ

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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?
Practical observations

In principle, we are in favour of any proposals which will enhance the tools available to promote company rescue. However, while widening access to the CVA moratorium and rescue finance may have a part to play in encouraging rescue, we believe that the current proposals fail to balance these objectives with adequate safeguards for creditors.

The availability of processes by which a business may be restructured and the availability of finance to do so are not, in themselves, enough to ensure the viability of a business and/or prevent its ultimate failure in the longer term. In our experience, which is supported by research, businesses do not fail because of the lack of an appropriate process; they fail because there are fundamental deficiencies in the business model and/or the competence of its management.

Restructuring a business requires analysis of why the business has failed or is failing, in addition to affording it protection whilst this process is undertaken. Too often directors fail to act quickly enough in obtaining specialist advice when their businesses are struggling. We suggest that any proposals for reform must encourage business owners to seek advice from specialists at an early stage.

Additionally, we would suggest that giving directors protection from liability in the moratorium period may have unintended consequences in that it may encourage abuse of the process, particularly in the absence of adequate professional oversight. Models used in Germany and France motivate desired conduct on the part of company directors with both incentives to seek protection and effective deterrents by way of punitive sanctions for failing to do so.

If the activities of a company are loss-making, it is difficult to see how they will become profit making simply by virtue of a stay on creditor action. Where the root cause of an otherwise profitable company’s difficulties is a temporary cash-flow issue, this can typically be resolved through traditional means; where the cause is not a simple cash-flow scenario, it does not seem unreasonable to assume that trading losses will continue to be incurred during any moratorium period. For this reason, we believe that any moratorium period should be as short as possible and that 3 months presents an unacceptable risk to creditors of a further diminution in the funds that will ultimately become available to them. Furthermore, the current proposals do not address how any losses would be met.

It is clear that the proposed changes would lead to greater involvement of the courts, particularly in dealing with challenges from aggrieved stakeholders. It would be necessary for the courts to be adequately resourced so that they could deal with such cases quickly. At present, unlike the United States, we do not have dedicated insolvency courts. Furthermore, the cost burden of initiating a challenge is (unfairly, in our view) placed upon stakeholders, without sufficient oversight that the process itself is appropriate at the point of initiation.

On the subject of super-priority, we are deeply concerned that in providing this protection for funders, the ordinary costs of borrowing for UK business will necessarily increase to reflect the increased risk borne by lenders who can no longer be assured of their priority in recovery. The impact assessment does not monetise this likely consequence and we consider, therefore, that it may not present an accurate picture of the real costs to the economy of these proposals.

Our final observation is that it is not clear whether any new legislation would be retrospective. Borrowers and lenders will have entered into contracts on the basis of the
current order of priorities and lenders will have priced their risk on the basis that they cannot be crammed down. We suggest that if the order of priority is to be changed it should only affect security created on or after the date on which the new legislation comes into force.

Regulatory observations

The current proposals provide for a moratorium supervisor to be drawn from a broader base of regulated professionals than the insolvency profession.

However, it should be noted that the regulatory infrastructures for accountants and solicitors are markedly different from those applied to Insolvency Practitioners. The framework for the regulation of IPs has been tailored over the last 30 years to apply appropriate levels of oversight to those conducting insolvency and restructuring work. It would be highly undesirable to create a situation of regulatory arbitrage, and we would expect all professionals acting in the capacity of moratorium supervisor to be regulated to the same high standards. It would also seem only appropriate for those acting in that capacity to be fully conversant with the insolvency options that may be required to be utilised by way of exit to such a moratorium.

The only way to ensure consistency is through the application of common standard setting processes and inter-regulator cooperation. These processes and fora are already in place in respect of the insolvency profession and largely function effectively under the oversight of the Insolvency Service.

The impact assessment does not monetise the costs of creating a similar system for ensuring regulatory consistency in the event that the role of moratorium supervisor were opened up to other professionals. There is also little commentary or explanation as to why it would be desirable to create a parallel profession to that of insolvency practitioners.

We understand the desire to avoid unnecessary barriers to entry to the role of moratorium supervisor. The recent changes to insolvency licensing mean that practitioners may now specialise exclusively in corporate insolvency, by sitting appropriate examinations and demonstrating sufficient experience, without having to qualify to act in personal insolvency proceedings. In our view, those wishing to act in the capacity of moratorium supervisor should avail themselves of this entry route to the profession, thereby averting the need to establish another regulatory infrastructure and ensuring all those seeking to act in this pivotal role are appropriately qualified and monitored.

The Introduction of a Moratorium

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

Not as currently formulated. In most instances, by the time of distress it will be too late to meet the conditions of the moratorium that trading is conducted on a breakeven basis. As explained above, it seems likely that a distressed business will necessarily continue to incur trading losses, which will ultimately be suffered by creditors who have not been consulted.
There needs to be additional clarity around what are considered to be “trading costs”; how they are funded and who meets any losses accrued. Additionally, it is not clear how the rights afforded to employees are to be affected (for example, consultation) and how any arrears of wages are to be treated.

Finally, no information is provided about how the conduct of the moratorium supervisor is to be assessed and regulated and how abuse of the process is to be prevented.

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?

The efficacy of a court-based system will depend largely upon there being sufficient capacity and expertise within the court system. Experience within the US system would suggest that court-based processes are usually more expensive than those conducted out of court. Requiring creditors to act to bring the moratorium to an end will effectively shift the cost and burdens to them.

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

No. We do not consider there are sufficient safeguards contained in the current proposals as the filing appears to be made by directors prior to an independent professional having considered whether the qualifying criteria have been met.

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?

No. The proposals as currently formulated provide too much potential for abuse. There is a lack of early oversight and a potential lack of scrutiny of the moratorium supervisor.

Dissatisfied creditors will have to expend significant sums of money to challenge a moratorium in the court and there appears to be a lack of punitive sanctions for abuse of the process.

We would suggest that directors should be required to make a declaration of eligibility and that it should be an offence to knowingly make a false declaration (similar to the process of a declaration of solvency in a solvent liquidation).

It is proposed that directors are afforded protection in respect of losses in the moratorium period, whilst the process appears to ignore their pre-moratorium conduct. The company’s current circumstances may have been directly impacted by poor pre-moratorium corporate governance and the process does not provide of any scrutiny of that conduct. This contrasts with directors’ obligations when proposing a CVA under Rule 1.3(2)(c)(iii) of the Insolvency Rules 1986, whereby they are required to explain whether there are any circumstances which could amount to challengeable transactions (where the company to enter into
liquidation) and the penalties imposed by s 6A of the Insolvency Act 1986 in the event that a director makes a false representation in this connection.

Generally, we consider that appropriate behaviours should be encouraged with both incentives and deterrent sanctions.

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

No. For the majority of companies, we consider that the initial 3 month period is too long, particularly as filing appears to be without prior professional oversight. This could lead to unnecessary creditor detriment. We would suggest an initial period of 21 days, extendable to 42 days would be more appropriate.

In respect of larger businesses, experience in the US would suggest that more complex restructuring plans are often agreed within 3 months. Schemes of arrangement typically take 6-9 months to establish and would not be ready to go to creditors at such an early stage.

We would suggest that a shorter initial period, combined with the ability for the moratorium supervisor to extend the period by application to the court would be more workable and would reflect the considerable difference in the needs of the entities utilising the process.

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

In part. We are content with the suggested powers, however do not consider the qualification requirements to be sufficient or appropriate (for the reasons amplified upon above within our Regulatory Observations).

We consider that all moratorium supervisors should be subject to the same professional standards and code of ethical conduct, as applies to insolvency practitioners. In essence, we believe that the moratorium supervisor should be a licensed insolvency practitioner, albeit, potentially one licensed exclusively to conduct corporate insolvency.

Any risk of “conflict of interest” occasioned by confining the role to insolvency practitioners is mitigated by the provisions that a moratorium supervisor may not then act as insolvency office holder (although it should be recognised that this safeguard will, in itself, create some duplication of effort and cost).

Additionally, we consider that the moratorium supervisor should be required to provide some form of opinion, at the point of filing, as to the company’s eligibility and the suitability of the existing management to continue to be in control of the company’s affairs, as a protection against abuse of process by the unscrupulous. Protection could be afforded along similar lines to that provided in a CVA by the filing of a Nominee’s report under Rules 1.7 or 1.38 of the Insolvency Rules 1986.

More generally, we would comment that any process which is largely based upon Court proceeding is likely to ultimately be more expensive than an out of Court alternative, as has been seen in relation to Chapter 11 proceedings. Such proceedings are not deliberately designed to be expensive; the high levels of costs merely reflect the natural consequence of basing the process upon potentially contested proceeding.
7) Do you agree with the proposals for how to treat the costs of the moratorium?

Yes – but the costs of the moratorium need to be subject to appropriate oversight. The recently introduced regulatory objectives apply such oversight to insolvency professionals. This protection would not be afforded in the event the role is capable of being undertaken more widely.

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

Given the role of the moratorium supervisor is largely passive (with the directors retaining control over the company and its affairs), the supervisor may not be in possession of the information, nor necessarily have ready access to it. Therefore, we consider that the directors should be obligated to respond to requests for information, rather than the supervisor. Any such obligation will need to be subject to some limitation in respect of commercial considerations and issues of confidentiality, costs and reasonableness.

With regard to requests for additional information in insolvency proceedings, there already exists statutory provision for this to be provided in respect of fees and expenses and we are unconvinced that these provisions require further extension. Practitioners are required to act transparently in accordance with the Ethics Code and may be subject to disciplinary action if they fail to respond to a reasonable request or communicate in an appropriate manner.

Any extension of rights to information must include safeguards against excessive or potentially vexatious requests, or requests which could prejudice the outcome of the moratorium or rescue process. It should also allow practitioners to weigh the benefits of providing the information against the risks and costs of doing so. However, we would suggest the current system achieves that already and any additional requirement is, therefore, unnecessary.

Helping Businesses Keep Trading through the Restructuring Process

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

We believe that a mechanism for affording protection from withdrawal of essential contracts may assist the restructuring process.

However, consideration needs to be given to why supplies are withdrawn: typically illustrative of a lack of trust and confidence in the existing management or business or the likelihood of being paid. In addition, there may be cases where the supplier is unable to continue to supply as a result of its own financial difficulties or, importantly, the withdrawal of credit insurance.
We would suggest that the current proposals go too far in limiting the rights of suppliers and may result in innocent parties having to defend their position in costly legal proceedings. We believe that under current proposals, the burden of proof is effectively the wrong way round.

It would be fairer and give better protection against abuse to extend the existing statutory provisions to those suppliers assessed by the office holder (rather than the directors) as being “essential” to the recovery plan.

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We consider that there is too much emphasis on court-based challenge having to be mounted by the affected party. Court proceedings are invariably costly and the proposals effectively shift the burden of instigating them to the innocent party.

We believe that it would be preferable to apply independent oversight at the outset and implement a process that adopts a more consensual approach to continued supply. Consideration also needs to be given to providing a level playing field in how to enforce continued supply both in the UK and overseas.

**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?

The existing moratorium framework is well known, if little used. We believe that it would be preferable to extend that process, subject to appropriate safeguards, rather than to create a new process.

With regard to CVAs under the current framework, our experience suggests that those that fail do so as a consequence of the underlying viability of the business, rather than as a result of defects in the process.

Furthermore, we would urge caution that the basic premise for secured lending is not unduly impacted by such changes. If secured lenders feel there is a risk of their rights being adversely affected, it may restrict the availability of lending and it may incentivise their precipitative appointment of administrators. It may also serve to drive up the costs of borrowing for all businesses, which would be counter-productive to the stated objectives of the proposals. We do not believe these factors have been fully costed into the impact assessment.

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

Yes – in theory. We would comment, however, that whilst this is superficially attractive, it may impact on broader UK lending practices.
13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

We broadly agree that the Court is probably the appropriate body to consider challenges. However, we would suggest that this is largely a question for banks and creditor groups. We note with some concern that only one such organisation is represented in the list of consultees and we would suggest broader consultation with the financial sector.

It is not immediately clear from the proposals whether the intention is to make all Schemes of Arrangement a variety of CVA, and suggest that this should be clarified.

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 cramdown onto dissenting classes?

A minimum liquidation valuation will not always be the appropriate point of comparison and we consider that the basis of valuation should depend on circumstances and potential alternatives available to that entity, at that time.

Whilst we support the concept of cramdown, thought should be given to who is benefitting from it, particularly if the ultimate outcome of the process is better than originally anticipated. We consider that whilst the voting rights of “out of money” creditors might reasonably be cramdown, their right to participate in any benefits to which they would otherwise have been entitled should not be compromised.

**Rescue Finance**

15) Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. To do so could adversely affect the availability of start-up finance and would be likely to increase the costs of finance to reflect the additional risk. We also understand that such proposals may cause the banking sector some difficulty in fulfilling their Basel III obligations, and suggest that this should be explored further with them.

We do consider that a removal of negative pledges would be of assistance in securing funding on any available headroom. Our members’ experience suggests that where there is a viable business, existing funders will lend, if there is sufficient headroom, and where they decline to do so, it is a reflection of their view of the company’s longer term viability.

Administrators are effectively already at liberty to borrow on a super-priority basis, if they negotiate with existing lenders. We do not consider that encouraging the further emergence of DIP Financing, to the detriment of existing lenders and unsecured creditors, would be in the long term benefit of UK business as the costs will ultimately be borne in increased lending rates to the solvent majority and a diminution in the returns to unsecured creditors of the insolvent minority.
16) How should charged property be valued to ensure protection for existing charge holders?

N/A. We do not consider that super-priority over fixed charge holders should be afforded to rescue finance providers, as to do so would adversely impact on lending more generally.

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

N/A

Impact on SMEs

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

In our members’ experience, SME’s are the most difficult to restructure. The costs can be prohibitive and formal insolvency, perhaps with a sale of the business assets, may be a less costly and quicker solution.

Why SME’s fail in the first place is highly variable, but a key and consistent factors are a lack of education on the part of the business management, delays in accessing professional advice and failure to acting swiftly to address financial distress at an early enough stage for restructuring to be a viable option.

We believe that company directors should be incentivised to act more quickly; not solely through providing them with additional protections, but also through more effective punishment when they fail to act.

Owner/manager personal guarantee liabilities will subsist, even where creditors are crammed down, to the effect that the impact of these proposals on the SME sector is likely to be minimal.

The proposals fail to recognise the inherent tension between encouraging entrepreneurial activity by facilitating re-starting without debt and the suggested broader benefits of restructuring as an alternative to liquidating, whilst under the burden of existing debt. It is arguable that the debt-free business is ultimately more likely to succeed, in the event that any underlying deficiencies in the business model and/or the management competencies have been addressed.

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.

The impact assessment is not persuasive of the economic benefits of necessarily restructuring a failing business, particularly in the SME sector, when countered against the broader risks of adversely impacting the availability of business finance presented by these proposals.
Further, it seems improbable that an increased reliance on Court proceedings will act to reduce costs and efficiency, given the example provided by the US system.

When previously consulted upon in 2009, it was noted that there was scepticism amongst consultees about the benefits of importing new measures drawn from the experience of other countries with very different histories and systems; and that there was wide support for the suggestion that changes should not artificially prolong the life of companies which were not fundamentally viable and which did not have competent management.

We do not believe that these propositions have fundamentally changed.

Given the potentially serious impact on the availability of business finance that a shift towards an US style system could have, we would suggest that this area should be considered by a Royal Commission formed for that purpose, rather than a brief period of consultation with a small number of selected parties.

**About the IPA**

The Insolvency Practitioners Association is a membership body recognised in statute for the purposes of authorising Insolvency Practitioners under the Insolvency Act 1986 and Insolvency (Northern Ireland) Order 1989. It is the only recognised professional body to be solely involved in insolvency and for over fifty years the IPA is proud to have been at the forefront of development and reform within the profession.

The IPA has approximately 2,000 members, of whom 577 are currently Licensed Insolvency Practitioners (479 of whom are authorised to take insolvency appointments).

The IPA currently licenses approximately one third of all UK insolvency appointment takers, who are subject to a robust regulatory regime, applied by the IPA’s dedicated regulation teams carrying out complaints handling, monitoring and inspection functions. The IPA also undertakes monitoring visit work for the Royal Institution of Chartered Surveyors under a joint voluntary regulation scheme for registered property receivers.

The IPA has a longstanding and continuing commitment to improving standards in all areas of insolvency (and related) work. It was the first of the recognised bodies to introduce insolvency-specific ethics guidance for IPs, and the IPA continues to be a leading voice on insolvency matters such as the development of professional standards, widening access to insolvency knowledge and understanding, and encouraging those involved in insolvency case administration and insolvency-related work to acquire and maintain appropriate levels of competence and skills.

The comments and opinions expressed below represent the views of the IPA’s Corporate Consultation Committee, a committee comprised of practitioners with a specialism and particular expertise in the area of corporate insolvency and restructuring, and are not intended to reflect the opinion of each individual and firm member of the Association (who remain at liberty to express their own views within their responses to this consultation).
A Review of the Corporate Insolvency Framework response form


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

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

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Organisation (if applicable): University of Oxford

Address: Merton College, Oxford OX1 4JD

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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?

Yes. This is a view I have expressed previously (see J Payne, Schemes of arrangement (CUP, 2014) pp 263-264 and Payne (2014) LQR 282)

The view was put forward by the Insolvency Service in 2011 that the case for introducing such a restructuring moratorium was not made out at that time (see Insolvency Service, Proposals for a Restructuring Moratorium- Summary of Responses, May 2011, 5). Of course it is possible for creditors to reach a contractual standstill arrangement to fulfil much the same purpose, and in the largest and most sophisticated restructurings involving schemes twinned with administration this is often enough since the restructuring will often involve only a small group of relatively sophisticated creditors who understand the benefit of entering such an agreement. However, this is not the case in all restructurings, and the increasing fragmentation of the debt market means that often identifying and locating all of the relevant creditors in order to get them to enter such an agreement is problematic. Further, the group is less homogeneous and thus agreement may be harder to reach. Such agreements also, of course, involve expense that would better be avoided.

As evidence of the fact that some kind of solution is needed see eg Bluecrest Mercantile BV [2013] EWHC 1146 (Comm) in which the judge needed to exercise the discretion of the court to order a stay in a scheme in order to give the company the opportunity to put the rescue plan in place.

It may also be noted that other jurisdictions offer some form of moratorium to deal with these issues see eg the Singapore scheme of arrangement (Singapore Companies Act, s 210(10) and the recently introduced reforms in Spain and the Netherlands which are based on the English scheme but do include a moratorium. The UK has been a centre for debt restructuring for both UK and non-UK companies in recent years, due to the development of the scheme twinned with pre-pack administration, but this option looks less attractive than some of the mechanisms being developed elsewhere (such as the Dutch regime). In order to stay competitive in an international market the UK does need to update its debt restructuring mechanisms, specifically to introduce a single mechanism that combines the benefits of a scheme with a moratorium and a cram-down option.

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?
Yes, this seems sensible. Some thought may need to be given to the issue of communicating the fact of the moratorium to the creditors. Depending on the nature of the debt in place it may be that it is not straightforward to identify and locate all of the creditors in order to send them a notice. Other forms of advertisement may need to be considered.

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

Eligibility tests

The 2016 consultation paper avoids one of the problems of the eligibility requirements in the 2009 consultation paper (“Encouraging Corporate rescue”), which attempted to restrict the moratorium to UK incorporated companies. Leaving this moratorium open to use by non-UK companies is to be applauded, particularly given the widespread use of UK debt restricting mechanisms (especially schemes of arrangement) by non-UK companies in recent years.

Of the three eligibility criteria that are specified:

(i) Companies would have to demonstrate, first, that they are already or imminently will be in financial difficulty, or are insolvent. This seems sensible although further guidance as to what “imminently” means in this context would be beneficial.

(ii) Second, the moratorium is not available to certain companies, such as banks, insurance companies and companies involved in certain financial market transactions. This is broadly sensible given that companies such as banks are subject to their own special resolution regimes.

(iii) Third, 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 qualify for a moratorium. Again the purpose behind this provision (to safeguard creditor interests) seems unarguable, but it may have the unintended consequence of encouraging creditors to present a winding-up petition early in order to prevent a moratorium being put in place.

Qualifying conditions

The qualifying conditions are largely unchanged from those proposed in the 2009 Consultation. The first is that 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 as they arise. This suggests, as a minimum that the lender(s) providing funding during the moratorium will need to consent to the proposals. This qualifying condition is broadly fine but further guidance might be necessary on specific issues eg whether account needs to be taken of any scheduled interest or amortisation payments.
Second, 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 concept of “satisfactorily” demonstrating this point is a little obscure and it is not clear how the company would be able to demonstrate that it had passed this test. Will the company need to consult with its creditors in advance in order to meet this test? And, if so, which creditors? All creditors? Only secured creditors? Only those with a remaining economic interest—and if so measured how? If creditor approval is required, what proportion of the creditors would need to consent to it in order for the company to satisfy this reasonable prospects test? Alternatively, will it be enough if the supervisor has been consulted and forms the view that the proposed plan meets the reasonable prospects test? But this may be difficult in the absence of consultation with 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?

Creditors would have the right to apply to court to challenge the moratorium during the first 28 days. This raises an issue about how creditors will receive notice of the moratorium in order to take the view about whether to challenge it, and also about what would be the effect, if any, if creditors do not receive notice. The consultation paper is unclear on this issue. Where the restructuring occurs at the level of the holding company there will be no trade creditors, only financial creditors, so this may simplify matters, although where the creditors include bondholders any requirement to provide individual notices may be problematic.

As regards directors, the consultation paper states that “for consistency across insolvency and restructuring procedures, directors’ duties will remain unaltered in the moratorium” so presumably directors will remain liable for wrongful and fraudulent trading and other breaches of duty. It is contemplated however that directors would be protected from liability for trading, under s 214 Insolvency Act for example, “if the conditions for a moratorium are maintained and the directors perform their duties as required under law” (although if they have performed their duties how can liability arise?). This makes it all the more important that there is clarity around the conditions for the moratorium.

In addition the consultation paper proposes new sanctions for actions including obtaining credit without first disclosing that a moratorium is in force and failing to supply information required by the supervisor. These mechanisms are clearly intended to provide creditors with protection but further details will be required about these potential claims and the sanctions that will attach to them before they can be properly judged.
5) **Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?**

The time limit for the moratorium is three months. It seems likely that more time will generally be needed for large restructurings (for which the moratorium is most likely to be used).

The inclusion of the right to extend the moratorium by a vote of the creditors is an improvement on the suggestion in the 2009 Consultation paper that this be achieved by way of a court hearing. The vote requires the consent of all secured creditors but only 50% unsecured creditors. One relevant consideration which isn’t taken into account here is whether the creditors are in or out of the money. Perhaps the vote by unsecured creditors should be constrained to those with some remaining economic interest in the company (otherwise it will potentially provide those out of the money with hold up rights) although it is acknowledged that this then opens up the difficult question of how this issue is to be judged (and by whom).

I note that the creditor vote here is simply by value – this is preferable to the by value and by number requirement employed at para 9.20 (see Q12 below).

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

The role and powers of the supervisor seem broadly sound. It is sensible that the supervisor should not be allowed to act as an insolvency practitioner for the company should the company subsequently enter a formal insolvency process, something that was not made clear in the 2009 Consultation Paper.

One issue which remains unclear, however, is exactly who appoints the supervisor (and, further, who determines the remuneration of the supervisor). This could be an important issue and should be clarified.

Also, what happens if the supervisor gets things wrong (eg regarding the continued application of the qualifying conditions)? What is the nature and level of liability? Will the supervisor be protected if s/he acts in good faith?

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

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

Yes, creditors should be able to request information, subject to the provisions set out in the document. A couple of questions, though; (i) will individual creditors be able to request information (any de minimis limit on this?) and (ii) if one creditor requests information will that information then be shared with all other creditors or made public in any way?

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?

In principle this is a sensible proposal and in line with the approach adopted in other jurisdictions. It seems clear that providing for the continuation of essential services beyond utilities and IT services is likely to increase the number of business rescues. In addition, preventing such suppliers from holding the company to ransom and extracting value at the expense of other creditors is undoubtedly a benefit.

The difficulty here revolves around the definition of essential vs non-essential contracts. While there are clearly dangers in providing a definition, the criteria provided in para 8.15 are rather vague and unlikely to provide a bright line for companies and creditors. In particular, given that the burden in this context seems to be cast on the supplier (because the proposals state that it will be for the supplier to provide an objective justification as to why the services are not essential) this is potentially problematic. Given the potential for abuse (with companies designating non-essential or borderline contracts as essential) casting the burden on suppliers in this way may be overly harsh.

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?

See above comments – it is not clear that the suppliers are provided with sufficient safeguards.
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?

The restructuring plan would work best as part of an existing procedure, since such a procedure will already have a developed jurisprudence, with many of the difficult issues, such as the protection of minority rights, already having been tested in practice and having received clear judicial and academic analysis.

The preferable existing procedure to which this plan should be linked is a scheme rather than a CVA. CVAs are infrequently used, especially in the big restructurings, and the jurisprudence regarding this mechanism is much less well developed. Most large restructurings already take place via a scheme twinned with an administration, so facilitating these to occur by way of a standalone scheme makes sense. The CVA structure does not readily lend itself to the proposed restructuring plan, not least because it does not bind secured creditors and has no mechanism for dividing creditors into classes and has no structure for the mandatory court hearings that are envisaged in this plan. The proposed restructuring plan fits far more comfortably with the existing scheme regime.

The potential downside of schemes compared to CVAs is the requirement of two court hearings and the costs that this entails. CVAs are thought to be more attractive for small companies because of the reduced costs involved (CVAs have no compulsory court hearings and are simpler procedurally in that they have no class voting, for example). However, the proposed restructuring plan requires these elements to be present (ie compulsory court hearings, class meetings etc), so that any perceived cost and complexity advantage for CVAs will disappear in any case.

Judges in schemes are already used to dealing with the issues that the plan would raise, such as class meetings, minority protection and valuation. The restructuring plan is almost identical to the existing scheme in structure and therefore it would be sensible to amend the existing scheme to allow for a cram-down (a relatively simple matter) rather than seeking to amend the CVA, which would require very substantial revisions to the CVA and would result in an inferior product.

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

Yes. I also agree that voting should be in classes and that these classes should be decided by the company and confirmed by the court. This is what already happens in schemes and
does work as an effective form of creditor protection. It is another reason why attaching these plans to schemes rather than CVAs makes sense, since there is a rich and developed existing jurisprudence on this issue.

One point on voting requirements, however: the suggested majority vote repeats the existing approval requirement for schemes ie a majority in number representing 75% in value of the creditors or class of creditors. The addition of the majority in number requirement (headcount test) is not found elsewhere in company law and has been heavily criticised, and indeed other jurisdictions have amended the approval test for schemes, removing the headcount requirement (for discussion see J Payne, Schemes of Arrangement (CUP, 2014) pp 61-68 and 184-187). This can prove a problem in both member and creditor schemes. For instance in bondholder schemes it is not clear whether the test applies to the individual bondholders or the trustee- if the latter then there can be difficulties applying the headcount test. The benefit of the headcount test (to protect small creditors) can best be dealt with in other ways eg via the exercise of the court’s oversight in approving the plan.

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

I agree that the structure of the restructuring plan should follow that of schemes ie a minimum of two court hearings, one to deal with the classes issue (and to ensure that the requisite disclosure is provided to creditors) and the second to determine whether to approve the plan. It is also clearly correct that the court should not be a rubber stamping device and that it should be able to refuse the plan in appropriate circumstances.

Broadly, the considerations set out in the consultation paper for the court to take into account at this point in time follow those that exist in schemes and these generally work well. There is an additional requirement, which operates in practice in existing schemes but which is made explicit here, namely 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. This raises the vexed issue of valuation, which the consultation paper tackles only very briefly. The issue of valuation is so complex and so divisive that a greater level of statutory guidance on this issue would be potentially beneficial (see Payne, Schemes of arrangement (CUP, 2014) pp249-253).

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?

See the answer to Q13.
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?

Yes, in principle it would be valuable to develop a rescue finance regime in the UK. Getting the system right could encourage business rescue. However, as the consultation paper acknowledges, this is by no means a straightforward issue and the needs of the company for new finance, and the incentives and desire for security from the new provider of finance need to be balanced against the need to protect existing creditors.

The devil with such proposals is generally in the detail and not much detail is provided by the consultation paper. It will be important to demonstrate that existing creditors are protected which would require careful thought as to valuation, amongst other things. The negative pledge could be overridden where it is deemed that the current security holders’ indebtedness can be fully discharged from the sale of the assets. When and how would that valuation be performed and by whom? What level of court oversight would be involved? There is the potential for abuse where a snapshot view is taken in volatile market conditions. It is also worth considering the likely response of existing creditors to this situation. For example, trading creditors may be less willing to continue to trade with the company given that rescue finance would rank ahead of trading expenses.

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

See Q15.

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

It seems likely that in some circumstances trade creditors and other counterparties may seek to renegotiate better terms or the payment of their debts to date as a condition of continuing to deal with the company (this will only be relevant where the restructuring involves an operating company). They may be barred from doing so if the contract is deemed essential, but in other circumstances, would these renegotiated terms be given super-priority?

More generally, the concept of “new lending” will have to be carefully defined.
Impact on SMEs

18) Are there any other specific measures for promoting SME recovery that should be considered?
The sort of regime envisaged by this consultation paper is likely to suit large businesses. The plan set out here, mirroring the scheme procedure and involving class meetings, two compulsory court hearings etc will inevitably have costs attached to it and this may make it unsuitable for small companies. A different regime is probably needed for small companies – one which keeps down costs. A CVA (as it exists at present) with a moratorium attached (ie a moratorium for companies of all size) may work well for such companies. The very smallest companies may even find the costs of such a regime too prohibitive – for such companies liquidation may continue to be the lowest cost option.

However, concerns about SMEs should not detract from the value of the proposals put forward in the consultation paper (especially the moratorium and cram-down options) which can provide real value and benefit to companies and which can help to keep the UK competitive globally in terms of its debt restructuring mechanisms.

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.

Other comments:

As regards the moratorium, it is notable that many large restructurings (where such a moratorium is most likely to be used) have an international dimension and such a moratorium might be thought to have most value if it is recognised and capable of being enforced in other jurisdictions. This point is not addressed in the Consultation paper.

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
A Review of the Corporate Insolvency Framework response form


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

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:

None.
Questions

Name: Tony Groom FEACTP (Fellow European Association of Certified Turnaround Professionals) (tony.groom@k2-partners.com)

Organisation: K2 Business Partners a trading name of K2 Partners Ltd (www.k2-partners.com)

Address: Blythe Farm, Mill Street, Gamlingay, Cambridgeshire SG19 3JW (01767 651600)

<table>
<thead>
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<th>Respondent type</th>
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<td>Micro business specialising exclusively in turnaround (up to 9 staff)</td>
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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?

Yes, I fully support the proposals as outlined and my responses below are intended to offer suggestions where the proposals might be augmented.

I view the proposals as offering two significant initiatives that will improve the prospects of businesses in difficulties:

a. Proposed moratorium – this should be regarded as a new initiative providing for a standstill on liabilities to creditors and I believe it should be distinct from the CVA moratorium. CVA moratoriums have not been used by insolvency practitioners because their own advisers, insolvency lawyers have advised that it imposes too much liability on them as supervisor of the moratorium. Attempts to update the CVA moratorium are also unlikely to succeed, hence my recommendation that it be regarded as a new initiative. In particular the moratorium should be seen by directors as a procedure they can adopt early and easily. The objective of any proposed legislation should be to change the current reality of directors from putting off the seeking of help until it is “too late”. The objective of the moratorium should be to provide for time to identify and implement a better outcome for creditors while protecting their interests;

b. Proposed cram-down – this should be regarded as a non-insolvency restructuring procedure since too many CVAs have failed, despite the scope for using CVAs as a restructuring procedure. The objective of any proposed legislation should be to change the current perception by directors and indeed most stakeholders who regard CVAs as an insolvency process rather than restructuring tool. The objective of any cram-down should be to improve the return to creditors against that achievable in a liquidation and to preserve jobs. I have addressed the reasons for the failure of CVAs in my responses below.

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?

Yes, I agree with the proposals for simply filing the application in Court.

Consideration might be given as to who is notified and when they are notified. Given the principle that no creditor should be adversely impacted then I would recommend that there is no need for prior notification of secured
creditors since they have the right to return to court to challenge the moratorium but they would need to demonstrate that their interests are adversely impacted if their challenge is to result in the moratorium being dissolved. The advantage of this is that it will limit the scope of advisers to secured creditors who in the past may have been influenced by their own self-interest when advising their clients.

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

I would argue that the current definition of insolvency (s123 IA 86) is adequate as the eligibility criteria for most companies to seek a moratorium but understand that certain exemptions might be applied.

I agree with the proposals for eligibility and qualification and specifically agree that the specified outcomes when filing for moratorium should only be to achieve a going concern whether via a CVA or consensual restructuring.

The going concern objective is unlike the possible outcomes in Administration which has been hijacked as a procedure to achieve a better realisation of assets prior to Liquidation. I understand that the Cork Report 1982 that led to the introduction of the Administration procedure as set out in the Insolvency Act 1986, and then subsequent attempt to reform it as part of the Enterprise Act 2002, were aimed at providing Insolvency Practitioners with a business rescue tool. The intention was to use the protection from creditors provided by Administration as an opportunity to restructure the company so as to achieve a going concern status. It was not intended that the Administration procedure would be used to sell assets as its primary objective. Nor was it intended to be hugely expensive.

As already stated under 2 above, creditors should have the right to challenge the moratorium and this ought to be sufficient to deal with abuse or any shortfall of eligibility and qualifying criteria that was not picked up by the court in the original application.

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?

Yes, creditors’ interests are protected by both the standstill provision and their right to challenge the appointment within 28 days. Essentially the prospect of having a moratorium as an automatic standstill will be useful since standstill agreements currently have to be agreed with every creditor.
The main benefit of a moratorium will be to deal with those, albeit few, creditors who pursue hold-out or ransom strategies.

A common strategy is when landlords restrict access to an office or to WIFI when arrears are due. This is often the case with serviced offices.

Bailiffs and Sheriffs are only interested in enforcing their client’s judgement which even when it is for a small amount can result in key assets being removed which may not be in the interests of all the creditors.

Creditors increasingly seek to prefer themselves by issuing a winding up petition. This can be when they become aware of a problem such as when I as a consensual turnaround practitioner approach them with a view to discussing a grace period (standstill agreement) and or terms for restructuring their debt. I would add that the increase in the money claim court fees has switched many creditors to using winding up procedure as a debt collection tool. Furthermore there are few and rarely used sanctions for issuing a winding up petition as an abuse of process such that it has become a default debt collection option for many solicitors. The abuse is such that all too often a winding up petition is presented without a statutory demand having been issued. And there is little that the courts can do.

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

Yes, I agree with proposals regarding the duration, extension and cessation of a moratorium. It also makes sense that creditor approval is necessary for an extension beyond the initial three months.

I would add that it should be easy to dissolve the moratorium early. It should also be incumbent on the supervisor to vacate office and notify creditors if she/he believes that circumstances have changed or if she/he is not getting sufficient information or support from the directors. Any failure by the supervisor to vacate should be investigated if the company enters Liquidation or Administration. These provisions would provide additional protection for creditors.

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

Yes, I agree but would request that approved members of the European Association of Turnaround Professionals be eligible for the role of supervisor.
In addition to a professional qualification, consideration might also be given to requiring supervisors to be a member of a turnaround organisation such as TMA or IFIT although membership is not a professional qualification.

While licensed insolvency practitioners are the only people who can currently become supervisors of a CVA moratorium, turnaround generally involves a different approach to those with experience of administering an insolvency procedure. Turnaround generally requires a hands-on approach to identifying and implementing fundamental change and is more than restructuring a balance sheet by cramming down creditors. Given this it may be worth requiring licensed insolvency practitioners to declare their expertise. A review of the R3 directory 2016 will reveal that very few list themselves as either specialising in or having an interest in turnaround.

Conflicts of interest might also be addressed where I believe that directors should have the right to appoint a supervisor and not be influenced to appoint a panel firm nominated by a qualifying floating charge holder. I would also argue that supervisors should not be able to become the Liquidator or Administrator if the company fails within a specified period after the moratorium is dissolved, say 12 months.

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

Yes, although I would argue that fees should be reasonable and reflect the time spent and experience of the supervisor such that they should be reviewed if the company subsequently enters Liquidation or Administration.

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

I believe that giving creditors the right to demand information may prove a hostage to those who make unnecessary demands.

It is, however, normal in a consensual restructuring to provide information to reassure creditors whose support is needed for proposals. It is also normal to provide a considerable amount of information if a CVA is proposed.

There may be grounds for filing a statement of affairs with the application or providing it to those creditors who request it may also be a solution.

If there are to be any provisions for a formal cram-down by requisite majority of creditors then a minimum disclosure should be a statement of affairs,
comparison of outcomes between proposal and liquidation, distribution statement and a list of creditors.

This area may offer scope for addressing the lack of creditor involvement in restructuring. Consideration might be given to the idea that creditors representing more than a fixed percentage of the liabilities, say 10% can be members of a creditors’ committee with specified rights such as to meet the supervisor, say, at least once a quarter and to review more information under a non-disclosure agreement.

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?

Yes, I broadly agree with the proposals but suggest that suppliers who don’t want to supply will find ways of frustrating any orders or will apply ransom terms. It may be possible to enshrine some form of obligation to supply providing prepayment has been made.

One area that might be considered for legislation is continued access to the bank account with detailed provisions to protect both the bank and the company.

Reliance on pre registering essential supplies in the application or subsequent applications to court might also be considered but enforcing this is likely to be a problem so I would recommend a light touch with any regulation of supplies other than specifying the right of access to the premises, continued use of lease equipment, heat, power, light and continued use of the bank account.

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?

This has previously been addressed.

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?

The introduction of a cram-down by a class of creditors is imaginative and would make a huge contribution to the success of any restructuring plans.

While it could be argued that CVAs are also a cram-down procedure, the scope for restricting the cram-down to one or two classes of creditors brings the benefit of a Scheme of Arrangement without the costs.

The cram-down provisions in a CVA and in particular its ability to deal with ransom creditors are powerful but underutilised due to a number of factors. All too often CVAs do not address the underlying viability issues and the cram-down is not supported by fundamental change to the business and its operations. I believe this is due to the fact that most CVAs are prepared by insolvency practitioners who focus on using CVAs to restructure the balance sheet but they do not get involved in the turnaround initiatives necessary to reorganise the operations to achieve viability.

Another factor impacting on the success of CVAs is their perception and stigma.

My experience is that these reasons are more an issue for directors who believe their clients won't do business with a company in a CVA. This is related to CVAs being formal insolvency procedure. I believe this is also a major reason why directors delay seeking help. It doesn't help that the undertakers are also the doctors. The result is that everyone argues that directors leave things until it is too late. The delay also contributes to a commonly held view that directors who let events slide too far must be rogues.

It is argued that suppliers won't supply but this is more to do with extending credit. Here I believe that CVAs or indeed consensual restructuring should not assume credit where payments for supplies should be on a pre-paid or proforma basis.

It is unfortunate that most agreements have terms that automatically trigger a default in the event that a company enters a formal insolvency procedure.

Another issue is that some banks won't continue to provide bank accounts to companies in a CVA, even if the account remains in credit. Related is the way institutions rely on computers in a way that deters them from doing business
with companies in a CVA where the institution has three options for a company’s status – Active, Dormant or Insolvent.

The above factors are down to CVAs being a procedure in the Insolvency Act 1986 whereas Schemes of Arrangement are a procedure in the Companies Act 1985.

I therefore would urge that any new cram-down provisions should not be regarded as a procedure under an Insolvency Act. Given that the outcome of a successful proposal is aimed at the company becoming solvent then the insolvency ought to be temporary. Ideally this ought to be a Companies Act procedure but I appreciate that it may be tacked onto other legislation. It should be remembered that no one refers to the Enterprise Act 2002 when restructuring companies despite its amendments to the insolvency procedures.

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

Yes, this is key to dealing with dissenting, hold-out, ransom and vexatious creditors who often have a different agenda. The requisite majority deals with the fairness principle. The provisions for a challenge through the court deal with those who wish to claim unfair prejudice.

It is also hoped that it will involve greater engagement by creditors who will have a greater stake in the business’s future where in the past few creditors have read CVA proposals let alone submitted modifications that may have contributed to improving their prospects of success.

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

Yes for the reasons stated above. In addition I think it is necessary for the supervisor to set out her/his reason for distinguishing between the classes of creditors and to justify why creditors have been included in one class rather than another. I also believe that creditors should have the right to challenge their inclusion in a class and if they are not happy then they should be able to make an application to court during the challenge period. The prospect of a challenge should make sure that supervisors give this area considerable attention to avoid any unfair prejudice or attempts at manipulating the requisite majority in a class.

Consideration at this stage might be given as to which class should cover HMRC liabilities.
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?

Yes for the reasons stated above. The principle of a better outcome should be enshrined in any cram-down procedure and be supported by a minimum disclosure including a statement of affairs, comparison of outcomes between proposal and liquidation, distribution statement and a list of creditors.

With regards to the basis for valuing assets, I do not believe that a formal third party valuation should always be required. There needs to be a level of discretion exercised by the supervisor where she/he should review and disclose the valuation principles. I also believe that creditors should have the right to challenge any valuation and if they are not happy with the responses then they should be able to make an application to court during the challenge period.

**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?

I believe that fixed charges should remain intact although any shortfall in the security should be subject to the cram-down provisions. This will protect companies from those debt traders who adopt a ransom strategy having bought bank or secured debt at a discount and then seek to enforce their security.

There is the unresolved issue of the floating charge portion of a debenture which only crystallises on appointment of a liquidator or administrator. By way of a background, I understand that consultation prior to the Enterprise Act 2002 originally sought to get rid of the floating charge but resulted in the bias towards Administration instead of Administrative Receivership.

I therefore propose that floating charge assets can be used by companies in a moratorium as collateral for offering security as is current practice during formal and consensual restructuring. There is therefore no need to define this as super priority.

16) How should charged property be valued to ensure protection for existing charge holders?
I believe this ought not to be necessary when the asset values exceed the liability. In the event that a shortfall is to be included in any cram-down then a formal valuation should be required by a suitably qualified professional firm.

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

This implies preference. I believe this is already covered by experienced turnaround professionals who minute or document the reason for such payments and can be held to account as shadow directors.

**Impact on SMEs**

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

Again a cram-down by class of creditors is imaginative and would make a huge contribution to the success of restructuring SMEs. My main request is that it not should not become regarded as an insolvency procedure.
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
6 July 2016

Dear Sir/Madam

Review of the Corporate Insolvency Framework

This letter and appendix constitute KPMG Restructuring's response to the review of the corporate insolvency framework paper prepared by the Government and issued on 25 May 2016.

Who we are

This response is prepared on behalf of the KPMG Restructuring Practice. We are a national practice with 13 of our offices within England, Wales and Scotland undertaking Restructuring work, with some 620 staff including 35 appointment-takers. In addition to those taking appointments, a further 31 staff have passed the JIEB examinations and 78 the CPI examinations.

We have a strong presence on several of the Technical and Regulatory committees in existence for the insolvency profession, including individuals on the Joint Insolvency Committee, the R3 General Technical Committee, the ICAEW Technical Committee, the ICAEW Regulatory Board, the IPA Council and the ICAS Technical Committee. In addition we have a member of staff on the R3 Education, Courses and Conferences Committee. This demonstrates the commitment we have made and continue to make to the insolvency profession.

Summary

We consider it important to the UK's prospects that viable businesses should be rescued as swiftly and efficiently as possible, and therefore in general we welcome the proposals. We consider that the proposals form a sound foundation for a restructuring process which will allow the UK to retain its place as a leading restructuring jurisdiction and assist in meeting the Government's objective of improving the UK's ranking in the World Bank's annual Doing Business Report.
We do, however, believe that there are certain areas where additional considerations and careful drafting will be required in order to meet the objective of a flexible, cost-effective restructuring process, and we have concerns about the need for certain suggestions.

We have not sought to answer the specific questions but have, in Appendix 1, made detailed comments on certain of the suggestions based on our extensive experience of all sizes of restructurings, including CVAs and Schemes of Arrangement in the UK and cross-border. We have also drawn on our experience of procedures in other countries and our representation on international groups.

We consider that the key areas to be explored, for which we provide more detail in the Appendix, are:
Introduction of a moratorium

The proposal to introduce a preliminary moratorium as a standalone gateway for all businesses appears prima facie sensible, but further consideration of the funding during the moratorium needs to be given. Any public knowledge of the distress of the company is also likely to increase the cash flow pressures, as will the costs of the moratorium itself. We presume that this route would not be made available to companies that should be placed into insolvent liquidation, even though an element of the entity may include a business element capable of continuation. We believe this to be a key reason why a suitable and experienced insolvency practitioner should be involved.

Rights and responsibilities for creditors and directors

There should be safeguards in place to ensure that creditors can challenge the petition at any time, and not simply within the first 28 days, if unfair prejudice or misfeasance is suspected or if there is a blocking minority of creditors, sufficient to render any potential plan unachievable.

Whilst the proposals suggest that, as a matter of practice it would be unusual for the company not to consult, we consider a key safeguard to be that the largest secured creditor(s) must provide written confirmation that they have been consulted and do not object to the moratorium application, and consideration is also given to approaching the largest unsecured creditors.

Length and extension of the moratorium

We strongly disagree with the proposal that the length of the administration should be reduced by the period the company has spent in the moratorium.

We consider that any request for an extension of the moratorium should not require approval from all secured creditors, instead it should require the same majority as is required for that class to approve the restructuring plan.

Powers and qualification requirements for a supervisor

We disagree with the proposal that the supervisor can be any individual who meets certain minimum standards and qualifying criteria. We think the supervisor must be either a qualified Insolvency Practitioner or a party with similar experience who would be qualified to act as a Court appointed party to ensure that they have the knowledge and experience to act as supervisor throughout the moratorium period and to ensure that the use of such moratoriums is not exploited, is carefully monitored and regulated. Whether this should be available to all Insolvency Practitioners should also be considered.
Creditors' right to request information

We believe this could lead to issues in relation to cost, time, confidentiality and inequality of information between different creditors or classes of creditors. (i.e. risk of insider trading).

Essential contracts

We support in principle the proposal to expand the definition of essential supplies for which ipso facto clauses may not be exercised. However, we consider that it will be necessary to scrutinise the further detail in relation to this proposal and how it would be utilised.

We consider that, given that this is intended to be a debtor-in-possession style of proceeding i.e. the directors remain in place and continue to have fiduciary responsibility and make decisions on behalf of the company, responsibility for these contracts remains with the company and there should be no personal liability for the supervisor.

Minimum liquidation value

We agree with the proposal that a minimum liquidation valuation should be provided.

Should you have any queries please do not hesitate to contact John Milsom or Samantha Bewick.

Yours faithfully

KPMG LLP
Appendix 1

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<td>7.9 and 7.48</td>
<td>Giving creditors the right to request information from a supervisor at any stage may lead to issues in relation to cost, time, confidentiality and inequality of trading (i.e. risk of insider trading). At present all insolvency procedures provide for reporting to creditors at regular intervals and allow for the creation of a creditors’ committee at which sensitive issues can be discussed without the risk of prejudicing the progress of the case and returns to creditors. There is a delicate balance between transparency, sufficient information, general education on the processes and prudent interest from, in essence, third parties.</td>
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Were this provision to be brought in, we consider that there would be a significant increase in the volume of creditor enquiries in relation to sensitive matters such as whether action will be taken against directors or other parties, or the progress of sale negotiations. In both these cases the disclosure of information may directly prejudice the process. However, if creditors are given an unfettered right to seek information they may lose confidence in the process if they do not then receive it, even where disclosing such information will lead to a worse outcome.

We currently deal with significant creditor queries on cases: for example, on a recent CVA, the case email address generated 933 enquiries within a six-week period. Whilst a proportion of these related to the submission of voting forms, the overwhelming majority of emails were enquiries from creditors seeking an explanation of the process and the impact it had on them. In addition, a significant number of enquiries were received through KPMG’s general email enquiry address, as well as by telephone. It is estimated that of the time costs incurred for the Nominee phase of the CVA, one quarter of them related to dealing with general creditor queries.

This proposal could therefore lead to significant time costs being incurred by the supervisor and their staff in dealing with such queries and less time being dedicated to saving the business.

In larger cases, where debt is publicly traded, or where private assignments are possible, a requirement to answer queries may give rise to risks around confidentiality and inequality of information, and even risks of insider trading.

We have had examples of landlords asking for information during a CVA process in relation to trading performance, to which they would not normally
have access, which they have then used to their advantage in subsequent rent reviews.

Employee information is also extremely sensitive and there would need to be clear guidance in relation to information that could be disclosed.

7.11 **Freezing the arrears owed to creditors** is a sensible approach for simple businesses.

However, consideration must be given to the issues that may arise where derivatives are being used to hedge commodities and there are margin calls, for example companies who have FOREX contracts to hedge their overseas trading.

The provisions of the Settlement Finality Directive and Financial Collateral Directive will also need to be considered, with regards to trading on exchanges and dealing in shares, such that there is a carve out in relation to any settlements which must be made during the period of the moratorium.

In addition, where there is a subsequent insolvency process the relevant date for calculating creditor claims etc. should be the date of the moratorium, rather than the date of the formal insolvency. This will ensure that creditors are not placed in a worse position as a result of the moratorium. In particular, we would not wish to see a situation arise where employees lost preferential status as a result of being dismissed during the moratorium but remaining unpaid until after any subsequent insolvency.

7.25 We consider that careful thought should be given to the proposal that there will be **no grace period during which the creditors would be able to challenge the application prior to the granting of the preliminary moratorium.**

Whilst it is acknowledged that creditors will have a general right to apply to the court during the first 28 days of the moratorium, there should be safeguards in place to ensure that creditors can challenge the application at any time if unfair prejudice or misfeasance is suspected on the part of the company, its directors or other officeholders. This is vital to ensure that where directors fail to comply with their fiduciary duties, the creditors are able to take action so as not to worsen their position further.

In addition, if there is a blocking minority of creditors, sufficient to render any potential plan unachievable, they should be able to petition the Court at any time to remove the moratorium. This should not be limited to the first 28 days of the moratorium.
Without this provision the moratorium could continue despite the fact that the restructuring will never obtain the requisite approvals. This would result in unnecessary costs being incurred by a supervisor and could potentially worsen the creditors' position in a subsequent formal insolvency process.

7.27 With regards to **consulting with the largest secured creditor(s)** we consider that a necessary safeguard would be that the legislation states that the same majority of the secured creditor(s) as would be required to approve a rescue or alternative plan must provide written confirmation that they have been consulted and do not object to the moratorium application.

The aim of this provision is to ensure that there is support for the restructuring from the major secured creditors, in order that there is a realistic prospect of rescue.

However, without stipulating that written confirmation must be obtained from the secured creditor(s) there is a risk that the consultation will not take place. Unnecessary costs could then be incurred during a moratorium period, despite there being no real prospect of a restructuring process being successful. Furthermore, consultation with other majority or significant creditor bodies must be sufficient to ensure appropriate transparency of the process and its application.

7.29 **Being able to formally designate certain contracts as essential where they relate to essential supplies** is commercially pragmatic and a welcome proposal.

However, it will be necessary to understand the detail in relation to this and how it would be used in practice: for example:

- How will essential be defined?
- What undertaking will be required to be provided to the suppliers who may already have significant arrears?
- What period would any such essential supply and therefore payment cover, given the potential for long lead times between order and supply for certain types of suppliers and therefore the financial commitments that they would need to make.
- Who will be responsible for the undertaking? In circumstances where the directors remain in control, it seems to us to be inappropriate to impose liability on any other party.
In circumstances where, for example, a company is reliant on financial contracts to hedge its foreign exchange or commodity purchases or sales, how will this proposal be conformed with existing legislation?

7.34 We agree that this would incentivise the directors to make use of the moratorium to develop a rescue plan, however it would be important to make clear that applying for the moratorium does not absolve them of responsibility for any breach of duty prior to the moratorium, in addition to any breach during the moratorium period.

This will ensure that the directors’ continue to comply with their fiduciary and other duties and make decisions which are in the best interests of the shareholders and, as the company may well be in the zone of insolvency, the creditors, whose interests have become paramount.

Where there is a subsequent insolvency process, the relevant period for the purposes of identifying antecedent transactions should be calculated with reference to the date the moratorium was granted rather than the date of the insolvency event.

7.36 Any request for an extension of the moratorium should not require approval from all secured creditors, instead it should require the same majority required for that class to approve the restructuring plan.

If this was not the case, a single secured creditor would effectively be in a position to block the restructuring against the wishes of the majority, which is the very problem that this legislation aims to solve.

7.37 We strongly disagree with the proposal that the length of the administration should be one year minus the period the company has spent in the moratorium. We do not believe that the moratorium should restrict the length of a subsequent administration. Considering the current population of administrations, there is already a significant proportion of cases that require extension beyond the initial 12 month period; to reduce this duration further will simply result in additional costs in extending cases.

Combined with the proposal that the supervisor of the moratorium may not be the administrator, there will be a new practitioner in place who will need the full period of the administration in order to perform their duties effectively. The statutory duties of an administrator will not be reduced or mitigated by the moratorium, and therefore we consider this to be an unnecessary constraint.
In addition, in many cases we consider this to be impractical due to having to obtain clearances and/or VAT refunds from HMRC prior to closure.

| 7.41 | We disagree with the proposal that the supervisor can be any individual who meets certain minimum standards and qualifying criteria. We think it is essential that the supervisor must be a qualified Insolvency Practitioner to ensure that they have the knowledge and experience to act as supervisor throughout the moratorium period, and in particular to ensure that the interests of creditors are properly protected.

There is a real risk that directors could be poorly advised and make decisions which are not for the benefit of the creditors as a whole if they are not being advised by someone sufficiently qualified and experienced in restructuring and insolvency matters.

The monitoring and regulation of the moratorium will also be an important consideration to ensure that the process is not exploited. The use of a qualified Insolvency Practitioner will aid this monitoring process, which can easily be picked up by existing Regulators, working with the Insolvency Service, who are already experienced in this area of regulation. |

| 7.43 | The supervisor's role seems appropriate but sanctioning transactions which are not in the ordinary course will need careful thought and safeguards. We await further details in relation to this proposal.

Whilst not currently detailed within the consultation paper, we would be very concerned were it to be suggested that personal liability would fall upon the supervisor relating to the actions of the company during the moratorium. If this were to be the case there would be very few, if any, professionals willing to take on such a role, given that this is intended to be a debtor-in-possession style of proceeding i.e. the directors remain in place and continue to have fiduciary responsibility and make decisions on behalf of the company. |

| 7.45 | We consider that it is a reasonable safeguard for creditors that an Insolvency Practitioner who had previously acted as supervisor would be prevented from taking a subsequent insolvency appointment, but note that this will inevitably increase the costs of the whole process, which may attract criticism.

The professional in place through the moratorium is not best placed to review the transactions that took place during the period, especially as a formal insolvency event will only occur if the restructuring fails. |
The proposal with regards to the **costs incurred during the moratorium** appears to be sensible.

The supervisor's role during the moratorium is essential and without this there would be no prospect of a restructuring being successful. Accordingly, the costs of paying the supervisor are a necessary expense and should rank as an expense of a subsequent administration.

However, consideration must be given as to where these, and indeed any other costs incurred during the period of the moratorium (which costs may be considerably greater than those of the supervisor), sit within the waterfall of payments. The current proposal could result in a subsequent officeholder being burdened with significant costs which rank before their own fees.

The proposal to **expand the definition of essential supplies** and prevent the enforcement of ipso facto clauses is a welcome change. However, the detail of this proposal will need to be carefully thought through to ensure that suppliers are not prejudiced by an overly wide interpretation of essential contracts.

As mentioned above regarding 7.43, we consider that there should be no personal liability imposed upon the supervisor, given that this is intended to be a debtor-in-possession style of proceeding; i.e. the directors remain in place and continue to have fiduciary responsibility and make decisions on behalf of the company.

We are concerned about the need for additional court time and its availability.

**Introducing cram-down provisions to impose a restructuring plan on junior classes of creditors even if they vote against the plan** is essential in order for this proposal to work effectively.

However, we consider it will be necessary to cram-down shareholders. If not, there could be a scenario where equity blocks the restructuring plan, despite the creditors being in favour and the shareholders having very little to no economic interest by this stage.

We consider that, with regard to the **cram-down mechanism**, it will be essential also to bind preferential creditors into a restructuring plan. At present, in a CVA, preferential creditors may not be affected without their consent.
If not, there could be a scenario where the preferential creditors block the restructuring plan despite it being in the best interests of the creditors as a whole.

9.18 & 9.20

The proposal states that the classes are to be approved by the Court and that the Court will decide whether the plan is in the best interests of the creditors as a whole.

This proposal is based on the effective UK procedure of Schemes of Arrangement, and provides fairness and independent review. However, as this new process becomes common, we are concerned to ensure that the Court would have enough resources to opine on each case rapidly. A delay at the Court stage might undermine the process.

Furthermore, the creation of a series of classes may fracture the process rather than unify it, thus making a holistic restructuring less capable of success.

9.24

As a safeguard for the cram-down mechanism we believe that the majorities required should be of those present and voting, as at the time of the vote.

This will ensure that all creditors are provided with the opportunity to vote but only those who actually use their vote determine the outcome. If not, there could be a situation where approval is not obtained due to failure to respond rather than due to the creditors opposing the restructuring. It would be unfortunate were viable plans to be rejected due to apathy.

We consider that there should be a second test, as presently exists in the voting for both CVAs and administrations, where there must be a simple majority of those creditors who are not connected and/or associated in addition to the super-majority of the whole body of creditors. This should be applied to each class. There is an obvious risk if a connected/associated creditor took senior-ranking debt in order to impose an unfair plan on lower-ranked classes or equity, and we note the concern around the role of connected parties within pre-pack transactions.

9.29 & 9.30

We are uncertain as to what the twelve month period relates to and would appreciate further clarification in relation to this.

It would be helpful to clarify whether it relates to the period of time it takes to agree the plan (to which we consider it should refer) or the time it takes to
implement the plan. The changes to be made by the use of a restructuring plan should be permanent.

We would also like clarification as to the situation where the Court decides to extend the duration of the moratorium over the duration of the plan. Will the moratorium apply only to pre-plan amounts, or will it provide protection against contractual rights for a longer period?

We consider that this is an area where detailed discussions are essential in order that the proposed legislation protects the interests of both creditors and debtors.

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<tr>
<th>9.35</th>
<th>We consider that the provision of a minimum liquidation valuation within the plan is an essential safeguard to show that creditors are expected to be no worse off than they would be in a terminal insolvency, as a result of the moratorium and restructuring plan. This will provide creditors with the confidence that the restructuring plan is the best course of action for the creditors as a whole and provide the best chance of obtaining support for the successful rescue of the company. Without this reassurance creditors may be unlikely to vote in favour of the restructuring.</th>
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| 10   | While we support the concept of improving the availability of rescue finance, our experience suggests that lenders are generally prepared to support viable businesses albeit the terms of new lending may be more stringent. We have some concerns that the ability to overreach existing security may be counterproductive, although we are less concerned by the proposals relating to overreach of the negative pledge clause than proposals which may affect the loan-to-value ratio of lending to security. It would be unfortunate if decisions about the prudent value of lending meant that in a rescue finance situation the headroom were removed — for example, if a lender were to lend on the basis of 70% of the value of the assets, which allows some security if values fluctuate and takes account of the risk of non-payment, if the 30% headroom were taken to be “free” assets which could secure a DIP facility or rescue finance. Such a change might adversely impact the lending bank’s risk metrics and/or capital requirements. |

| 11.3 | We strongly support the proposal that there should be no further changes to the prepack regime. |

| 11.4 | We do not agree that the proposal will benefit SMEs due to having a larger pool of expertise to choose from. There are already a considerable number |
of small Insolvency Practitioner firms who provide high quality services at very competitive prices for SMEs.
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I want my response to be treated as confidential ☐

Comments:
Questions

Name: David Milman; Kayode Akintola

Organisation (if applicable): Lancaster University

Address: Lancaster University Law School, Bowland North, Lancaster, LA1 4YN

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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?

No. In our view, this will add another layer to what, for many companies, is already a drawn-out winding up process. The Companies House is littered with the insolvency filings of many companies going into CVAs, followed by administration, an extension to the administration, and ultimately into liquidation – typically CVLs. To add another standalone procedure would only increase costs (monetary and time) and reduce the certainty that should come with a well-honed insolvency regime. Perhaps some lessons could be drawn from CVAs which, despite having something akin to a debtor-in-possession feature, have experienced a decline in recent years. This poor return, though disappointing for the rescue ideology, is largely due to the fact that many directors do not avail themselves the use of this procedure until it is too late. The current CVA regime bears a striking resemblance to the proposed non-insolvency moratorium. As such, there is nothing to suggest that directors would suddenly be precipitous (we use the term non-pejoratively) in engaging the procedure.

What should be done in our view is that the rescue framework within our insolvency regime should be streamlined in such a way as to get rid of inefficient procedures, such as CVAs, rather than adding another layer of complexity. If required, the new-style administration procedure, which already has many attractions, could be further strengthened to take into account the needs of larger entities.

Perhaps, the major benefit to the proposed procedure is that it would operate outside insolvency and, to that extent, could avoid the damage to goodwill that often comes with entering into insolvency. In our view, this benefit may be more ideal than real. Once creditors are precluded from taking enforcement actions against companies in this procedure, and if such companies eventually proceed into insolvency, it is only a matter of time before the procedure is seen as a desperate lifeboat for zombie companies.
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?

It is our view that for the benefit of SMEs, the definition of essential contracts should include contracts for the provision of finance through factoring and invoice discounting. At present, such agreements are not caught by statutory moratorium because they are outright assignments, and are often terminated (with the financier charging a termination fee) once a company enters into insolvency. Nevertheless, these agreements are crucial to financing any rescue since many SMEs would not have significant assets outside their stock in trade as well as present and future receivables.

Such extension would without doubt be unpopular with the invoice finance industry as it would represent a major incursion into contractual freedom. Nevertheless, the industry has recently benefited from a similar inroad with the ban on anti-assignment clauses in business contracts. It is conceivable that the absence of such extension would prejudice the proposed standalone moratorium – should it come to fruition. This is because the invoice finance industry could specify in their finance agreements that the procedure is a termination event. The removal of such finance and the attendant fees for termination are likely to increase the complexity and costs of any workout.

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?

Yes. In our view, certain aspects of the court’s approach in Re Atlantic Computer Systems plc [1990] BCC 859 may be relevant where a court is faced with a determination of which contracts are essential. For example, will the removal of the goods or services likely impede the achievement of a rescue? Will significant loss be caused to a supplier or invoice financier if the contract is designated as essential and caught by the moratorium?

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?

For the reasons we set out in (1) above, we believe that such restructuring plan should be assimilated within an existing procedure – administration – due to its popularity and range of workout tools that is available to the office-holder. In any event, as the consultation paper rightly notes, and as we noted in (1) above, the CVA regime is increasingly becoming an ineffectual rescue mechanism and, as such, it is our view that it should probably be excised from legislation altogether.

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

Yes

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

Yes

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?

Yes

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?

Due to the fact that the costs of finance already rank highly as administration expenses, we do not believe that there is a need for such super priority for rescue finance in all cases, save where there is a
negative pledge clause (if such clauses are now shown to be effective following the 2013 amendments to the registration requirements under the Companies Act – we think some research is needed on this). Moreover, such priority will further depress the priority of a secured creditor with a floating charge. As we note in the “other comments” section below, it is important to think about these proposals along the current priority positions of fixed and floating charge holders.

However, in reality, much of rescue finance in an insolvency scenario will come from existing secured creditors by using existing assets within the business that is subject to security, or by providing further finance. In this regard, we will like to draw out two points:

a) Since the consultation concentrates on the provision of new finance, we believe that existing secured creditors will be better protected from the effect of these proposals if they are given something akin to a “right of first refusal” to provide rescue financing. We have made this recommendation to the Secured Transactions Law Reform Project which is also working on many of the issues raised by this consultation paper; and

b) There is a clear link between an administrator’s power to use floating charge assets and rescue financing. However, post spectrum, much of what would otherwise be floating charge assets are now caught by factoring and invoice discounting agreements. We think that any proposal on rescue finance should address this point. For example, an office-holder should be able to use a proportion of factored invoices to fund the insolvency. It is our understanding that office-holders sometimes enter into a post-filing financing agreement with existing invoice financiers in order to fund a trading administration. If, on the other hand, it is the office-holder’s view that further invoice finance is not the most suitable financing option for a particular rescue project, then perhaps a new financier should be given some priority over the existing invoice financier’s recoveries.

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.

We are of the view that this consultation should also be used as a platform to consider the distinction between fixed and floating charges under the current insolvency framework. It is clear that a number of stakeholders are increasingly becoming irate at the outcomes generated by this distinction in insolvency. To take a few examples (which exemplify why we would welcome an abolition of this distinction): difficulties encountered by practitioners when structuring secured transactions; avoidance of floating charge inroads by creditors through the use of alternative financing structures such as factoring and invoice discounting; the impact of such avoidance behaviours on the funding of insolvency proceedings; and the failure of floating charge inroads to improve the realisation prospects of the general body of creditors.

We are aware that a number of organisations, including Secured Transactions Law Reform Project and City of London Law Society’s Financial Law Committee, have been engaged in reform projects in this area. We however believe that the time has come to put this issue on the front burner of proposed policy initiatives by the Government.

Finally, we will like to reiterate our desire to see the insolvency framework streamlined, with inefficient procedures excised from legislation. The CVA is the obvious culprit here due to the decline in its use and high failure rate. The focal point of this streamlining should be the schedule A1 CVA alternative which, in our view, has not attracted as much interest as its administration counterpart.
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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Comments:
Questions

Name: Mrs. Genny Millinger (Assistant Land Registrar)  
(genny.millinger@landregistry.gov.uk)

Organisation (if applicable): HM Land Registry

Address: Trafalgar House, 1 Bedford Park, Croydon CR0 2AQ

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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

Questions (1) – (8): Land Registry is not in a position to comment.

Helping Businesses Keep Trading through the Restructuring Process

Questions (9) – (10): Land Registry is not in a position to comment.

Developing a Flexible Restructuring Plan

Questions (11) – (14): Land Registry is not in a position to comment.

Rescue Finance

Questions (15) and (16):

Land Registry cannot comment on matters of policy. However, you may wish to consider the following observations as to the relative priority of charges over registered land under the Land Registration Act 2002 and the practical and legal issues to address if the consultation proposals are adopted.


1. Sections 48 – 57 LRA 2002 deal with registered charges over registered estates in land. The basic rule, as set out in section 48 (and also in rule 101 LRR 2003), is that – subject to any entry to the contrary - registered charges rank as between themselves in the order in which they appear in the title register. (The priority of charges that are protected by entry of a notice under section 32 LRA 2002 is governed by principles of equity. Put simply, as between themselves, noted charges retain whatever priority they had before being noted in the register).

2. Lenders may agree between themselves to alter the respective priorities of their charges and, provided that an application is made to the registrar together with the consent of the proprietor of any charge that would be adversely affected by the alteration, an entry may be made in the title register to reflect such agreement (rule 102 LRR 2003). In addition, the priorities of registered and noted charges may be postponed by agreement and such agreement may be noted in the register, provided that an application is made to the registrar (rule 116A LRR 2003).

3. Some charges arising under statute may have overriding priority by virtue of the relevant statutory provisions that create them, and the registrar must
make a note of that priority (or claimed priority) in the register, subject to a satisfactory application being made for that purpose, and must notify other registered or noted chargees (section 50 LRA 2002; rules 105 and 106 LRR 2003). Examples of statutory charges are those imposed by a street works authority for expenses incurred, or by a local authority of the expenses of repairing and improving houses.

4. If a policy decision is taken to adopt the consultation proposal that a charge to secure rescue finance is to have priority over any existing prior registered or noted charges (“super-priority”), thus creating a different rule of priority from the rules that currently apply under the LRA 2002 or in equity, then steps would need to be taken to ensure that it is clear on the face of the register that the new security had such “super-priority”. This might be achieved by:
   (a) appropriate statutory provision in relation to the creation of such a charge, including amendment of the LRA 2002, to the effect that such charges have overriding priority over any other registered or noted charge appearing in the title register; or
   (b) appropriate statutory provision in relation to the creation and overriding priority of such a charge, including a requirement for the chargee to apply both to register the charge and at the same time to apply for an entry to be made in the title register in relation to the priority of that charge, pursuant to rule 105 LRR 2003 (but that if such application is not made the charge would not have such overriding priority).

5. In any event, the relative priority of the rescue finance charge should be apparent on the face of the title register to the affected land so that third parties thereafter seeking either to deal with the registered proprietor(s) or any chargee(s) of the land, or to register or note their own interests in the register, are not misled.

Land Registry is happy to assist or give further information if required and would wish to be involved if a decision is taken to adopt the consultation proposal.

Question (17): Land Registry is not in a position to comment.

Impact on SMEs

Question (18): Land Registry is not in a position to comment.

[HM Land Registry: 4 July 2016]
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.

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Comments:
The Loan Market Association (LMA) is the trade body for the European, Middle Eastern and African syndicated loan markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 630 organisations across 55 jurisdictions and consists of banks, non-bank investors, borrowers, law firms, rating agencies and service providers.
Questions

Name: Nicholas Voisey
Organisation (if applicable): Loan Market Association
Address: 10 Upper Bank Street, Canary Wharf, London E14 5JJ

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The Introduction of a Moratorium

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

No.

As the consultation paper acknowledges, the UK restructuring regime is well regarded, and in our view operates effectively in its current form. We are therefore not convinced that the case for introducing additional mechanisms is made out. We are also of the view that should the proposals be adopted there would be a negative impact on the English regime in terms of its predictability and would represent a significant shift in power away from lenders on enforcement, and this increased risk may make it more difficult for companies trying to borrow.

At present businesses of a significant size, which are seeking to restructure, already make use of standstill arrangements. These take place on a consensual basis and are often agreed, or already operate, as part of existing intercreditor arrangements. We are therefore not convinced that there is any need to introduce a statutory moratorium and are of the view that once a statutory moratorium is applied for, the chances of a debtor reaching a consensual restructuring will be very low.

Despite the proposals representing a wholesale shift in the statutory framework, to a "light touch" and debtor favourable regime, the Impact Assessment seems to suggest that the changes for secured creditors at paragraph 1.35 "are largely clarifications of existing law". This is misleading. Having the ability as a secured lender to influence and achieve a restructuring on a consensual basis, or using a non insolvency process to implement it, is completely different from a regime that is statutory in nature and lacks any of the current flexibility. Average familiarisation costs of £0.058m appear to be inadequate for proposals which would fundamentally change the corporate restructuring landscape – but more importantly there does not appear to be any analysis within the Impact Assessment on the negative impact which the proposals may have on the UK market, in particular the costs and availability of credit. In our view the proposals would represent a fundamental shift in creditors' rights to such an extent that there is a real risk this could have a negative effect on growth within the UK economy.

However, notwithstanding these concerns, in the event that a preliminary moratorium is introduced, we believe that it should aim to complement, rather than replace, existing procedures (both formal and informal). We note that the proposed moratorium is described as a ‘single gateway to different forms of restructuring’; we assume that this means it would not be tied to any one restructuring process, but available as a precursor to all, rather than that it would become a requirement; we would strongly discourage any proposal to make the preliminary moratorium a requirement for entering a restructuring process (whether formally or informally via ‘comply or explain’ type
pressures), as in circumstances where it was not in fact needed the potential for adverse publicity, costs and delays could in fact end up destroying the prospects of a successful restructuring.

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?

No, we think the current consensual approach is more efficient.

However, in the event a formal moratorium mechanism is introduced, we think that further thought should be given to whether a court hearing should be required, in order to better protect the interests of creditors.

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

See above our general reservations about the need to introduce such a measure in the first place. In relation to the eligibility tests and qualifying criteria – these require much greater detail and lack clarity.

We note that there is no proposal to restrict the eligibility for a moratorium according to the size of company which currently operates in the small companies’ moratorium regime for a voluntary arrangement. At paragraph 7.19 of the consultation, it is suggested that those companies which are excluded from eligibility for a small companies’ moratorium are also “for the most part” to be mirrored here. However the precise exclusions are not entirely clear from the consultation. In our view, if the proposals for a moratorium were to be introduced, protection for the arrangements which currently benefit from a disapplication of the prohibition on the appointment of an administrative receiver, as included in sections 72B-GA of the Insolvency Act 1986 and paragraphs 4A to J of Schedule A1 of the Insolvency Act 1986, are required.

We also note there is no specific reference to the transactions that benefit from the Financial Collateral Arrangement Regulations and currently enjoy a disapplication of the effects of insolvency. Notwithstanding our objections to the introduction of the statutory moratorium, if one were to be introduced, we are of the view that these arrangements need to be excluded from the effects of the moratorium.

Likewise in terms of the eligibility criteria and qualifying conditions, they are expressed in very general terms.

Paragraph 7.18 of the consultation indicates that in order to be eligible the company must demonstrate that it ‘is already or imminently will be in financial difficulty, or is insolvent’. However, paragraph 1.26 (a) of the impact assessment says that in order to be eligible the company must ‘satisfy the court that it is already or imminently will be in financial difficulty, ‘but is not yet insolvent’. This needs clarification. Furthermore, if insolvency is to be a
criteria (whether for allowing or prohibiting entry into the moratorium), thought should be given to the meaning of 'insolvency' in this context, as the definition of insolvency is a very complicated question. In particular, if the company is (in conjunction with the supervisor) effectively self-certifying as to insolvency, we believe that detailed guidance will be needed to make sure it is clear what that means in this context.

Under the proposed qualifying conditions, the company will need to demonstrate that it is "likely to have sufficient funds to carry on its business" and it "must satisfactorily demonstrate...there is a reasonable prospect that a compromise can be reached". There is little detail about how this is to be established, and whilst it may be appreciated that this is a commercial judgement on the part of the debtor, it must also be recognised that it needs to be sufficiently robust to provide confidence to creditors and other stakeholders (i.e. suppliers), whose continued support will be required. It appears that much reliance is to be placed on the expectation that the debtor will consult with key stakeholders, but there is no obligation to do so.

The requirement that the company must have sufficient funds to carry on its business during the moratorium needs more detail. The consultation refers to the company 'meeting current obligations when they fall due as well as any new obligations that are incurred'. Paragraph 1.26 (a) of the impact assessment suggests that 'obligations' includes 'trading costs and debt obligations'. Clarification as to whether this is intended to catch all finance payments due in the period would be welcome. If it is, thought should be given to what the position would be if a creditor had agreed to an extension or suspension as payment as part of the restructuring negotiations. Would the company still have to demonstrate that it had the funds to make this payment if called upon to do so, or would the payment be discounted for the purposes of the test? This is not a moot point, but goes to whether the test is intended to protect creditors generally by making sure that companies which cannot satisfy their current debt burden cannot benefit from the moratorium (in which case the payment obligation should still be counted) or to protect individual creditor's rights (in which case, presumably, it should not). It is also not clear from the consultation as to whether the verification exercise by the supervisor, which occurs "on commencement", as to whether the conditions have been met, can be tested or challenged, other than in the context of a general challenge, which is only available in the first 28 days. We believe that for creditors to be adequately protected, there must be a way for creditors to challenge the moratorium after the 28 day period has elapsed, for instance if they believe that circumstances have changed or the conditions are no longer being met.

4) Do you consider the proposed rights and responsibilities for creditors and directors to strike the right balance between safeguarding creditors and deterring abuse while increasing the chance of business rescue?

We are of the view that the balance between the directors and creditors is too much in favour of the directors. In particular the availability of the
moratorium, which is to be achieved without any independent oversight or involvement (the role of the supervisor only begins at the start of the moratorium) is potentially open to abuse. It leaves the onus on either the supervisor or individual creditors to challenge the suitability of the moratorium. It is suggested that the government "may" introduce new sanctions to prevent abuse – but disqualification after the event will be cold comfort to creditors who may have been exposed to greater credit risks, as they wait for a court hearing to stop the moratorium in its tracks.

We think further thought should be given to whether a specific protection for liability from wrongful trading is necessary. As currently proposed, the company must demonstrate that there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors in order to be eligible for a moratorium. In circumstances where directors have grounds to believe that there is such a reasonable prospect, they would surely also believe that there is a reasonable prospect of the company avoiding insolvent liquidation or administration. As such, they should be able to get comfortable that they are not exposed to wrongful trading liability. Conversely, if they could not get comfortable on this point, it would probably be a good indication that they did not genuinely believe that a compromise or arrangement with creditors is likely. Given this, we feel that suspending liability from wrongful trading would send out the wrong message to directors and also potentially muddy the waters as to the correct interpretation of the wrongful trading test.

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

While in some cases having an initial 3 month period may provide a valuable breathing space for the debtor, given the lack of creditor involvement it may, in some cases, be too long a period from a creditor's perspective, who would then be reliant on making a challenge. This is limited to a 28 day window, presumably with a hearing for some date in the future. While the court may be able to expedite the hearing, this approach puts the burden on the creditors (who will already be exposed in terms of credit risk) to the further cost of making the application to lift the moratorium.

It is unclear as to what the position would be in terms of any loss or increased loss to the creditor if the challenge is successful or if a workout is ultimately not achieved and a formal insolvency process ensues.

It appears that there will be little risk to the directors in terms of personal liability and the costs of the failed rescue (including the supervisor's fees) will rank as an expense, diminishing the value of recoveries to unsecured creditors, including preferential creditors (e.g. unpaid employees) and those with the benefit of floating charge security.

Any such moratorium must also be considered in light of a bank's current eligibility of certain security rights of capital relief under the Capital Requirements Regulation (CRR). Article 194(4) CRR requires recognised
funded credit protection only if the bank has the right to liquidate or retain the assets in a “timely manner”. A similar requirement applies to unfunded credit protection (Article 213(1)(c)(iii) CRR).

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

From the brief details provided in the consultation, it appears that the supervisor will perform a monitoring role only.

The powers of the supervisor appear to be limited to: (i) applying for the discharge of the moratorium when the conditions are no longer met; (ii) the right to attend meetings; (iii) request information; and (iv) sanction "non ordinary course transactions”. This limited role of the supervisor, which appears to be reactive in nature, will not provide much reassurance to creditors. There is no suggestion that the supervisor has a duty to those creditors, unlike the role of an insolvency practitioner in a formal insolvency procedure. While we think that the nature of the role may be suited to a turnaround specialist or insolvency practitioner, it is unclear what is envisaged by way of “certain minimum standards”. No reference is made to what level of relevant expertise in restructuring is to be required, is this to be determined on the basis of number of cases, or number of years' experience?

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

No.

These will erode the potential recoveries to existing creditors. Further detail is required as to the treatment of such costs i.e. how are they to be assessed? Are they to be capped? Must they be reasonable? Who decides if they are reasonable? Do these costs include the payment of ongoing contracts?

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

We think that the rationale that creditors have access to information to enable them to make informed decisions in relation to a restructuring is sensible. However, we can see that providing individual creditors with a general right to request such information at any time may be a distraction, and will add to the costs and time taken to achieve a restructuring. Obliging the supervisor to produce timely, standard reports may be a better way of approaching this.
Helping Businesses Keep Trading through the Restructuring Process

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

We are of the view that the approach is too favourable towards the debtor, in the same way as the moratorium puts the onus on the creditor to challenge the designation.

While the formal insolvency procedures will have some measure of independent assessment on the ability to meet the payments as they fall due requirement, in the proposed moratorium, the supervisor will be completely dependent on the debtor's own assessment. Even in cases where the debtor or officeholder approaches the assessment in an appropriate manner, the business may not always have sufficient funds to meet the payment. Suppliers therefore, who have been obliged to continue to supply against their wishes and potentially be exposed to a credit risk which they never wished to accept, may in cases where the assessment turns out to be wrong, have little recourse or hope of recovering compensation for the supplies provided. The consultation seems to envisage that companies will not be able to designate contracts as essential unless they are able to meet payments as they fall due; however, we are not sure that this takes into account the position of the large number of suppliers who supply on extended payment terms. We are not persuaded that the continuation of essential supplies will result in a higher number of rescues, and to continue a business based on the premise that you need to rely on a statutory provision imposing the supply to continue (for up to a year) appears to be an unsound basis upon which a business should be continued.

There is nothing in the consultation that provides for the debtor to reject non-essential contracts, presumably those contracts which are not designated, follow the pre-agreed terms including the ability to terminate?

In terms of the ability to designate any contract as essential, it is unclear as to whether this would apply only to supply contracts for goods and services or whether it is also intended to include other contracts, in particular contracts which provide for finance. We consider that there should be an express exclusion of financial contracts (including hedging contracts) from any threat of designation as an essential contract. This is because the effectiveness of those provisions which allow for termination are essential in the context of financial market transactions, and in particular may have a significant impact on a bank's own capital adequacy requirements. It would also have an adverse effect on the credit market generally.

Whilst the consultation recognises that preventing the use of ipso facto clauses interferes with the right of the freedom to contract, it would also, given its potentially wide application, create a significant amount of uncertainty and unpredictability. Such uncertainty and unpredictability may affect the approach to supply agreements and result in additional cost as
such uncertainties are factored in as unquantifiable risks. It is also likely that such risks will have an impact on the cost of and availability of credit insurance. In the Impact Assessment at paragraph 1.74 it is recognised that estimating the number of suppliers that will have to pay additional insurance costs is difficult to assess. The best estimate, however, seems to be predicated only on the number of cases to which the designation of essential contracts may apply, thought to be between 30-80 cases with a £2.7m best estimate mid point range value. Assessing the cost in this way, appears not to recognise that such provisions may affect all credit insurance, not just the agreements for debtors who have been the subject to a rescue or restructuring.

We also think that the consultation may be underestimating the number of contracts which companies in difficulties may wish to designate as essential overall (and may be permitted to so designate under the proposed criteria). For instance, one of the factors which goes to whether a supply is essential (in paragraph 8.15 of the consultation) is whether an alternative supply can be found in a reasonable timeframe at a reasonable cost. While these are sensible factors in determining whether a contract is essential to a solvent business, the reluctance of suppliers to enter into new contracts with businesses in known financial difficulties means that they are unlikely to reduce significantly the number of contracts which are essential in this context.

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?

It is not clear whether the supplier’s ability to go to court is to challenge the decision to categorise a contract as “essential”, to challenge the assessment that the business would be able to meet its payments as they fall due, or both. Assuming the former, the supplier’s availability to challenge the designation as non essential does not in our view represent any safeguard at all in relation to an assurance that they are to be paid. Suppliers may seek the court’s approval to each contract designated as essential, but there does not appear to be any mechanism for having an independent assessment carried out in relation to the business being in a position to meet its payment obligations, which from a supplier’s perspective will be key.

We also do not think that the Court’s role and the supplier’s ability to challenge addresses the greater risks faced by a supplier who supplies on extended payment terms. If suppliers are obliged to abide by all the provisions of their contracts once they are designated essential, and these include terms such that the supplier is not due to receive payment for 90 or 120 days (or even 60), it will be in a very vulnerable position, and the company’s assessment that it will still be able to meet the payment when due is unlikely to be of any real comfort, even if scrutinised by the Court, given the real possibility of its financial position deteriorating before then if the rescue is unsuccessful. If the proposal does go ahead, we think
consideration should be given as to whether suppliers should be able to request up front for accelerated payment terms for any new supplies made after the onset of insolvency (or the insolvency related event that would otherwise have allowed termination) as a condition of supply.

**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?

We are not convinced of the need to introduce a further procedure either as a standalone process or by way of extension to an existing process. In fact the information provided in the consultation as to what a restructuring procedure would comprise of, largely follows the blueprint provided by the existing scheme of arrangement. One of the key advantages of the scheme for debtors is that it is not an insolvency procedure, nor is it included in the insolvency legislation, and as such it does not attract the negative association and potential stigma that may attach to the more formal insolvency procedures.

To reiterate, we are not persuaded of the need to introduce a new restructuring plan, either on a standalone basis or by modifying an existing process, nor that the benefits of such action outweigh the costs and risks. However, if the proposal is to go ahead, we think it may be more appropriate to develop a new procedure which closely follows the scheme of arrangement precedent. We think that in general terms, the scheme is a better blueprint than the CVA, but it would not be appropriate to add a class cram down mechanism as the scheme is not an insolvency process, and doing so might impact on the positioning of schemes outside of the EC Insolvency Regulation (or any framework that replaces it in the future). Such a procedure could potentially benefit from the established body of law and practice around schemes, and also sit within the EC Insolvency Regulation (or, perhaps, any framework that replaces it in the future) as an alternative procedure available for restructurings in which mutual recognition across Europe is desirable.

However, very careful thought would need to be given to the new procedure, in particular to ensure that it did not impact on the Court’s current jurisdiction over schemes of arrangement. Thought might also be given as to whether the requirement for a ‘majority’ in number to vote in favour within a class is still justified or whether it is antiquated and should be replaced with a pure value percentage requirement (with any concerns as to minority interests going to fairness).

If this proposal does go ahead, we would strongly urge the government to consult further once more detailed proposals have been developed (and in particular including the jurisdiction issues) and to give careful consideration to the treatment of shareholders in any new procedure. We believe that introducing an entirely new process as being a major step which could have
significant impact on the restructuring and credit markets, and as such requiring detailed scrutiny of a type not possible at present given that the details have not been enumerated.

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

No, we think the existing approach in schemes is to be preferred.

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

We think that the proposed safeguard, in particular the conditions being taken into account, appears to be reasonable, save that instead of all creditors being no worse off than in liquidation, we would suggest that this is broadened and includes "being no worse than the most likely alternative to the restructuring", as is currently the approach in schemes of arrangement. We consider that the safeguards which ensure that the secured creditors are granted absolute priority for the repayment of their debt will be welcome, and as such suggest that junior creditors do not receive any payment until those senior to them have been satisfied.

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?

The difficulty in imposing a minimum valuation basis is that there is a danger that it will become the default position and could have a significant effect on creditors and their treatment under the plan, i.e. they could receive nothing when in fact the more likely alternative in practice may be more favourable than liquidation. In any event we do not consider that imposing a minimum valuation would alleviate the likelihood of disputes arising in this area, which ultimately goes to the heart of any restructuring, where there are insufficient assets to satisfy the liabilities. The current practice of the court considering issues of valuation on a case by case basis, based on independent valuation evidence, would seem to be the most appropriate way of continuing. This is presently how it operates in the context of schemes of arrangement and as there have only been a small number of cases that have been considered by the court in this respect, this tends to suggest that such issues will be the subject of negotiation rather than challenge before the court.

**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?

We do not consider that the consultation and the supporting Impact Assessment make a good case for the introduction of rescue finance. We
appreciate that the model proposed follows the mechanism used in Chapter 11 of the US Bankruptcy Code, however the provision of finance in the UK and security rights are in our view not conducive to the same approach. In addition, seeking to impose new rescue finance on existing secured creditors, even with the safeguards proposed, appears to be thwart with practical difficulties – how is the existing charge holder going to be adequately protected? Is there reallocation of assets between the existing and new lenders? What happens if the valuation turns out to be wrong or the value fluctuates? Who bears the risk if it turns out that the secured creditor has been prejudiced after all? Where there is no insolvency practitioner is it the debtor or the supervisor who has to satisfy the court that security is required? The additional risks of the security being diluted will also be something that will inevitably result in additional costs and difficulties in obtaining credit in the first place.

Finally, it should be noted that there are already mechanisms in place for giving funding priority over existing floating charges (through the administration expense route) or existing fixed charges (under a scheme of arrangement or through consensual restructuring). The issue is therefore not necessarily one of the legal framework blocking the creation of a rescue finance market.

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

See our comments in 15 above. We do not consider that the valuation to facilitate protection for existing charge holders will provide any protection at all.

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

It appears from paragraph 10.24 that rescue finance is limited to the additional finance to be provided, but the detail of those paragraphs do not suggest that the additional finance will get any "super priority". The proposals suggest that existing creditors will be adequately protected and whilst it is suggested that they may share any excess collateral, we had not understood that this would be ranked as a super priority. We had understood that any super priority would only apply in relation to costs and expenses incurred in the rescue process, which would be treated in a similar manner to those now treated as an expense in a formal administration regime. Further clarification is required.

**Impact on SMEs**

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

We do not think that the proposals will necessarily ensure more rescues or better recoveries in the SME market. In fact we think that the potential
negative effects of such proposals being introduced would have an adverse affect on the credit market in terms of access to and availability of credit.

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.

The UK public's vote to leave the European Union on 23 June 2016 may have a major impact on the future financial landscape in the UK. Current speculation as to the UK's future with Europe is creating uncertainty in the market, and we would seriously question whether now is the right time for the government to seek to amend a well functioning and operationally effective Corporate Insolvency Framework.

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
Mark Homan led Price Waterhouse’s insolvency practice for many years prior to the merger into PricewaterhouseCoopers. He remains a consultant to the firm, but is responding as an individual.

He is a past president of the Association of Business Recovery Professionals; he was one of a panel of four insolvency accountants retained to advise the Insolvency Law Review Committee (the Cork Committee) that preceded the Insolvency Act 1986 and was a working group member on the development of the World Bank’s “Principles and Guidelines for Effective Insolvency Systems”.

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**A Review of the Corporate Insolvency Framework**

**Questions**

**Name:** Mark Homan

**Organisation (if applicable):** Individual

**Address:**

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He has considerable experience of Chapter 11 proceedings, most notably through the Maxwell Communications Corporation (“MCC”) case. MCC was the quoted company side of the business empire of the late Robert Maxwell. Although an English company, MCC itself was not only in administration in the UK, but simultaneously the same company was subject to Chapter 11 proceedings in the United States where the court recognised the UK administrators rather than the directors as debtor in possession.

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?

Please see memorandum below

- The Introduction of a Moratorium

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

NO see below

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.

A Review of the Corporate Insolvency Framework

Consultation comments by Mark Homan*

The consultation covers four proposals. The comment in this response is concerned with one only of the proposals; namely the proposal to create a new moratorium.

This proposal is misconceived and fundamentally flawed. It will have serious unintended consequences.

The new moratorium is proposed as a gateway to different forms of restructuring (see para 7.7) (unless the company is restored to solvency through an agreement with its creditors). These other forms include administration. The new moratorium is not intended to take the place of existing insolvency procedures such as administration or liquidation (see para 7.16)

It is a misconception to suggest that the new moratorium and administration can co-exist successfully within the same insolvency framework. The unintended
consequence would be very serious damage to administration as a constructive insolvency process.

It is proposed (see para 7.46), that debts incurred in running the business 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 enters 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'.

This kind of debt seniority in insolvency is sometimes referred to as 'super priority'. Without it, a 'new moratorium' could not work as once suppliers, including labour and even customers (for guarantees, after sales service etc.) are aware of the company’s difficulties they would otherwise rapidly begin to terminate business relations with the debtor company.

Similarly, administration would not work without the super priority which is afforded to those who supply the administrator. The proponents of the proposal are seemingly performing the conjuring trick of granting super priority twice out of the same assets. This is an impossible illusion.

The proposal lacks clarity in this respect. The words 'debts incurred in running the business during the moratorium will be treated in the same way (underlining added) as costs in administration' might be intended to mean with absolute super priority or to mean with equal priority to debts in a subsequent administration. The more likely intention is 'with absolute super priority' Without it, suppliers will not be persuaded to supply and the new moratorium will not work. However, this has serious consequences for any subsequent administration (or other proceeding). The situation is no better if super priority is intended to be shared.

At present, if an administrator is appointed he can and does borrow money and order goods and services on credit to be paid with priority out of the assets available to him. He is not personally liable like a receiver, but his reputation and the credibility of his office as an administrator (and a court official) is dependent on his not causing the debtor company to incur fresh liabilities that may not be met. The credibility of the system depends on it. In some cases, he will go further and will contract in to personal liability to obtain supplies. One of an administrator's most urgent tasks is to satisfy himself that even if he does not achieve a going concern sale of the business, there is sufficient asset backing to enable any fresh credit to be met in full. Only then can he proceed to take fresh credit. If he is to keep the business going he may have only a few hours to make that assessment, before, for example, he says to the labour force 'Keep working and I will pay your wages on Friday'.

If administration is to be preceded by a new-style moratorium and that moratorium does not lead to a restoration of solvency, the administrator will be faced with the assets already being charged with the obligation to pay off the super priority credit taken during the moratorium period. In the short time available to him before he needs to incur credit to keep the business going the administrator will have no
reliable means of assessing the amount of super priority credit already taken. That super priority credit is not just money borrowed or credit from suppliers. Other obligations incurred during the moratorium such as contractual completion obligations and guarantees to customers will also have super priority status. It cannot be readily assessed by the incoming administrator. ‘Keep working and I will pay you some time if the obligations incurred during the moratorium (once they have been worked out) leave any money in the kitty’ is not calculated to get the administrator a good turnout from the labour force.

The administrator cannot rely on the directors of a failed company for such important information. Nor is it an answer to say that the new moratorium is subject to supervision. The administrator will not wish to rely on the supervisor for so important a matter when the taking of credit in the administration is subordinate to unpaid credit from the moratorium and if not met can lead to personal liability of, or at least serious professional damage to, the administrator.

It is not part of the proposal that prior ranking super priority credit be certified by the supervisor and there is no way that he could do this in practice because of:

- the imprecise nature and degree of difficulty (such as with contract completion obligations and guarantees to customers, for example)
- the supervision appears to be intended to be fairly ‘light touch’ with the supervisor, for example, depending on being able to ‘request information’ from the directors (see para 7.42 and 7.43) and there is no way the supervisor can know the true extent of the credit taken by the directors.

For that reason, it would not help much for an IP who has acted as supervisor to be allowed to become the administrator (see para 7.45).

It follows that no administrator would put his personal liability or his reputation and standing as an officer of the court on the line in obtaining supplies on credit in an administration following a new style moratorium.

An administrator in those circumstances will inherit a business in which, during the moratorium:

- Customers, suppliers and employees will have started to drift away
- Work in progress will have begun to diminish
- Liquidity will have been reduced
- The more liquid assets will have begun to be realised to meet the needs for cash
- The backing available to him from which to meet new credit in the administration will consist of a reduced amount of assets less an unidentifiable amount for liabilities that have been incurred during the moratorium.

- It will not always even be clear that he can pay his fees and those of any professional advisers that he needs. Quite possibly no-one will be found to take office as administrator (or liquidator) following a new style moratorium, with the task being left to the Official Receiver to be funded largely by the public purse.
In short the ‘new moratorium’ is not capable of acting, as proposed, as a gateway procedure.

It is interesting to postulate what the consequences would be:

- Certainly considerable damage to the present system. Administration is a highly successful means of business rescue, but following a new-style moratorium would, for all practical purposes, be a liquidation. The proposal is not to have a new moratorium and administration, but new moratorium instead of administration. The consequences of which would be far reaching.
- A ‘new moratorium’ may be a tempting avenue for businesses that would have been better reconstructed ‘behind the scenes’ (for which there are well developed procedures) because the nature of their business is such that making public the company’s plight could cause panic.
- We will lose the benefit of cases where an administrator would in any case have greater chances of rescuing the business through sale (or even the company through reconstruction) than the directors would have through a new moratorium.
- The proposal could turn out to be the thin end of a wedge the other end of which is the adoption of a system akin to Chapter 11 in the USA, a result that some advocates of change may be seeking. Left without a sound fully fledged office-holder-led business rescue mechanism there may be a tendency to expand the ‘new moratorium’ process as a substitute through successive extensions of the initial three-month moratorium. There is little or no evidence that Chapter 11 offers better business rescue outcomes than administration. In a great many cases it leads to Chapter 7 liquidation. and it has many undesirable aspects. I have written at some length elsewhere on the pros (a few) and cons of Chapter 11. This response is perhaps not suitable for repeating them. Suffice it to say that introducing Chapter 11 ‘by the back door’ without a full consideration of the implications and a fully-fledged body of law in support would be very ill judged. Not least because a UK equivalent of the US bankruptcy courts would require (having regard to the relative size of the economy) some 50 full time specialist judges. Paragraph 10.12 of the consultation document ‘It must, however, be remembered that what works in one jurisdiction may not work in another, owing to factors including the wider legal framework, nature of the court system and prevailing business culture and practice’ is apt.

Two other aspects of this proposal are worth comment:

**Entry qualifications**

Paragraph 7.22 suggests that to qualify to enter a new moratorium a company must be able to meet current obligations as and when they fall due and new obligations. This is ambiguous or at least unclear. Generally, a company that can meet its current obligations as they fall due *and* expects to meet new obligations is not in need of a moratorium. The exception might be where there is a pre-moratorium obligation that is not yet current, but which is seen as unable to be met at a future date when it will become current (such as a loan repayment date). It is not clear
what is intended with regard to the moratorium. Is it to be a moratorium against all
pre-moratorium debts or only against debts which were not current at the outset of
the moratorium? If so, what justification is there for not treating them equally? And
what happens to them when they become current? Does the precondition then fail
and the moratorium end? What of the obligation which automatically, by its terms,
becomes current in the event of the company having a suspension of payments?
Greater clarity is needed.

Rights to information

Paragraph 7.48 proposes creditors having a right to information from the
supervisor. Paragraphs 7.42 and 7.43 appear to give the supervisor limited powers
to information beyond requesting it from the directors. This would seem to create
an unsatisfactory situation in which the supervisor has apparent responsibility, but
no power. Time will be spent gathering unreliable information from directors to be
passed on unverified when there are other critically urgent matters to be attended
to, particularly in large cases where debt traders have a thirst for information for
purposes unconnected with business recue.

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 [ticked]
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response form


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I want my response to be treated as confidential ☐

Comments:
Questions

Name:

Organisation (if applicable): Mazars LLP

Address: Tower Bridge House, St Katharine’s Way, London E1W 1DD

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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?

We agree that, in theory, there is a place for a standalone gateway moratorium for all businesses however we have concerns as to how the proposed supervisor would monitor the Company sufficiently so as to discharge his statutory duty and avoid any personal liability for the acts of others (see question 6 below). Our belief is that it is due to this issue that the Schedule A1 moratorium is used infrequently.

The proposed moratorium will be for a period of up to 3 months (with an option for further extension). This represents a longer timeframe currently afforded under Schedule A1 (generally around 28 days). A Supervisor will therefore potentially be party to a longer timeframe of business decisions to which he/she might be criticised for at a later date in the event that it is not possible to achieve a successful outcome.

Insolvency Practitioners have always recognised the need for a breathing space to restructure and have used an Administration exiting via CVA to obtain such. The Administrator is in control of the Company while it continues to trade and therefore has the proper ability to ensure that the Company continues to remain viable and meets all new obligations.

It is appreciated however that the announcement of an insolvency procedure (such as administration) may have a more detrimental impact on the goodwill of the business compared with the announcement of a restructuring of a work out.

A debtor-in-possession option, whilst being more flexible for restructuring options, places a high degree of reliance on the directors in providing regular and accurate information. The absence of such information poses a risk to the Supervisor, who appear to hold a high proportion of responsibility in determining whether the requirements for the moratorium continue to apply. If there are proposals for the protection of directors in respect of potential action from stakeholders, then we believe the same, or similar provisions should be granted to proposed Supervisors (on the basis that they act reasonably). Without this, Supervisors may be prematurely forced to withdraw their support for the moratorium and restructuring proposal if they are not provided with timely and accurate information.

2) Does the process of filing to court represent the most efficient means for gaining relief for a business and for creditors to seek to dissolve the moratorium if their interests aren’t protected?
We believe that the only way to ensure that the system is not abused (by the Company or creditors) is to ensure all applications are made to Court for consideration. It is suggested that after the initial 28 day period any creditors feeling that their interests are not protected must contact the supervisor in the first instance. Only if the supervisor does not deal with their concerns to their satisfaction should they be able to make an application to Court.

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

We believe that the eligibility tests and qualifying criteria provide the right level of protection, however we have concerns that the Supervisor will not be in a position to provide assurances to creditors as to the upkeep of the qualifying conditions while not being in control of the Company.

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?

Yes these do strike the right balance, however they depend on the on-going ability of the Supervisor to scrutinise the company’s financial position.

Creditors will be given an opportunity to appeal the moratorium and have the right to apply to court within the first 28 days of the moratorium on the grounds of unfair prejudice to their interests or in dispute of the qualifying criteria.

After the period of 28 days, it is unclear what rights will creditors may have if they have grounds to believe that the company may cease to meet the qualifying criteria at any point during the moratorium. We note our comments in section 2 suggesting that after the period of 28 days, the creditor firstly raises their concerns with the supervisor. If the supervisor does not deal with their concerns to their satisfaction should be they be able to make an application to Court.

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

Yes we agree with the proposal in this regard and the requirement for any extension to be agreed by all secured creditors and 50% of unsecured creditors. Although we do not anticipate creditors being in favour of many extensions beyond the 3 month period.

In respect of the proposal at paragraph 7.37 of the consultation paper, we would recommend that the timeframe for Administration remain at a period of 12 months from the Administration appointment and that no amendment be made for the period the company has been in moratorium. This is on the basis that the Administrator’s
statutory duties will remain unchanged. If the Administration period was to reduce to 9 months it is more likely that extensions would be required for a variety of reasons such as collecting deferred consideration in respect of a sale of the business, recovery action in respect of antecedent transactions, agreeing secured and preferential claims etc. The current delays in receiving clearance from HMRC are likely to also impact on the need for an extension.

It is unclear what date would be deemed as the date of commencement, if you were to use a Moratorium first. Administratively it would be far more straightforward to keep the processes separate – akin to Administration followed by CVL.

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

Powers of a Supervisor

We believe that the powers of the Supervisor need to be further clarified. It appears that what is suggested is that (like in a CVA) the directors prepare a “proposal to restructure”. The nominee supervisor should be required to file at Court his views on the proposal.

The proposal should state how the Supervisor proposes to scrutinise the Company during the moratorium. Legislation (or a Statement of Insolvency Practice “SIP”) should provide a statutory minimum in terms of supervision required during the period.

Qualification requirements of Supervisor

We do not agree that accountants and solicitors should be able to act as Supervisors. Acting as a Supervisor in the manner suggested requires a Supervisor to have experience not only in preparing and reviewing financial information and dealing with applications to Court, but having specific restructuring and insolvency knowledge. Insolvency Practitioners are uniquely qualified and experienced in dealing with distressed businesses in the manner proposed.

From a regulation perspective it follows naturally that Supervisor’s work be regulated as part of an Insolvency Practitioner’s regulatory review. In particular now the SRA has ceased licensing insolvency practitioners there is a concern that the SRA would not be in a position to review such work performed by their members.

If accountants and solicitors were eligible to act as Supervisors then the familiarisation costs assumed in section 1.33 of the Impact Assessment are too low.

Independence
We do not agree that an Insolvency Practitioner who had previously acted as Supervisor should be prevented from taking an appointment should the company enter a formal insolvency process.

We note that as Insolvency Practitioners are regulated by their Recognised Professional Body and adhere to the Insolvency Code of Ethics, they are aware of the requirement to act independently. In instances where this is not possible, an alternative course of action would be taken. We note that the Code of Ethics currently enables an Insolvency Practitioner to accept an appointment as administrator or liquidator following appointment as Supervisor of a Voluntary Arrangement, on the grounds that the Insolvency Practitioner considers whether there are any circumstances that give rise to an unacceptable threat to compliance with the fundamental principles. We would suggest that this approach be adopted for the current proposals.

This is a further reason why we believe that only licenced Insolvency Practitioners should be eligible to act as Supervisor as there is currently no regulatory control to ensure that solicitors and accountants adhere to the same standards.

In addition, in the event that an alternative Insolvency Practitioner was appointed, we would envisage that this would see a duplication of work and result in further costs being incurred, reducing any potential return to creditors.

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

We have concerns that where a restructure is not possible and insolvency must follow the moratorium, the unpaid costs of the Supervisor may be so significant that it will mean that compulsory liquidation is the only option left. Unpaid Supervisor costs should not deter the appointment of an Administrator. The costs should rank after those of the officeholder. This will ensure that the Supervisor is paid regularly throughout the moratorium.

Obviously having to include the Supervisor’s costs in the projections for the moratorium period could significantly affect cashflow and the ability to trade profitably in the period.

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

We do not believe that allowing creditors to request information on an adhoc basis will be cost effective. Instead, consideration should be given to requiring the Supervisor to provide shorter updates on a creditor portal, say fortnightly. These updates would need to be shorter than the progress reports provided in formal insolvency proceedings.
We agree with the importance of informing creditors throughout the process, however, the costs of the Supervisor responding to individual requests for information would by far outweigh the benefit to the creditor(s). We do not agree that such a requirement should be legislated as it could result in the demands of a difficult minority creditor increasing costs and depleting funds that could be available to all creditors.

As noted above we believe that the provision of periodic information would be a better alternative for all creditors. We would suggest a consultation process with creditor bodies to ascertain the level of information they deem appropriate in these circumstances which could then be set out in legislation or in a SIP.

In addition, we believe that the supervisor should retain the ability to use their discretion and the provision of certain confidential or sensitive information should be excluded if it in any anyway impacts negotiations.

**Helping Businesses Keep Trading through the Restructuring Process**

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

We agree with the proposed criteria for essential contract, whereby it can be evidenced that the supply or service is deemed essential to the continuation of the business.

We think that the continuation of essential supplies would result in a higher number of business rescues. We have concerns though that a creditor could end up being compelled to continue trading with a company (due to it providing an essential supply) and be being bound by a flexible arrangement with a customer which it does not want to trade with. Being in such an untenable position will not be pleasant for either customer or supplier.

At present an officeholder has to personally guarantee payments in respect of essential supplies. Presumably it would be the directors providing guarantees during the new moratorium or during a CVA?

10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We believe that the Court’s role is paramount to ensure suppliers are protected. At present an Administrator must make an application to Court to sell secured assets
without the permission of the secured creditor and this process works well in balancing the rights of the secured creditor and the interests of the creditors as a whole.

Under the current proposals, in the event that a supplier does make an application to appeal, it is unclear of the position during the period leading up to the appeal hearing. Will the supplier be obliged to continue to supply until the Court deems otherwise? If so, how can this be enforced? In the event that the supplier refuses to supply until the appeal hearing (say a timeframe of 3 weeks), this could have a significant impact on the ability of the business to continue.

**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?

We think that the Flexible Restructuring Plan should be separate. It is likely to cost more than a CVA and therefore the more simple CVA option should be available also.

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

From the Insolvency Practitioner’s perspective, this would be useful subject to safeguards.

We agree that there are many occasions where restructuring plans may be thwarted due to the inability to bind all creditors (particularly secured creditors), and the proposal provides greater flexibility.

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

Yes this appears to be sufficient protection for creditors. The key requirements should be that creditors receive prompt and continuous communication (particularly regarding the types of classes and where they fit in).

We agree that there needs to be a clear demonstration that creditors will be no worse off than in liquidation. We would propose a requirement for the directors to provide a declaration as to the accuracy of the information provided in reaching such a conclusion in order to protect against inaccurate or fabricated projections and abuse of process. We would also suggest that the Supervisor be required to qualify the extent of any investigations into the information provided by the directors.
We are in complete agreement of the necessity of the court’s involvement for the review of the classes of creditors and confirmation that the plan is fair and reasonable.

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?

Yes this would be needed, and we would recommend that this be on a forced sale valuation.

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?

We agree that in principle granting security in priority to existing charge holder would encourage business rescue. However, we also acknowledge that there is difficulty in striking the right balance so as not to deter the funding for businesses generally.

In cases where there is sufficient equity in assets, we believe that there should be greater flexibility for companies to negotiate with existing charge-holders.

In cases where charges are secured against assets which are insufficient to discharge the amounts owed, we believe that any shortfall should rank above floating charge holders, but not above preferential creditors. We do not believe that it would be fair and reasonable for the level of return to preferential creditors to be affected. An alternative may be that the Government increase the protection afforded to preferential creditors under the Redundancy Payments Service (for example, increasing the statutory weekly cap for preferential claims or increasing the level of preferential wages from the current level of £800). The RPS would have a higher subrogated claim in paying a higher proportion of preferential debts and the savings in the insolvency could be allocated to rescue funders.

Another alternative may be for the government to provide a funding scheme whereby a proportion of rescue finance is government backed.

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

We think that to be fair to the existing charge holders that a forced sale basis should be the valuation method used.
17) Which categories of payments should qualify for super-priority as ‘rescue finance’?

We think that both finance provided by financial institutions and trade credit provided by essential suppliers should qualify for super-priority. However only the essential suppliers should rank above officeholder fees, if the officeholder has control over the company.

As noted in question 16, we would welcome a government backed scheme for rescue financiers, whereby the government guarantees a proportion of the shortfall should the company be unable to repay the full amount due.

**Impact on SMEs**

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

It is our experience that CVAs do not necessarily fail solely due to the inability to bind secured creditors. Unrealistic modifications also materially impact the success rate. A method of incentivising creditors to accept reasonable proposals would be useful, particularly Crown bodies.

In addition, agreement for business rates exemptions would also be helpful in restructuring plans.
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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Comments:

**Questions**

**Name: Simon Underwood**

**Organisation (if applicable): Menzies LLP**
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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

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

  There is an obvious risk of serious abuse here. The damage that could be done to creditors is significant, so no.

- 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?

  N/A

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

  N/A
• 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?

N/A

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

N/A

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

N/A

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

N/A

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

Yes but there is a significant cost implication here to all types of insolvency. There are commercial and pre litigation sensitivities and this is open to abuse. The concern, which should be measured against transparency, is one creditor increasing the cost for all creditors vexatiously.

Helping Businesses Keep Trading through the Restructuring Process

• 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?
This passes the risk to the supplier. What if there is no contract? What mechanism would be used to dictate terms? What if the supplier cannot supply? What if the contract stated that it could not be used for essential services?

It is likely that there would be a higher number of business rescues but I would be unable to determine how many.

- 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?

My concern is the time between dispute and resolution. If there is no supply, what can be done to protect the company’s position? What powers would the court have to enforce supply practically?

If the administration were extended, I would have thought you would want your essential supplies extended accordingly.

**Developing a Flexible Restructuring Plan**

- 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?

  The plan would work better as an extension of the CVA procedure

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

  I do, but if the matter is proceeding to court for ratification regardless of the creditors view, it would be cost-efficient to take the process to court without junior creditors voting.

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

• 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?

Is the minimum liquidation value actually break up value? Given the increase in value of non tangible assets in companies, would this really assist in any event?

Rescue Finance

• Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?
  No. There is a risk that finance would become expensive or even unavailable outside of a formal process and therefore it would cause more failures.

  If it is introduced, Administrator's costs should be met prior to rescue finance.

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

  It would be difficult to appropriately legislate as to how an asset is to be valued. The onus should lie with the valuer.

• Which categories of payments should qualify for super-priority as ‘rescue finance’?

  None

Impact on SMEs
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.

The small company moratorium should be made less onerous for nominees and therefore brought into play in the CVA market. This would be a big step forward.

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.

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I want my response to be treated as confidential ☐

Comments:

Personal background

I am a chartered accountant and a Fellow of the ICAEW. I have been involved full time in company rescue and insolvency for over 25 years.
The comments below are my own personal views and do not necessarily reflect the views of my firm.

**Restructuring frameworks**

It is my belief that the skill levels, knowledge and experience of professionals involved in company rescue, restructuring and turnaround have improved immeasurably since the early 1990s.

There will always be companies that fail, but there are now many more that survive circumstances that would have resulted in insolvency in the past. In many situations a viable business can still emerge from an insolvency process, the question is whether there is a more efficient way to create a viable ongoing business that minimises the financial loss to creditors and/or provides some opportunity for them to recoup losses in the future.

A robust restructuring framework needs to balance the interests and rights of the various stakeholder classes in the outcome. It is an important principle that no creditor class should be materially disadvantaged in the outcome compared to the alternatives. Equally it is important that minority or subordinated creditors do not have the ability to derail bona fide attempts to equitably restructure a viable business for financial gain, thereby disadvantage other creditors and in some circumstances putting employee jobs at risk.
Questions

Name: Michael Prangley
Organisation (if applicable):
Address: c/o

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The Introduction of a Moratorium

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

I agree with the principle. However, the period of the automatic moratorium should be shorter, say 1 month with any extension required to be sanctioned by the Court.

In the majority of cases one month will allow time for:
- a broad path to rescue to be outlined (or the Court to grant more time to establish one if appropriate);
- the likely funding requirements and possible sources of those funds to be established; and
- allow a single forum for any material creditor or other stakeholder issues to be recognised and aired without undue delay.

I believe that 3 months is too long a period for an automatic moratorium to suspend creditor actions against a company without the Court being satisfied that it is appropriate. A longer moratorium would also increase the likelihood of creditors applying to Court to have it lifted.

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?

I agree that filing the relevant documents at Court (and with the registrar of companies) represents the most efficient means to achieve the moratorium, as with the existing Notice of Intention to appoint administrators.

Creditors wishing to dissolve the proposed 3 month moratorium can apply to Court under current proposals within 28 days. A process that allows each and every creditor to make an application to dissolve the moratorium would potentially be cumbersome and not a good use of the Court’s time.

By allowing only a 1 month automatic moratorium, this would allow all creditors a single forum to have their views heard early in the process and all objections can be heard simultaneously when an extension is considered.

There may still need to be provision for creditors to appeal directly to the Court if they are faced with adverse consequences from a moratorium that they would not face if the Company had filed for administration instead.
3) Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

**Application**

The draft proposal states that to be eligible for a moratorium the company “...must demonstrate that it is already or imminently will be in financial difficulty, or is insolvent.” Any moratorium filing should therefore include an explanation of why the company believes it is eligible, supported by cash flow forecasts and/or other relevant evidence to support this.

Under the current proposals the Court is not required to sanction the moratorium initially. However, there needs to be some safeguard to avoid ineligible companies applying for a moratorium simply to buy time with creditors.

I suggest that the company application is accompanied by a simple statement from the proposed supervisor confirming that in his/her view the company meets the eligibility criteria.

**Existing winding up petition**

The draft proposals provide that a moratorium cannot be entered into if the company (amongst other things) is already subject to a winding up petition. In my experience the existence of a winding up petition does not necessarily mean that a company is not capable of being rescued as a going concern, it may simply indicate short term cash flow problems. It would be unfortunate if a viable rescue plan was unable to be explored due to a single creditor having issued a winding up petition.

I therefore suggest that in that situation the company could apply to the Court for a moratorium. The Court would only grant a moratorium if the company can establish that there is at least a reasonable prospect of a restructuring plan being implemented (e.g. support of the secured creditors and proposed supervisor). This is consistent with the fact that a company could apply for a Validation Order to continue to trade post issuing of the petition, but would provide greater flexibility to develop a restructuring plan.

In practice it is likely that most companies will enter a moratorium before any petition is issued or that small creditors would be paid to lift the petition prior to a moratorium, but the option should be available in case of need.

**Impact of the moratorium on creditor claims**

The purpose of a moratorium is to bring temporary relief from creditors to allow the company time to find a solution. The draft proposal requires that a company must be able to trade “...meeting current obligations as and when they fall due...” If the company is already able to do this then there would be no need for a moratorium.

I suggest that the test should be that the company is able to meet all of its new obligations incurred within the period of the moratorium when they fall
due. i.e. liabilities at the start of the moratorium are frozen for the period of
the moratorium but no creditor’s debt is materially worsened during it other
than by consent. For example, secured financial creditors could choose to
advance additional funds to allow the company to meet trading liabilities
incurred during the moratorium, whilst a rescue plan is explored.

This could mean either that the company continues to make ordinary
payments on the usual dates, with new credit replacing old amounts paid off,
or it pays for ongoing goods or services used during the moratorium in line
with the agreed standard terms, subject to ensuring there is a final true up at
the end of the moratorium if necessary.

However, I suggest that the company should not be required to pay liabilities
already incurred that arise due to the passing of a due date. For example the
company should not be required to pay PAYE already incurred by paying
pre-moratorium wages, which falls due for payment during the moratorium.
Capital repayments falling due to financial creditors during the moratorium
period should also be suspended.

The Company should be given the ability to agree additional credit during the
moratorium on a supplier by supplier basis. This will allow for any creditors
with a higher degree of interest in a successful outcome to contribute to the
process if they so wish. I propose that any such credit extension should rank
ahead of other unsecured creditors (but behind secured creditors) in any
subsequent insolvency.

There may be circumstances where the Directors wish to pay some pre-
moratorium creditors (e.g. to avoid financial hardship for individuals or small
suppliers). I suggest that there should be a mechanism to facilitate this
without falling foul of the rules around preference should the business
subsequently fail. However, there would need to be checks to prevent
possible abuse. This could therefore be subject to any or all of:

- a maximum limit per creditor;
- the agreement of the Supervisor; and
- Court sanction.

Actions available to any creditors with financial or other covenants that are
breached during the moratorium should also be suspended until the end of
the moratorium. These creditors would still be able to apply to Court if they
felt they were being unfairly prejudiced by the actions of the directors during
the moratorium.

**Ongoing position**

There should be an obligation on the Supervisor to continually review the
position and if the appropriate conditions (allowing for any agreements with
specific suppliers) are no longer met then he/she will terminate the
moratorium.
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?

The measures outlined in the draft proposal broadly strike the right balance, although there are a couple of points that I believe need to be addressed.

**Creditor rights**
Under the current proposals creditors wishing to dissolve the moratorium can apply to Court within 28 days. As outlined in answer 2, a process that allows each and every creditor to make an application to dissolve the moratorium would potentially be cumbersome and not a good use of the Court's time.

Allowing only a 1 month initial moratorium, with any extension to be sanctioned by the Court, would provide all creditors with a single forum to have their views heard early in the process. There may still need to be provision for creditors to appeal to the Court but only if they are faced with adverse consequences from a moratorium that they would not face if the Company had filed for administration, which would be the alternative scenario.

It is right for creditors to have the ability to challenge the actions of directors where they are unfairly prejudicial to a creditor or creditors.

**Essential goods or services**
I agree that essential suppliers should not be able to withdraw services during the moratorium and the procedure outlined in the proposal is appropriate.

**Directors’ powers and responsibilities**
If the conditions for a moratorium are that creditors are in no worse position at the end of the moratorium period than at the start then the measures set out in the draft proposal are reasonable.

The directors should be liable if the position of any creditor is materially worsened during the moratorium without their consent.

**Asset sales**
In order to procure sufficient funding to undergo a restructuring it may be necessary for the company to sell assets.

In the case of secured assets I believe that the company should still require the consent of the relevant secured creditor(s) to sell the asset and will need to agree with them how the proceeds are to be distributed if not in accordance with the security documents.

However, the sale of unsecured assets will indirectly affect all creditors if the proceeds are used to fund payments to suppliers. In this scenario then
should the company subsequently enter insolvency the asset would no longer be available to a liquidator/administrator and the dividend to creditors would therefore be reduced.

In these circumstances then I propose that individual asset sales other than in the ordinary course of business are subject to agreement by the supervisor, with material assets (in excess of 5% of the gross assets of the company or 15% in aggregate) subject to agreement by over 50% of the unsecured creditors by value.

**Ongoing monitoring**

In addition to the above I propose that each week during the moratorium the company is required to prepare a daily cash flow forecast for the period of the moratorium to be submitted to the supervisor and filed at Court. This will ensure that any material detrimental changes to the company’s position are identified promptly and the cash flow forecasts will provide a record of how the ongoing liabilities are being dealt with.

**Buying and selling of debt**

It is a frequent occurrence in multi-bank restructurings that syndicate members sell their debt at some stage in the restructuring process. This can prolong restructuring efforts severely in some cases, especially where this creates the opportunity for hold-out.

I propose that during a moratorium creditors should be prohibited from selling their debt in order to provide a stable basis for the restructuring discussions. This is consistent with the principle that creditors are prohibited from taking action during the moratorium as to allow this to continue could affect the outcome of restructuring discussions.

**Employees**

I propose that one exception to the creditor moratorium is that all employee wages and salaries should be required to be paid in full and on time during the period of the moratorium, except where otherwise agreed with the employee. This will ensure that employees continue to receive payments to which they are entitled and also ensure the business continues to operate as normally as possible during the moratorium.

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

**Duration and extension**

I believe that the initial automatic moratorium should be a period of 1 month rather than three.
At the end of the initial month the Court should be required to sanction an extension based on the evidence before it. This should include analysis of:

- the outline plan or a broad path to rescue including a timeline;
- the likely funding requirements and possible sources of those funds;
- the level of secured and unsecured creditors supporting an extension;
- support of the Supervisor for the extension; and
- reasons why any opposition from dissenting creditor(s) should be overruled.

Whilst the support of the majority of creditors in each category would likely be persuasive it should not be a pre-requisite for an extension as there may also be other factors to consider (e.g. public interest).

**Secured creditors**

Requiring consent of all secured creditors would provide the opportunity for minority secured creditors to hold out and effectively derail a process which may be beneficial to creditors as a whole.

If secured creditor consent is to be required for any extension then this should be 75% by value.

Any minority creditor should still be able to apply to the Court if it felt its interests were being unfairly prejudiced by the actions of the directors.

**Multiple extensions**

The company should be able to apply for multiple extensions as it is not unusual for restructuring discussions to extend beyond the timeframe initially envisaged. In agreeing to subsequent extensions the Court would be able to assess the situation prevailing at the time and whether a rescue still has a reasonable chance of being achieved.

**Administration**

It is reasonable to deduct the length of any moratorium from the length of a subsequent administration, which could be extended in the normal way if required.

**Cessation**

Cessation of the moratorium should occur on any of the following events:

- the appointment of an insolvency practitioner, supervisor or nominee to commence a formal procedure;
- the company gives notice to Court that the moratorium is no longer required;
- cessation of the initial automatic moratorium without any application for extension;
- the extension of the moratorium sanctioned by the Court expires;
the supervisor terminates the moratorium at any time; or
a creditor successfully petitions for the cessation of the moratorium.

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

Qualifications
I agree with the proposal that the supervisor comes from one of the three regulated professions.

It is not clear from the proposal whether individuals would need to apply for registration as an accredited supervisor, which would be my preference. The accreditation process should require the individual to set out his/her relevant experience in restructuring as part of the registration process.

Alternatively this statement of experience should be submitted with the moratorium application if registration is not required.

There is no indication in the proposal as to the extent to which the proposed supervisor should be independent of the company. Whilst familiarity with the company may beneficial to a supervisor, on balance I suggest that the proposed supervisor should be independent of the company, with independence being assessed using the same criteria that would apply to an administrator. This will help ensure that the reasons for the moratorium are bona fide and properly considered.

As part of the application for a moratorium the proposed supervisor should be required to submit a statement that includes:
- confirmation that they are a suitably qualified person;
- confirmation that they have had no material professional relationship with the company or its directors in the preceding three years, other than in connection with the proposed moratorium; and
- statement of relevant experience (if not covered through registration scheme).

I agree with the proposal that the supervisor should be prevented from taking a subsequent insolvency appointment.

Role
The role of the supervisor as set out in the proposal document appears reasonable.

In addition I propose that the supervisor should be required to provide an update to all creditors on a regular basis by way of report, meeting or conference call. Whilst many creditors will be actively involved in restructuring discussions this should ensure that all creditors are kept
updated with progress. I suggest this should be done initially within 14 days of commencement of the moratorium and monthly thereafter. This should be a brief update only on the proposed timescale, likely exit route and major issues affecting this rather than a detailed explanation of the issues.

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

It is a common principal in restructuring that the fees incurred in completing it are paid either as incurred or on completion. It is therefore appropriate for the supervisor’s costs to be treated in the same way as those of an administrator.

In respect of unpaid moratorium debts the issue is more difficult. If the principal of the moratorium is that creditors should be no worse off, then these debts will be paid during the course of the moratorium. If these debts remain unpaid and the rescue fails then unsecured debts should rank ahead of other unsecured creditors but behind the secured creditors.

However, the provision of weekly cash flow forecasts as proposed above and careful monitoring by the supervisor should help avert this situation in the majority of cases.

The directors should be protected from any action if they have acted bona fide in the best interests of the creditors. Rescue attempts will fail occasionally and the directors should not be punished for actions during the moratorium if they have acted in line with the conditions of the moratorium and cooperated fully with the supervisor.

If a company subsequently falls into insolvency then the supervisor should be required to confirm that he/she has no issues with the conduct of the directors during 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?

In any insolvency process there is naturally a desire on the part of the creditors for information. However, that has to be balanced with the time (and cost) this potentially takes in dealing with creditor requests, particularly in large administrations. Most insolvency practitioners are aware of the need to communicate fully with the creditors and make appropriate provisions where necessary.

In order to provide a balance between providing information to creditors and avoiding overburdening insolvency practitioners then one solution is for the insolvency practitioner/supervisor/nominee to provide brief informal updates on progress at monthly intervals (in addition to the existing formal reporting
requirements). This should be a short note on progress, any material issues identified and the answers to any questions or requests for information that have been received.

There will inevitably be requests for information that may be detrimental to one party or another to divulge. For example, commercially sensitive information, information that may hamper the achievement of a restructuring, or information that may disadvantage one creditor compared to another etc. In my view any information requested should be subject to the judgement of the insolvency practitioner/supervisor/nominee as to whether it should be disclosed. If the creditor disagrees with the judgement of the insolvency practitioner/supervisor/nominee then they should be allowed to make an application to Court.

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?

The proposals in respect of essential contracts are reasonable.

The continuation of essential supplies would result in less disruption to a business and therefore inevitably lead to better outcomes from a restructuring process.

Credit insurance

Another issue that can have a profound effect on the prospects for restructuring is the withdrawal of credit insurance, leading to a reduction of credit from suppliers. A moratorium process that ensures suppliers continue to supply on "normal terms" should help negate this affect although non-essential suppliers may still refuse to supply.

Consideration should therefore be given as to whether the provision of credit insurance to suppliers on the same terms existing at the start of the moratorium is a service capable of being classed as “essential” under the draft proposals.

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?

The proposals provide sufficient safeguards to suppliers, when taken in the context of the obligation not to worsen their position during a moratorium.
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?

I believe that the restructuring plan should operate as a standalone procedure. I believe that any extension of existing procedures would run the risk of tainting the solvent restructuring process with insolvency.

The other processes would remain as options if the solvent restructuring completed under the protection of a moratorium cannot be completed.

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

Votes by class
The proposed voting rule that a majority in number representing 75% in value can bind dissenting class creditors is reasonable in my view. This would prevent minority creditors holding the process to ransom.

Cram down of junior classes
Whilst in principal there is merit in allowing cram down of junior classes of out of the money creditors there are two issues that need to be addressed.

1. I do not believe that liquidation is correct value to benchmark whether creditors are out of the money; this should reflect realisations in the next best alternative. In many situations failure of a business does not lead to liquidation but to a sale of some or all of the business and assets. Many sales of distressed businesses are completed using an accelerated sale process (“AMA”), with the transaction being effected by a pre-pack administration. These situations can be very different from the results achievable in a liquidation. I question whether the terminology in the World Bank documentation referred to is strictly comparable given the UKs other insolvency options, which often lead to better results for creditors than a liquidation. Using liquidation values as the comparable benchmark could lead to some creditors being unfairly treated in the restructuring.

2. If the cram down of junior creditors creates value for equity holders then this is in my view inequitable. The restructuring needs to ensure that creditors subject to cram down receive some reward from any future equity value created, particularly if the shareholders are not contributing additional capital to the rescue solution.
13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

The role of the Court as propose in approving the Restructuring plan will provide an important 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?

As outlined above I do not believe that liquidation is the correct absolute benchmark for financial recompense in the restructuring plan. In my experience the insolvency of entities where the company is considered viable (as required to qualify for a moratorium) rarely end with liquidation as the primary insolvency process.

However, it is often difficult to predict the outcome of alternative processes with any certainty. Therefore I propose that whilst a minimum liquidation value should be provided, the nominee should also provide the Court with his/her view on the best alternative likely outcome for the creditors (as a range).

Whilst not an absolute financial benchmark, this analysis should be considered when proposing the terms of the restructuring and should be made available to the Court when it is asked to approve the restructuring plan.

This will help prevent creditors being unfairly treated compared to the likely realistic alternative outcomes.

**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?

There are circumstances where it may be appropriate for rescue finance providers to be granted security in priority to existing charge holders and negative pledge holders. However, the rights of existing creditors need to be recognised in any framework that allows this.

In many consensual restructurings additional rescue finance is provided by incumbent lenders on the basis that the outcome it facilitates for them will be better than allowing the business to fall into insolvency.
This may be advanced under existing security arrangements, as super-
priority money or as unsecured lending depending on the circumstances. 
Also trade creditors may provide the company with extended credit terms for 
a period of time to facilitate a rescue.

I envisage that in situations where restructuring provides a better outcome 
than insolvency then incumbent lenders will continue to be a valuable source 
of rescue funding.

I therefore suggest that in any scenario requiring rescue funding the 
incumbent lenders are given the opportunity to provide it ahead of any third 
party.

In circumstances where incumbent lenders are either unwilling or unable to 
provide additional funds the company should be able to obtain additional 
finance, subject to the agreement of either the secured lenders or the Court.

Negative pledges may not just be held by secured lenders and some 
unsecured creditors may also have some form of negative pledge. For 
example, companies with a defined benefit pension scheme may give 
negative pledges to the scheme to underpin the strength of the employer 
covenant, where the scheme has no security. Such situations will need to be 
taken into account, rather than being overridden automatically.

Where it is proposed that rescue finance is provided with new security and 
there is existing security or negative pledges in place then the interested 
parties should be asked to agree, failing which the company should apply to 
the Court for consent.

Commercial aspects of rescue finance
If new lenders provide rescue finance supported by security then they should 
be prohibited from providing it at a price any higher than the lender secured 
on the asset being given as security.

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

If the effect of the proposals is to overreach existing security arrangements 
then in my view charged assets should be valued on the basis of open 
market value on a forced sale basis.

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

Super-priority should be given to finance facilities provided to the company 
where the existing secured lenders have declined the opportunity to do so 
(subject to Court agreement as set out above).
I do not believe that extended trade credit during a moratorium should be given super-priority above existing secured lenders as to do so would undermine the whole premise on which secured funds are lent.

In administration any credit provided to the company already ranks as an expense of the administration and ahead of existing unsecured creditors at the date of appointment.

In my view any additional unsecured credit granted during a moratorium that is not repaid during the period should rank ahead of the existing unsecured claims in any subsequent insolvency.

**Impact on SMEs**

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

The period of the moratorium should be included as part of the employee consultation process should the business subsequently enter insolvency. The directors should be required to keep employees informed of progress during the moratorium.
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?

[X] Yes [ ] No
A Review of the Corporate Insolvency Framework response form

Not confidential

Questions

Name: Mira Makar MA FCA

Organisation (if applicable): member, SME Alliance Ltd

Phoenix Management Consultants Ltd (service company for corporate recovery and company turnarounds -“rescue”- as well as provision of company directors and other office holders – from 1994)

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e-mail:

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<td>✓ Business representative organisation/trade body</td>
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<td>✓ Charity or social enterprise</td>
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<td>✓ Individual</td>
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<td>✓ Large business (over 250 staff)- including subcontractors</td>
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<td>✓ Small business (10 to 49 staff)</td>
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<td>Trade union or staff association</td>
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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.

Where the state interferes as between private sector entities and each other, it is at risk of those harmed taking action. It must exercise its protective obligations, ensure HRA compliance and respect the right to be heard with provision of personal data, which it must not traffic without written consent, to stay out of trouble. Its Leeds call handling is technically ace and should be recognised, as should the estates team for transparency and integrity.

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 problem has not been defined.

The indicators have not been identified.

The analysis has not been done nor is it the subject of consultation.

The vocabulary has not been set out.

There are no “costs” per se.

The Chilcott Report published to-day has been criticized as, although long, lacking analysis and rigour.

The proposals, such as they are, do not fly nor do they provide a path supported by the Insolvency Service for those prejudiced and HRA compliance. There is no HRA compliance check.
PUBLIC CALL FOR EVIDENCE

BY DEPARTMENT FOR BUSINESS INNOVATIONS AND SKILLS,

ON BEHALF OF

SECRETARY OF STATE RT. HON. SAJID JAVIT

Statement:

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
The Business Secretary's statement raises a number of questions. Comments are below.

I. Business Secretary's personal experience: can it be replicated and, if not, is it a relevant factor?

The Business Secretary’s family experience may not currently be repeated, given the approach to immigrants. Consequently it cannot be held up as a realistic prospect for families seeking to come to the UK. A commentary was provided on 14 April 2014 by the New Statesman’s political editor, George Eaton.

http://www.newstatesman.com/politics/2014/04/sajid-javid-s-father-would-never-have-made-it-cameros-britain

Sajid Javid’s father would never have made it into Cameron’s Britain

Extract: “The truth that eludes the pessimistic and xenophobic right is that immigrants don't just "take our jobs", they create them too. But when today’s entrepreneurs seek to enter Cameron's Britain, all they will be greeted with is a closed door”. George Eaton, political editor, New Statesman, 14 April 2014

II. Business Secretary’s approach to “jobs, growth and opportunity” and “making Britain the best place for a “start-up””. Is a public consultation or a private letter (3 July 2016) more efficient?

The Business Secretary’s approach was set out in a press release dated 3 July 2016. The letter referenced appears not to have been published with the press release nor the hundred chosen recipients identified. It is a call by the Business Secretary to industry and business to help him to shape future trade and investment policy. Importantly it says: “Now more than ever, businesses need certainty to ensure the best outcome for the UK economy in the coming months so it’s vital that the government maintains an open and continuous dialogue. This is all part of BIS’ Business Strategy to work collaboratively with businesses and we must keep on working together to make sure the world knows that the UK is open for business and remains an attractive place with which to trade and invest.” The key phrase is that “businesses need certainty”.

It is unclear when the Business Secretary asks BIS/Insolvency Service to run his calls for evidence/public consultations and when he operates by letter to a chosen few and how these few are chosen. The press release is below:


Press release

Business Secretary calls on industry to help shape UK’s future trade map

From: Department for Business, Innovation & Skills, UK Trade & Investment, The Rt Hon Sajid Javid MP and + others

First published: 3 July 2016

Part of: Exports and inward investment

Business Secretary’s call for industry and business to help shape future trade and investment policy.

A letter outlining action already taken by government to engage businesses and planned next steps, following last week’s referendum outcome, has been sent today (3 July 2016) to over 100 of the largest businesses and trade organisations in the UK.
Penned by Business Secretary Sajid Javid and Trade and Investment Minister Lord Price, the letter follows a series of meetings that have taken place over the past week to engage businesses in an “ongoing dialogue” with government to hear their “priorities, issues and ensure we are clear on what you want to see in terms of the end result”. It provides an update on future engagement activity and asks businesses to contribute to “informing our approach and priorities for engagement with all of our international partners to set out the options for UK trade policy going forward”.

The Business Secretary and Trade and Investment Minister also confirmed that the Chief Executive of the Intellectual Property Office John Alty, has been asked to lead a team tasked specifically with engaging with businesses of all sizes on trade policy issues.

Business Secretary Sajid Javid said:

Now more than ever, businesses need certainty to ensure the best outcome for the UK economy in the coming months so it’s vital that the government maintains an open and continuous dialogue. This is all part of BIS’ Business Strategy to work collaboratively with businesses and we must keep on working together to make sure the world knows that the UK is open for business and remains an attractive place with which to trade and invest.

The letter has been sent to businesses including those who attended the Business Secretary’s business roundtable on Tuesday 28 June 2016, those who Lord Price has spoken to and met with over the past week and those who attended the Prime Minister’s business advisory group meeting on Thursday (30 July 2016).

It also asks what further work UK Trade and Investment (UKTI) could be engaged in to help them as a business find and capitalise on new export opportunities and attract inward investment.

Trade and Investment Minister Lord Price said:

As part of BIS’ wide-ranging business engagement activity, I have written to a number of companies and inward investors to reiterate that part of my role, as with my predecessors, is ensuring that government’s trade and investment policy is guided by their needs.

The first meeting of the new inter-ministerial group on business engagement, chaired by Mr Javid, will be held next week.

Published: 3 July 2016

III. Business Secretary view that entrepreneurs start and grow business and must be guaranteed restructuring (rather than analysing and repairing) in order to be incentivised to start at all

It is stated that in order “to make Britain the best place in the world to start and grow a business” …“entrepreneurs have to know that they can restructure when times are tough”. However the logic does not flow. Entrepreneurs including serial entrepreneurs are more likely to seek to pre-empt problems before they become insuperable and to seek to repair them where things go wrong. There is no “restructuring”. There is in any event no generic concept of a “restructuring”.
Where there is a hole for example, or contingent liabilities such as amounts due to a pension fund, as in the BHS case, no “restructuring” can make it go away. However this does not stop insolvency practitioners selling “restructuring” as a way to avert paying out and blocking come-back. An evidence session on 28 June 2016 suffices by way of example.


The responsibility of the auditor is important. However the time it takes to investigate this is long: two years is currently being quoted by the FRC. Pensioners, as the Maxwell pensioners, have no recourse.


IV. Business Secretary view that option of “restructuring” must guaranteed….. “without removing much-needed protection for creditors and employees”

Protection is defined in statute and is the obligation of the state. This includes the fact that a “creditor” is no more than a contingent creditor, and must prove each of his claim and his identity before he can sue. This rigour applies whether he represents himself or gives another a power of attorney or appoints them as agent.

No notional administration or bankruptcy or even liquidation can properly circumvent either proving or the fact that such a person with a potential claim is outside the hermetic seal of the estate (personal or corporate) without any proper mechanism to get inside it or find out what is inside. Employees are automatically protected in law given the duty to act in their best interests at all times. An administrator properly offering to take up office assumes such obligations.

V. Business Secretary view that there is a balance between “restructuring” and “much needed” “protection for creditors and employees”

There is no such “balance” to be struck. The protection of the state is guaranteed for all those interested. Contingent creditors are at risk, a commercial matter that they evaluate before exposing themselves. Employees are protected by law and can benefit from statutory redundancy. The state has the obligation to prosecute where there is untoward activity such as a “pre pack” or use of protected cell companies; third party financial dependence; alternative business structures and other devices exploiting the “Legal Services Act 2007”, effective late 2011. This ended the curtailment and sanctioning obligations provided by the Master of the Rolls and Tribunal, for a free-for-all permitting an “authorised body” which is neither a natural person nor a legal one. “Solicitors to the court” charged with the administration of the law disappeared to be replaced by commodity business services with unidentified clients whose interests were paramount. The circus continues.
VI. Business Secretary view that there is some form of connection between “rescue” and unresolved third party contingencies

A rescue is unconnected with a company deciding to call in the administrator. A rescue or turnaround does not usually involve third parties. Whether there is enforceable debt or not is not in point. In the case of RSM Tenon, Deloitte, Cannacord Genuity, Lloyds Bank and the former Baker Tilly partners (billed as a “pre-pack”), there was a failed attempt to enter an arrangement in subsidiaries on the day the public company was de-listed (22 August 2013). Objections were received before midnight on the day. The transaction is no good.

VII. Business Secretary view that there is some form of duty to intervene in the capital structure and the trading operations of an enterprise: “should the worst happen to a business, we have a duty to give it the best possible chance to restructure its debts”. There is no such duty to intervene. On the contrary there is a duty not to intervene in relationships between private entities and each other and between them and the state. Intervention should be limited to market failures e.g. security; health; fresh water; welfare etc etc.

VIII. Business Secretary view that there is some form of duty to “restructure” debt (undefined) and “return to profitability”: “the best possible chance to restructure its debts and return to profitability”. Restructure of the capital base of the company (e.g. redemption or conversions etc) can happen for a plethora of reasons not necessarily related to profit. Neither in any event are necessarily linked to a rescue or turnaround.

IX. Business Secretary view that: “sometimes, insolvency is unavoidable”. The word “insolvency” does not exist in the English language and should be avoided if confusion is to be avoided.

X. Business Secretary invitation to consider “these proposals”. The press release does not set these out.
The Introduction of a Moratorium

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

No. A moratorium is defined as a temporary prohibition of an activity. Freezing operations can destroy business goodwill and customer and supplier confidence as well as that of employees and families. There is no such notion as a “gateway” nor any mechanism by which the state can usurp the powers and obligations of the directors severally and the autonomy of the members or even burst into what is inside the corporate (or personal) estate veil.

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?

Filing in court is the only mechanism a person outside the corporate or personal estate veil has to assert a claim. If they do not maximize damage mitigation steps in advance of filing they are on risk of not recovering any expenses they incur. If their claim is not capable of enforcement it is an act of contempt to file for which they may face a penalty.

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

No. These are commercial matters between those concerned. The state has no role to play apart from to keep out. There is no effective branding as “creditor” or “debtor”.

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?

No. This is not a matter of balance. The state has no role to play between an enterprise and its suppliers. Importantly the nature of instruments must be understood and whether the FSA/FCA conduct rules apply.


SD Middleton Dip PFS, CeMap, Cert PFS (Securities), 24 June 2016

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

No for the reasons set out in (2) above.

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

No. The directors are those chosen by the enterprise and its members. If third parties do not like them, they do not need to do business with them in the first instance.

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

No. There should not be additional costs. If there are, these should be minimal, incidental and not include external labour.
8) Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

A creditor filing in court will be entitled to ask for and receive production relevant to asserting his claim and a gist statement of the defence, including from third parties. There is no alternative mechanism. They can ask in advance of filing and can also make a subject access request.

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?

There is no such process as a “restructuring process”. There is no mechanism for state involvement or subsidizing one group against another including with the benefit of the public purse. Employees isolated with no redress is a problem. Continuing the contracts of an enterprise with, for example, the benefit of authorisation in the case of those entitled to run client monies accounts, is partisan and would not stand scrutiny in a properly convened and informed courtroom.

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?

The court does not have a “role in a process”. The court is enforcer of the law. A properly issued and served Claim Form with a valid cause of action will be heard.

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?

A “restructuring plan” does not work and cannot be made to work where it interferes in pre-existing rights without consent of those prejudiced.

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

No. There is no mechanism for lumping together unproven creditors or even allowing any of them to know who the others are. It is a contravention of HRA and possibly the rules of court to have a majority vote and seek to bind a minority. Genuine creditors are those of the enterprise and only that enterprise, through its directors, can properly look after them.

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

No. Safeguards are a matter for the directors, those charged with the governance of an enterprise.
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?

No. Valuations are matters for the directors of the enterprise and their auditor, in particular whether a going concern basis of valuation applies. It is an offence to trade fraudulently.

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?

There is no funding called “rescue funding”. An equity injection is risk capital. Priority to new money is potentiality theft. It cannot be “regularized” retrospectively. It unravels with the rest on subsequent scrutiny or accountability. No proper enterprise can emerge from improper manoeuvres.

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

The debenture will address such matters. A valuation cannot alter rights or be used to facilitate “skimming”. There are no RICS enterprises providing “valuations” for £200 to support a “sale” to a RICS purchasing agent, with the difference divvied up amongst the opportunists.

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

None. Subordinated risk equity is all that can be countenanced in circumstances of uncertainty.

Impact on SMEs

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

Yes prosecution of those cannibalizing their customer base to plug pre existing holes in their balance sheet; those seeking to enforce that which properly is not recoverable; those refusing to provide records to which a counterpart is entitled; those operating anonymously, using the courts maliciously or using registers and media to advantage at the expense of others or using a person’s identity without their knowledge or permission. Disgorge the proceeds of crime, identified by PAC in March 2014 as the only effective mechanism of curtailment.
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.

Layout

This is good and easy to use. Having the option to reply by paper or email is very helpful. Being provided with a name and phone number is very good, to deal promptly with and questions.

Consultation process: general observations

1) There are a plethora of consultations at any one time and many cover the same territory. For example the Justice Committee had a one-off session on the Legal Services Act 2007, without a full blown call for evidence and enquiry (28.6.16). At the same time NAO had been running a review of regulation for some months. There was huge overlap in underlying materials.

This has happened against a background that MoJ already reviewed Human Rights (“Balance of Competencies”) in late 2013 with submissions due in mid January 2014, published later. Such activity could usefully be shared and one pool of evidence used to inform another.

2) The general landscape has been much harder to negotiate without the OFT, CC and OGC. These need restoring. The replacement to the Audit Commission has left gaps. The use of unvetted private sector operators as “auditors” to local authorities does not work and would not have passed OGC procurement.

3) Generally it would be useful to set out the indicators of a problem and to consult on evidence which helps diagnose the problem and suggested solutions. For the Insolvency Service it is important that HRA and ECHR is unaffected by BREXIT. It needs to remember that its older staff members with their experience are its treasures and deal with them with the respect that is due rather than bemoaning an ageing population. It has been slow in severing all links with the private sector save by providing help lines to everyone equally. It could do with documenting what it does, identifying control points, authentication, authorisations, audit trails, subject access requests and having its own internal auditors. Its private sector board adds no discernible value, is not contactable and should go. Its technical advisers in enforcement should have greater responsibility and profile. Those in the Official Receivers office must be MoD security cleared to the basic level and the OR should based themselves in court and not attempt to run an alternative forum outside.

4) Dr Stephen Baister’s comments from 20 January 2012 have not yet been taken into account or resolved.

http://www.insolvencynews.com/article/13299/industry/baister-lambasts-insolvency-service-at-ipa-lecture

Baister lambasts Insolvency Service at IPA lecture 20 January 2012

Last night’s venue: The RAC Club, Pall Mall (picture)

Chief bankruptcy registrar Stephen Baister last night lambasted Insolvency Service proposals to allow civil servants to act as adjudicators in insolvency cases. Speaking at the renowned Insolvency Practitioners Association’s annual lecture, Baister said the suggestion that the current court process be replaced by an online service for petitioning for bankruptcy and winding-up was preposterous.

He said a fundamental flaw in the proposed new system was that it ignored the fact many “ostrich” debtors – so-called due to their head-in-the-sand mentality – will not respond to the letters, emails and text messages sent by the creditor or adjudicator. The result, said Baister, is that many more bankruptcies and company liquidations could occur.
He explained: “The Ostrich debtor bowls up to court and says for the first time, something sensible. It happens all the time. It is in the interest of the creditor to give them a chance. The Insolvency Service’s answer to that is it will all be dealt with in this pre-action process.

“Currently many winding-up petitions result in settlement of the debt, often very late in the process – in the ‘last chance saloon’, perhaps after a court adjournment. Many of those cases in the future could end up with businesses being shut and employees dismissed.”

Baister – who is also the president of the Institute of Credit Management (ICM) – said the industry should give further scrutiny to proposals on how the new approach will deal with the “concept” of dispute.

He said the new proposals mean that the civil servant will decide whether there is a dispute or not, and that, in itself, is wrong.

He added: “Everyone is entitled to a fair and public hearing. The lack of public scrutiny bothers me. It may be inconvenient to the government … but there is a practical value in a hearing.”

He also invited everyone to consider whether a purely administrative “automatic” mechanism to obtain a bankruptcy order might be the “thin end of the wedge” and suggested this could set a precedent, perhaps leading to ‘undisputed’ divorces without court involvement?

He questioned whether a government employee could have the experience and knowledge, and competence, to adjudicate on the validity of disputes in potentially complex areas of law, and noted an inherent conflict in placing the adjudicator in the same government agency as the Official Receiver.

He said: “The fact that a petition is not in dispute, doesn’t mean you make a bankruptcy order. There are lots of cases where the debt hasn’t been disputed but the order is refused. Deciding when to adjourn really is quite tricky.

“Since 1986, making an order always involved discretion and in all cases, that discretion should only be exercised by a judge.”

He said that, in cases of dispute, the only way to stop the civil servant adjudicator processing the case would be to apply to the court – which he claimed was absurd.

“The only way would be to make an application to the court to get it out of the adjudicator’s hands and pay £80 for the privilege. This is the first time that anyone has ever had to pay to defend themselves as far as I am aware.”

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

The witness thanks Nicholas Blaney and the Insolvency Service for the opportunity to provide evidence and to assist the Business Secretary as requested.
A Review of the Corporate Insolvency Framework response form


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

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I want my response to be treated as confidential ☐

Comments:
Questions

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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?

In April 2016, R3 published A Moratorium for Businesses: Improving Business & Job Rescue in the UK. We consider that R3’s proposals are well thought through and provide a workable moratorium that strikes the right balance between the interests of struggling businesses and their creditors. We have referred to specific aspects of R3’s proposals in our responses to the consultation questions.
The Introduction of a Moratorium

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

Yes, in principle we agree that the introduction of a preliminary moratorium would be helpful but believe that more detailed proposals are needed in order to consider both positive and negative consequences.

We have particular concerns about the suggested duration of the moratorium, the obligations imposed on creditors to continue to supply to the business and the qualification criteria for supervisors.

2) **Does the process of filing at 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?**

Yes, the most efficient means for businesses to apply for a moratorium should be by filing a notice in court.

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

We agree with R3’s proposal that any business should be able to apply for a moratorium if it is insolvent or if insolvency is in prospect.

We agree there should be restrictions on the number of times a business may enter a moratorium and that if the business has entered into a moratorium, administration or CVA, or has been subject to winding up proceedings in the last 12 months, it should not normally be entitled to another moratorium.

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?**

No. We feel the proposals would shift the balance too far in favour of the debtor company and its directors. We are particularly concerned about the effect on minority creditors who have insufficient knowledge and bargaining power to influence the restructuring plan. These creditors are likely to be SMEs.
We do not consider that creditors’ ability to apply to court to challenge the moratorium should be restricted to 28 days. It would be an important protection against abuse for creditors to be able to apply to court at any time.

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

No, we prefer R3’s proposals which would be more workable on a practical level.

We believe that an initial three month period is too long a period for the suppliers who need to be protected against rogue and incompetent directors.

We also query whether a three month period will be viable for most businesses due to funding difficulties.

The 21 day moratorium suggested by R3 would provide a better balance between the company’s and suppliers’ interests. Where absolutely necessary this could be extended for a further three weeks.

We agree that an extension of the moratorium should require a vote by creditors. However, we are not persuaded that it should require consent from all secured creditors as this may put those secured creditors with limited economic interest in a ransom position.

We would prefer for the existence of a moratorium to have no effect on the duration of a subsequent administration.

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

No. We believe that the supervisor of the moratorium should be a licensed insolvency practitioner.

Insolvency practitioners are strictly regulated by their regulatory bodies, and are the only professionals whose expertise is specifically targeted towards balancing the legal and commercial interests of businesses and their creditors in distressed situations.

Where applicable, if the moratorium is for a short period of time it would make commercial sense for the supervisor to be able to accept an appointment as administrator. If the moratorium is extended for a lengthy period consideration should be given to appointing a different insolvency practitioner as a fresh pair of eyes might be useful to alleviate any concerns regarding a perceived lack of independence. This could be achieved by creditors being given the opportunity to vote for an alternative insolvency practitioner.
7) *Do you agree with the proposals for how to treat the costs of the moratorium?*

Yes.

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

Creditors should be able to obtain a certain amount of relevant information during the moratorium and we envisage a sensible level of communication with creditors for the planned outcome of the moratorium to receive necessary creditor support.

Creditors should not be able to flood the supervisor with requests for information or use the moratorium as an opportunity for an early investigation of directors’ conduct.

We agree with R3’s proposals that the directors of the debtor company should provide a weekly progress report to the supervisor.

**Helping Businesses Keep Trading through the Restructuring Process**

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

We are very concerned about the criteria for judging essential contracts and the potential for businesses to exploit suppliers in a way they would not be able to outside of a moratorium.

The issue of late payment by large corporates in, for example, the retail sector, is well documented. We would strongly oppose any provisions governing essential suppliers’ contract terms that were inconsistent with the Prompt Payment Code.

We feel it would be unreasonable to expect creditors to continue supplying the debtor company for the suggested three month moratorium if they had entered into a contract when the business was not in such financial difficulties. We agree with R3 that suppliers should be able to request to be paid pro forma or require a guarantee from the directors.

We would like to see more research on how many failing businesses might be rescued by the continuation of supplies provisions, and a comparison with
the potential harm to entrepreneurial activity as a consequence of the increased credit exposure imposed on suppliers.

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?

No. The current proposals give the business wide discretion to designate contracts as essential and this is open to abuse. Without a cost effective and rapid process of appeal for suppliers this could cause considerable harm, in particular to SMEs in the supply chain.

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?

We believe it would work better as a standalone procedure.

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

Yes, provided sufficient majorities approve the restructuring plan.

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

The safeguards may provide reasonable protection for secured and larger creditors with influence over the outcome but we believe that the associated costs may make safeguards inaccessible to smaller 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?

Yes.
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?

The position of existing charge holders should not be weakened. If rescue finance providers are funding trading, their security should be restricted to new assets created through that trading and should not reduce the value of the charge holders’ existing security as at the date of the moratorium.

More evidence is needed to assess whether this would encourage business rescue. Moreover, the proposals regarding priority may in fact discourage business lending in the first place if lenders are faced with the prospect of a rescue finance provider taking priority in the future and thereby preventing the enforcement of their now subordinate security.

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

Charged property should be valued at its realisable value.

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

Payments for new supplies and costs associated with the process should qualify for super-priority.

Impact on SMEs

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

A distinction should be drawn between SMEs that fail through misfortune and those because of bad management. More rigour should be applied in securing the disqualification of directors who disregard their obligations under companies legislation.

We suspect that protecting good businesses from credit risk is much more important to a thriving economy than attempting to rescue failed businesses.
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 ☒

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☐ Yes ☐ No
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Comments:
Questions

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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?

Yes, the presence of a moratorium would do much to offer a breathing space for businesses to address their problems and would also deal with the possibility of hold-out creditors preventing access to successful reorganisations. Any issue of moral hazard would be dealt with through the supervision element and through the possibility of creditor challenge before the courts. Minimising exposure to a wrongful trading sanction and/or personal liability might encourage early resort to restructuring. An analogous treatment of transactions that could be coloured in formal proceedings by an avoidance action might also be considered. However, perhaps to discourage vain attempts to delay the inevitable (and thereby prejudice the position of creditors), a deterrent sanction similar to that in section 6A of the Insolvency Act 1986 might be necessary.

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?

In respect of creditors, a court filing seems the best way to balance the interests of particular creditors against the interests of the collective and of the debtor in achieving a successful restructuring. To discourage frivolous challenges, the provision of security for costs and, in the event of a successful appeal, a measure validating any steps taken in the process should together be sufficient to protect the various interests. However, in respect of some debtors, a court filing may not be the most effective way of obtaining relief as the costs may still be considerable for smaller businesses unless the process were extremely streamlined. As an alternative, for those businesses or others which could benefit, for example where the number of creditors is small and/or the creditor body is known to already support restructuring, an out-of-court process which puts the supervisor in place and has effect with the consent of the creditors (a standstill type arrangement) could be considered. The choice of whether to file in court or attempt a standstill arrangement would be a matter for assessment by the directors. The same would be true of the choice between a pre-pack and the moratorium procedure, which it is assumed would be the subject of publicity because of the requirement for a court filing, where the directors could weigh up the benefit of the moratorium.
process (with attendant publicity) against any reputational damage in electing to pursue the option most favourable to them.

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

Yes, the ease of access to the procedure should encourage early resort. The flexibility of the “imminent insolvency” test should aid this, as it is doubtful if being in actual insolvency would assist matters much, given that the prospects of a successful restructuring are considerably reduced once the debtor has crossed the line and has ceased to pay debts as they fall due. In terms of the 1-year period between procedures, preventing access to “serial insolvents” may be a legitimate aim of public policy. However, it should be possible for a debtor who demonstrates a real and cogent need to be able to apply to abridge the period.

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?

For the debtor, the protection of essential supplies (which may differ depending on the nature of the business) is crucial. In the way the proposal seeks to balance the maintenance of contracts (in some instances against the will of the creditor concerned) and the interests of creditors, the application to court is perhaps the only way to resolve this (whether it is a challenge to the moratorium or to the classification of essential supplies). The extra duties with respect to gaining credit and transparency of the process are laudable, provided there is no undue restriction on the directors’ scope of action. In line with the eligibility requirement for sufficient funds, the addition of a duty on the directors to ensure this is the case and that any question of viability has been properly assessed (with expert advice where necessary) could be envisaged.

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

Three months appears to be a reasonable period for the process. However, including this period to reduce the period of subsequent proceedings would not be efficient unless it is envisaged that the supervisor would also be eligible for appointment as the administrator (contra para 7.45), so as to reduce the need for familiarisation with the business. If the intention is to safeguard the supervisor’s independence by preventing such an appointment, then the period of an administration should not be reduced by the time spent in previous efforts at a restructuring.
In respect of extensions, it is unlikely that the creditors would grant an extension unless there are real prospects of a positive outcome. Subordinating extension to a positive vote might thus inadvertently encourage holdout behaviour. To guard against this, authority may need to be provided to enable such creditors to be bought out, without exposing the directors/creditor to the possibility of an avoidance action in the event that the restructuring is unsuccessful.

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

The role and powers of the supervisor appear reasonable. However, eligibility should be further extended to turnaround professionals. Perhaps the pre-requisites should simply require appropriate qualification, experience and membership of a relevant professional organisation.

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

Yes.

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

The provision of information on a reasonable basis for all procedures appears to be a good idea. This prevents information asymmetry and enhances the reputation of insolvency procedures generally among stakeholders. Balancing the efficiency of the process with transparency requirements should remain a matter for the discretion of the office-holder. As such, any requirements for disclosure and provision of information should be “light-touch”.

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?

Yes, the criteria appear reasonable and the logic of supporting rescue attempts through ensuring essential supplies appears reasonable.
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?

The measures ensuring the protection of the creditors concerned by enabling challenges to be brought are sufficient. The requirement to pay for on-going supplies during a restructuring process should safeguard creditors’ exposure to further insolvency risks.

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?

A standalone procedure is the better option. As such, a restructuring plan could be conceived of as a means of exit from a variety of procedures, such as the moratorium process, CVA or scheme of arrangement.

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

Where the intention is to affect all creditors, a restructuring plan should be able to bind all creditors. The provisions on voting arrangements, which are reflective of the current position in schemes, are reasonable. The constitution of the classes for these purposes can be left as a matter for the debtor’s management to consider for the purposes of any application. Making a cram-down available is also a reasonable option, especially to avoid the risk of hold-out behaviour, and excluding impaired classes from voting is a reasonable extension of this principle. This is provided adequate safeguards exist for creditor challenges, particularly where there may be an issue as to valuation. The possibility of including secured creditors within the ambit of a restructuring plan is also a positive step, particularly where the secured assets are to be subject to the terms of the restructuring.

It should also be possible, however, for the debtor to elect to deal with only certain creditors for the purposes of a restructuring plan and to leave untouched other interests. In these circumstances, however, it may be prudent to allow for a moratorium-like effect on the exercise by unaffected creditors of their rights, so as not to prejudice the implementation of a restructuring plan. A court could impose such a moratorium, following the expiry of which those creditors would recover their rights to pursue the debtor.
13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

Yes, the proposals as to the safeguards are sufficient protection and will also mitigate the possibility of challenges, particularly where use is made of the liquidation valuation test as a point of reference.

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 cramned down onto dissenting classes?

Yes.

**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?

Yes, the security/priority should also be extended to interim finance, i.e. finance made available in anticipation of a restructuring taking place (for example for specialist advice etc.). Protection for the parties involved as envisaged in points 27-28 of the EU 2014 Recommendation could be considered.

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

No view.

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

No view.

**Impact on SMEs**

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

No view.
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.

No view.

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
A Review of the Corporate Insolvency Framework response form


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.dwp.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:** Malcolm Weir  
**Organisation (if applicable):** Pension Protection Fund  
**Address:** Renaissance, 12 Dingwall Road, Croydon CR02NA

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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?
General Comments

The concept of a moratorium has been discussed before and the issues that have caused concern with it in the past continue i.e. creating a meaningful and properly funded moratorium that works with adequate safeguards to protect creditors who are already exposed.

We are concerned that the proposals seem to be very debtor friendly, overreaching supplier and security rights and enabling creditors who are out of the money to be crammed down. What if there are non-financial reasons for creditors wishing to withhold support, e.g. concerns with the directors? Under these proposals, they will not get a say if they are out of the money.

Creditors have a chance to object, e.g. make the case that they are not an essential supplier or challenge voting in their class, but the onus (and cost) is on them to go to court.

We are also concerned about how the proposal will interact with other legislation such as the Pensions Act 2004. This provides for certain events to trigger a pension buyout debt becoming due and a PPF assessment period to commence. Usually this results in the pension scheme having a seat at the table in any negotiations. The concern with these proposals is that the pension scheme which could be significantly disadvantaged, is not properly represented. Questions also exist as to whether a cram down involving amounts due to the pension scheme could be considered as compromising the pension debt and making the scheme ineligible for PPF entry, to the detriment of its members.

The Introduction of a Moratorium

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

The concept of a moratorium is sensible but there must be stringent safeguards to ensure that it is not subject to abuse. We consider that the proposals as drafted do not provide these.

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?

A Court application in some form is essential. However with the directors able to choose the Supervisor and simply being able to file a document, there are insufficient measures proposed to ensure that a moratorium is the correct process to adopt. A challenge by creditors after being notified is too late and too expensive. A majority of
creditors by value should have an automatic right to veto a Supervisor without the need to go to Court.

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

It is not clear how these tests and criteria will be measured and who will be certifying them. There appears to be no sanction should this be done in bad faith or negligently. The risk is that this could easily be abused by fantasist directors aided by fee chasing IPs.

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?

It is not practical or cost effective for the burden of challenge to be placed on unsecured creditors to make Court applications. Effectively this is unlikely ever to happen. There should be an obligation to consult and obtain agreement with a fixed percentage of the unconnected unsecured creditors who are effectively being forced to take the economic risk.

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

The moratorium period is too long and gives more than a breathing space. It should be no longer than 1 month with the option to extend if agreed by the creditors.

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

The risk of abuse is increased by the wide definition of the qualification of the supervisor. It is likely that unsuitable individuals will take the role in the belief that that are qualified. There appears to be no sanction on the supervisor at any stage for supporting/continuing an inappropriate proposal. See the response on question 2 about changing the supervisor.

The restriction on any subsequent IP needs to be extended to prevent them being from the same firm or a connected party.

7) Do you agree with the proposals for how to treat the costs of the moratorium?
There is the risk that the assets of the business that are available for creditors at the start are dissipated during the process with a significant adverse effect on the return to creditors. This is particularly true for involuntary creditors such as the pension scheme which may have no ongoing interest in the business if a restructuring through an insolvency process is implemented.

It is unclear how the supervisor’s fees are authorised and paid. It would be unacceptable for them to be agreed between the company and the supervisor without creditor ratification.

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

Transparency is a good thing however creditors as a whole are unlikely to know the right information to request. There is a problem that the supervisor may be inundated with requests from various creditors and competitors could take advantage of the situation by acquiring creditor claims and therefore a right to information.

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?

This poses significant risk to suppliers who may already be seriously disadvantaged as a result of the moratorium. If supplies are essential then the credit terms offered should be restricted to no more than seven days so creditors are not disadvantaged.

The supervisor should certify what supplies are essential and suppliers should be able to make them personally liable for supplies if they choose, as with the existing legislation.

IPs are able to deal with this issue very effectively in the majority of cases so a change is unlikely to have a significant impact.

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?
No – this again places an additional cost burden on the supplier and is likely to take far too long given the capacity restrictions in the court system.

**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?

*This could work either way and needs to be flexible.*

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

*This would be required for the system to work. However there must be stringent safeguards in place.*

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

*This is the key area and will be subject to most dispute. Again significant additional court cost is imposed on creditors to defend their position. There is a question of how creditors’ claims will be valued*

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?

*The liquidation basis is inappropriate and a restructuring plan should be assessed against the estimated recovery on a going concern sale basis.*

**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?

*While this may be attractive as a recue tool, it may have a significant adverse impact on ongoing businesses. In particular the possibility of all uncharged assets or charged asset with a surplus being absorbed will weaken the ongoing covenant of companies with a defined benefit pension scheme. As a result trustees will seek to repair any pension*
scheme deficit more quickly and increase the pressure on the sponsoring employer.

Any use of rescue finance should incorporate the consideration that it should result in a better return for all creditors than if it was not taken out.

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

It is not only the existing charge holders who should be considered. The lack of a charge over the assets is a major consideration for many creditors and this should not be overlooked.

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

No comment

Impact on SMEs

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

No comment
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
Insolvency Service Review of the corporate Insolvency Framework

Introduction
This note is split into three parts:

- Some general comments;
- Responses to the specific questions; and
- Some points and questions on particular paragraphs of the condoc.

General Comments
I assume that the proposals in the condoc result from independent research data which lead to the conclusion that there are viable businesses which have failed but which, with the benefit of a moratorium, would have been able to negotiate successful restructurings. Such a conclusion might seem counterintuitive given the prevalence of the practice of “extend and pretend”; this suggests that informal standstills are readily available in appropriate cases.

It is not explained why administration, including the “notice of intent” practice, cannot be used where justified. There may come a stage where the sheer multiplicity of possible procedures becomes an impediment to rapid decision making.

What is the problem the condoc proposal is designed to solve?
It may be worth considering the sort of situation in which one could envisage the moratorium being triggered.

The company is question will presumably have been in discussion, probably for some time, with its lenders and will among other things have requested an informal moratorium, covenant relaxations and any new money. One has to assume that those requests have been turned down, for reasons explained to the borrower. The existing lenders may have had the benefit of independent reviews of the company’s business. In addition it must be assumed that the lenders have also been unable to transfer the debt to a more supportive holder; this would be the logical next step for a bank which decides it cannot justify providing further support to a distressed borrower.

In comes the prospective supervisor, who is asked to second guess the decisions of one or more lenders who have been following the company’s business for a much longer period of time. On the basis of more limited familiarity, the prospective supervisor concludes that the existing lenders are wrong and that the business, under its incumbent management, has a viable future and, possibly, should be provided with more credit. That additional credit may increase the risk exposure of the existing lenders. Decisions of this nature are likely to require considerable courage on the part of the supervisor community.

US Comparator
One gets the impression that the proposals are influenced by a superficial understanding of US practice. It is therefore interesting that para 9.22 of the condoc indicates that the World Bank rates the current UK regime as returning money to creditors more quickly and at a lower cost than the US system. The US Chapter 11 regime, which is ultimately an adversarial process, can be very expensive.

There is a risk that the proposed moratorium is abused by companies whose businesses are not viable to hold to ransom its creditors and to produce, eventually, in administration or liquidation, a result which is less favourable for creditors, employees and counterparties.

**Interrelationship between proposals**

The condoc contains proposals for a new moratorium mechanism and also discusses questions relating to cramdown and new money. It is not always clear whether these proposals are independent of each other or only apply to a moratorium procedure.

**Costs**

The condoc suggests that the new moratorium would reduce costs. It is not stated on what evidence this conclusion is based, not least because of the (necessary) involvement of the supervisor (and his advisors) as well as the possible need to have recourse to the courts at various stages.

**Experience of the Existing moratorium**

Strangely the condoc does not make any reference to the experience, positive or otherwise, of the existing small companies moratorium.

Whilst on the subject of experience, it is worth noting that the existing administration procedure is perfectly capable of being used as a form of debtor in possession process, inasmuch as the services of incumbent directors and management do not have to be dispensed with by the administrators.

**CVA failures**

The condoc does state (para 11.2) that the Government believes that CVA failure (by which I assume is meant CVAs being rejected, not companies collapsing despite a CVA being put in place) is largely caused by the inability to bind secured creditors. No evidence is cited in support of this. Experience suggests that some CVA proposals are inherently implausible.

**New money**

The condoc is right to stress the importance in many cases for a business to have new money to operate while the proposed restructuring is being put in place. Ignoring the question of why a new source of lending would come in (except perhaps on exorbitant terms) when existing lenders had declined, what is not clear is what happens in a case when there are disputes about the viability of the business or the amount of “free” security which is available to be used to protect new money, be it on a pari passu or a superpriority basis. It is sadly possible that the business would not survive the time taken to overcome these issues. This would be bad for the business and its employees, but might also mean that the eventual recovery for creditors in a post moratorium insolvency would be reduced.
Security

One senses a governmental prejudice against holders of security, as well as an implicit assumption that a security holders’ rejection of a restructuring proposal may be a sign of bad faith. Secured lenders have no particular interest in the failure of the debtor. It would be unfortunate if the policy behind reforms of corporate restructuring were based on the allegations in the Tomlinson report.

It is important to recognise that the taking of security (including trade or asset finance) is an acceptable and, indeed, prudent course of action for financiers. Debt service costs for the borrowers are reduced if security is provided.

Retroactivity

It is important to know whether these reforms, especially those for allowing new borrowing ranking pari passu with, or ahead of, existing secured debt, would be retroactive. If so, the law would in effect be overriding previous credit assessments made by lenders. They might be forced to increase their provisions for bad or doubtful debts as a result.

Cost of going concern finance

Before implementing any of the proposed reforms, it will be desirable to investigate whether and to what extent the cost of finance for going concern businesses may be increased as a result of the proposals, notably insofar as they may be seen to reduce the protections provided by taking security.

Loan Liquidity and Transferability

The increased willingness of lenders to on-sell loans, particularly secured debt, has become a useful feature of the distressed debt landscape. This assists banks who decide they are unable to continue to support a particular borrower and allows a new lender, who may have a higher risk appetite and a more creative approach to solutions, to take over. This is in the interests of the debtor.

Consideration needs to be given to what impact these proposals might have on the debt trading marketplace.

Set off

I have in the past been involved in projects carried out by the FMLC in relation to legal uncertainties associated with the operation of set off in administration. It may be that there would be risks of further legal uncertainties in this area if the moratorium is introduced, although appropriate drafting ought to enable counterparties to know where they stand.

Exemptions

Reference is made to the need for specific exemptions from the proposed moratorium for banks, insurers and other companies in the financial services sector.

It is not specified whether the specific exemptions contained in Chapter IV of the Insolvency Act 1986 would also be preserved.
Role of the courts

Some of the proposals could, in their operation, prove quite contentious and raise questions where multiple divergent opinions are reasonable, not least when it comes to cram down or dilution of security. The condoc assumes that these issues can be resolved by the court system, despite the fact that many of the underlying issues are ultimately questions of economic forecasting. Some of the points raised (in the context of cramdown or security dilution) might include complex arguments based on human rights principles.

What is less clear are some of the practicalities around how the court system will deal with questions put before it. For example:

- Will there be some expedited process?
- Will it call for a small panel of judges with expertise in this area?
- Would there need to be special rules as to publicity?
- Who decides what minimum information is required to be supplied to the court?
- Is there any way of minimising costs?
- Can a “battle of expert reports” be avoided by some procedure under which the court appoints an independent expert whose duties (having listened to the views of all sides) are to the court and all affected creditors?
- What appeals are permitted and can they be expedited?

Pensions

It may be necessary to consider whether there are any possible conflicts between the policy underlying this moratorium proposal and the policies and legislation relating to the protection of defined benefit pensions.

Companies vs businesses

The document in numerous places talks about viable companies and rescuing companies. What is important is whether a business is viable, even if it may be carried on within an overindebted corporate shell.

Shareholder votes

If a company is listed on the LSE, shareholders may be called upon to vote on a restructuring proposal. This has led to the practice of their being offered some continuing economic interest in the future reorganised business, even when this cannot be justified by reference to the underlying financial position of the company. It would seem unfair to cramdown groups of creditors having a superior place in the capital hierarchy but to confer rights on shareholders, who rank lower. This may need to be considered further.

Status under Insolvency Regulation

There are of course much wider questions in relation to the Insolvency Regulation following the referendum result. The condoc does not indicate whether it would be intended to add the moratorium procedure to the annexes to the Regulation, or to any equivalent substitute cross border recognition regime which replaces it.
**Condoc questions**

Question 1: I am not persuaded that an additional statutory moratorium is required. If it is introduced, there may be a need for more protections against abuse. In addition, there may need to be more exemptions, notably to maintain the existing protections now contained in Chapter IV of the Insolvency Act 1986.

It is not clear to me that the proposal will lead to a reduction in the costs of rescuing troubled businesses. It would be interesting to see the evidence base for this conclusion.

Question 2: it must be doubtful whether the unilateralism proposed will be conducive to constructive discussions between a company and its creditors. It is hard to see how the supervisor can perform his (pre moratorium) responsibilities without principal creditors being actively involved and, indeed, supportive.

There is a risk that the existence of the procedure will prove counterproductive and may lead to lenders withdrawing support prematurely, anxious about the impact of a moratorium and the dilutive effect of pari passu or superpriority new money.

Question 3: Greater clarity is required on the responsibilities of the proposed supervisor prior to the filing of the moratorium papers. It is also unclear what happens to new or increased liabilities incurred to “non essential” creditors during the moratorium.

Question 4: I am not persuaded that wrongful trading liabilities should be suspended during a moratorium. It has never been credibly suggested that directors could be liable for wrongful trading in circumstances in which, in good faith, they work to seek to achieve a restructuring, even if, ultimately, those efforts fail. A moratorium (be it statutory or unofficial) is capable of being entirely consistent with compliance with directors’ duties in a manner which eliminates wrongful trading risk. If a moratorium is not directed at “minimising loss to creditors”, it is hard to see how it can be justified as a matter of policy.

The role of the supervisor should reduce even further the risk of exposure of a director.

The wrongful trading provisions offer a useful discipline within which directors need to operate when a company is in financial difficulties. Suspending this regime would send the wrong message and might encourage fraudulent or at least reckless exploitation of the moratorium procedure. Finally, it would be anomalous if directors operated under one regime in an informal moratorium (which may entail fewer costs) and under a different regime in a statutory moratorium.

Question 5: The moratorium should come to an end as soon as it becomes evident that rescue is not achievable.

Question 6: the rights and duties of the supervisor will need to be explicitly set out, as well as any exonerations which may apply in the exercise of his functions. Consideration will need to be given to the bonding and insurance requirements and the associated costs implications.
Question 7: superpriority (over pre moratorium creditors) is likely to be necessary for moratorium costs, including the fees of the supervisor and his advisors. It is not clear whether the proposal is that moratorium costs would have superpriority over the costs of a subsequent administration or liquidation. It may also be necessary to specify what costs are covered; for example, does this include incremental interest, finance lease costs and premises costs attributable to the moratorium period?

Question 8: It is essential that creditors should have access to information, even if there is a cost associated with it. This may be most efficiently addressed by the supervisor providing regular updates, rather than each creditor seeking its own information package.

Question 9: experience suggests that, in informal restructurings, financial creditors recognise that trade creditors need to be paid on an ongoing basis.

Whilst it may be difficult to legislate in advance to define exhaustively what is or is not essential, some guidance may be called for, notably in relation to employment and property costs, leasing liabilities and debt service costs.

Question 10: more thought may need to be given to the practicalities around using the courts to resolve these issues.

Question 11: Does the law have to be prescriptive on this point?

Question 12: How different will the proposed new voting methodology be from the principles currently used to establish classes in a scheme of arrangement?

Under present arrangements, at least for schemes of arrangement, it is well established that any creditor whose claim has no remaining value cannot block a restructuring proposal.

There can be considerable disputes and battles of expert reports and valuations, as well as rival methodologies, in establishing, in any particular case, where the value breaks. Given that valuations and projections are likely to be heavily judgment based, the scope for even more litigation (and associated costs) relating to proposed restructurings will be increased. What role will the supervisor play?

Where a creditor’s claim may have some value, it may be preferable to find a way of obtaining his support for a restructuring rather than overruling his objections.

In more complex financings, there will be intercreditor agreements which legislate for some at least of the situations which may arise.

Question 13: Plainly, there needs to be an opportunity for creditors who feel aggrieved or unfairly treated to appeal. A cramdown or security dilution power only increases the scope for disputes of this nature. This has implications, both in terms of costs and delay; some businesses may not be able to survive the time it takes to resolve issues in dispute.

Question 14: the condoc does not explain how any such minimum basis would be calculated. It might seem perverse and possibly unfair to adopt a liquidation basis to justify cramdown in the context of a procedure designed to avoid liquidation. Nor can it be assumed that there is a single, objective, liquidation value: this is likely to be expressed in a range and to be dependent on a number of (potentially contentious) variables, including the amount of time available to find a buyer.
Question 15: I am not persuaded that any of these mechanisms would encourage business rescue. One possibility worth exploring might be that if there are financiers who are prepared to take increased exposure, compared to existing lenders, the company could be entitled to require the existing lenders to transfer their debt plus its security to the new lenders who could then rely on the existing security to make additional loans. The transfer would be at par, because by definition the existing loans would have been independently and objectively determined to be adequately secured.

If it is demonstrated that there is “equity in charged assets” (para 10.19), and, as a result, the new money is given the benefit of existing security, is superpriority required for this new debt? How would any superpriority interrelate to the proposals in relation to payments for “essential suppliers”?

Question 16: This is an enormous question. There is unlikely to be a single formula appropriate to all cases. In practice, the only fair way is to allow a dialogue to take place between the debtor and all interested parties with a view to reaching, or at least getting close to, a consensus. As already stated, this could be time consuming and expensive.

Question 17: arguably all new or incremental credit attributable to the moratorium period should have superpriority over other unsecured debt. The justification test for any moratorium should be a “reasonable prospect” (or some other objective benchmark) of the company being able to restructure so that it will be able to pay all its liabilities (including historic liabilities, unless compromised) on a going concern basis. It is not self evident that a particularly important supplier should rank ahead of other credit incurred during the moratorium (as opposed to pre-existing creditors). What is important is that essential suppliers should be prepared to continue supplying notwithstanding the moratorium.

Question 18: consideration should be given to improving rescue mechanisms for unincorporated businesses.

It may also be necessary to determine whether overseas companies, with a COMI in England and Wales, can invoke this new procedure.

**Specific comments and questions on the condoc**

(adopting the same numbering)

7.1: this quotes a World Bank report stating that “a stay of actions by secured creditors should be imposed... where the collateral is needed for the reorganisation”. This quote begs a number of questions. First, it suggests that the moratorium should apply only to secured creditors, which would be unfair and unproductive. Secondly, the reference to the collateral being needed for the reorganisation could be taken as implying that the secured creditors would be deprived of their protection, which would also be unfair and, possibly, illegal. Either the quotation is very selective or has been taken out of context. This seems an odd basis to justify the proposals in the condoc.
7.8: this refers to the prospect of significant savings. It is not obvious that this would be the result, not least because of the costs of the supervisor process. What is the evidence base for this statement?

7.11: presumably one of the preconditions to entry into the moratorium will be for the directors to demonstrate to the satisfaction of the prospective supervisor that the company will have adequate liquidity to make payments to creditors during the moratorium period.

Will there be specific rules to apportion periodic payments such as rents?

Will liabilities incurred during the moratorium but remaining unpaid in a subsequent administration or liquidation continue to have superpriority? How will they rank compared to new liabilities incurred in the subsequent administration or liquidation?

7.13: there seems to be a degree of contradiction between the unilateralism of the triggering of the moratorium and the need to have some objectively demonstrable prospect of a successful financial restructuring. See 7.21 and 7.27. It must be questionable whether a “surprise” moratorium would be conducive to constructive restructuring negotiations.

There will need to be sanctions for abuse.

7.23: What role would the supervisor play in vetting, before appointment, the prospects of the proposed moratorium?

The identity, independence and reputation of the proposed supervisor are likely to be material to the support which creditors, particularly financial creditors, give to the process. There should be consideration whether creditors should have the right to be involved in the process of selecting the proposed supervisor.

7.29: Presumably any cancellation would be immediate and would bring an end to the moratorium, since a service essential to the business would no longer be available.

What would happen during the moratorium to payments for non essential services and supplies?

Reference is made to “altering the terms of the contract”, but it is not easy to understand what is contemplated here.

7.30: It may be necessary to specify what would constitute services for this purpose. Would it include, for example, the provision of overdraft and revolving credit facilities? Similarly, would this also apply to trade indemnity and similar credit enhancement services (despite the evident increase in risk borne by the counterparty during the moratorium)?

7.31: this statement seems misleading, in view of the proposal to suspend any risk of liability for wrongful trading during the period.

7.34: the use of the word “observation” to describe the role of the supervisor suggests a very light, reactive, touch, which will not provide much reassurance to creditors and will make the supervisor’s role rather invidious. Nor is it evident how
such an approach can be reconciled with the supervisor’s important responsibility to bring the moratorium to an end whenever it has ceased to offer the prospect of a successful restructuring. See comments on 7.43 below.

7.36. it will be necessary to consider what is included among the unsecured creditors. For example:

- Will it include secured creditors to the extent their debt exceeds the value of the collateral?
- Will it include creditors who, by reason of subordination or otherwise, are “under water”?
- What is the position of preferential creditors?
- How are prospective and contingent creditors dealt with?

7.43: this continuing responsibility on the part of the supervisor will require him (and his team in complicated cases) to be heavily involved in the affairs of the company. This could entail considerable costs.

This paragraph states that the supervisor will report to the court. Does that mean that a court decision will be required in order to bring the moratorium to an end?

What happens if the board disagrees with the supervisor’s conclusions?

7.45: this policy decision is doubtless the correct one but will increase the overall costs (and therefore deficit to creditors) of a moratorium followed by an administration or liquidation. Indeed, it may be an argument in favour of the company going direct into administration.

7.46: it is unclear whether the proposal is that these costs will rank ahead of debts subsequently incurred in an ensuing administration. In practice, it may be necessary to allow the liabilities of the administration or liquidation to have priority of moratorium and pre-moratorium unsecured liabilities.

It may be desirable to prescribe what debts are covered by this superpriority.

This paragraph seems to indicate that the priority will apply to all debts attributable to the period of administration, not just “essential” expenses. Is this correct?

7.48: This has cost implications.

8.4: it must be borne in mind that an insolvent’s failure to pay suppliers may put those suppliers in a delicate financial position.

8.9: some guidance as to what may be essential is going to be needed. The condoc seems to imply that a supplier has to be a monopoly supplier in order to be “essential”. Surely if this test is going to be applied, it should be a question of whether the insolvent can carry on his business without the supply in question, however many sources of the supply there may be.

It is important to understand whether “essential services” will include access to payment services, credit insurance and other intangibles. There may be objective reasons why some of these supplies should be repriced during a moratorium or other insolvency process.
8.13: courts may not consider themselves as well placed to make judgements of this nature. At the least, the prospective supervisor should support any categorisation of supplies as essential.

8.15: presumably the company should also be able to demonstrate that it can pay the supplier in full during the moratorium.

8.17: if the supply is essential and is going to be paid for during the moratorium, it is not apparent why the supplier's support for the restructuring plan is needed. Does this assume that substantial arrears are owed to the supplier?

9.8: any proposal for a cram down must recognise the need not just for valuations but for the preparation and objective testing of “counterfactuals”. The assumptions underlying both valuations and future projections (be they going concern or liquidation) need to be clearly set out and creditors need to have the opportunity to probe and, if necessary, challenge what is put forward by the company. Incidentally it is unclear what role the supervisor has in this process.

This seems to involve two separate processes: demonstrating that particular creditors are out of the money and then demonstrating that they (or other classes) would not do any better in a liquidation.

This implies both time and costs.

9.9: does the government believe that there is merit in the survival of corporate entities as well as their businesses?

9.13: the hypothesis of junior secured creditor being able to derail a restructuring approved by senior secured creditors seems implausible, as most intercreditor agreements will require juniors to follow the decision of the seniors, at least until the seniors are repaid in full.

9.18: Does this proposal involve a change in the mechanism of establishing classes at the outset of schemes? It certainly seems to indicate that, at this stage, the company might have to supply more information to creditors generally than may currently be the case. Where a company is listed, the implications may need to be considered further.

9.19: the double test applies to those actually voting.

9.20: the role of the nominee is not explained. Schemes do not necessarily have a nominee. Would the supervisor be able to be the nominee?

This involves the court making a commercial judgment, quite possibly in a contested context. This seems to go further than the role of the court in sanctioning a scheme of arrangement. What materials will be available to the court?

Is the “fair and equitable” test separate from the “in the best interests of the creditors as a whole” test?

10.9: It may be a relevant factor that the proposals in the condoc will in practice only apply where existing lenders have had the opportunity to provide finance and have concluded that it is not appropriate.
10.10: The condoc refers to negative pledge clauses. It is not clear what is proposed in relation to other provisions which might have relevance, such as financial covenants. The operation of some of these can have financial consequences, such as interest rate ratchets, which would need to be addressed.

10.13: It may also be worth having regard to the increase in invoice and trade finance over recent years. As it may be more difficult from a practical point of view to compel financiers to share this collateral, they may move to an increased use of this technique as well as lease financing.

10.19: It is easy to talk of there being “equity in charged assets”, but there may well be multiple opinions in any particular case as to whether there is any equity and, if so, how much. Arriving at a single conclusion can be a lengthy and costly process.

This seems to assume the lenders only need an exact correspondence between value of collateral and amount of debt. In practice, prudent lenders expect there to be a margin of security and the regulators would also expect this. It is not clear that the condoc recognises this.

10.23: One of the safeguards which would be required would be some form of statutory intercreditor arrangement to deal with how the benefit of the security, now shared, would be enjoyed and enforced. Would the legal holder of the security owe duties of care or fiduciary duties to the new lender? What would happen if subsequently the amount of the debt (or its sterling equivalent) increased, or if the value of the security diminished, so that any margin of cover was lost?

10.24: This sets out, as one of the preconditions, that the interests of existing charge holders are “adequately protected”. There is scope for considerable (time and cash consuming) argument as to what this may mean. Is it suggested that the company’s unsecured creditors could override the decision of secured creditors (and, possibly of the supervisor or administrator)? Even if this is a decision put to the court, the court may find it hard to make what is a commercial decision in the absence of very specific guidelines as to what is “adequate”. The question of how much (if any) of a margin of security is permissible is just one obvious point. Determining matters of adequacy will also need to involve some degree of forecasting.

10.25: What tests will be sufficient to enable the Insolvency practitioner/nominee to “demonstrate that the existing charge holder was not being disadvantaged”? It has to be assumed that in the circumstances the existing chargeholder will have concluded, based on applying its own credit assessment methodology, that it was not able to provide additional money.

Peter Bloxham

July 2016
A Review of the Corporate Insolvency Framework response form


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

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: Restructuring and Insolvency Group

Organisation (if applicable): Pinsent Masons LLP

Address: 30 Crown Place, Earl Street, London, EC2A 4ES

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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?
General comments

We believe that there is merit conceptually in many of the proposals, if they are specified to apply solely to large companies with complex debt arrangements. We do not believe that the majority of proposals will currently benefit SMEs. In fact, at the current time, we believe that most of the proposals, if applicable to SMEs, would be to their detriment (as well as to their creditors), due to the additional time / cost burden as a consequence of the proposals, and also the significant impact on many SMEs’ ability to access affordable secured finance (see below).

Any actual or perceived loss of creditor protection by secured creditors is likely to result in potential constraints on access to finance by companies, as the additional risks will be priced into secured finance transactions going forwards. This is a particular risk for SMEs in this country, which currently rely on secured bank lending as their primary source of funding.

The proposals are significant and ambitious in that they will involve not only changes to laws and procedures, but more fundamental changes to cultural mind-sets in this jurisdiction as regards the balance between a debtor’s interests (and achieving business rescue) and those of its creditors (particularly, in the protection of existing secured creditors).

Many of the proposals in the Consultation seek movement towards more of a US Chapter 11 style “debtor-in-possession” restructuring process. Although some may consider that companies are best placed to seek and action their own rescue, in many cases this has been found not to be the case, and better outcomes (for business rescue as well as creditors) have occurred from creditor led restructuring processes.

The UK has a long history in insolvency laws which are “creditor-friendly” and many of the proposals seek to move the balance culturally much more in favour of debtors. There are advantages and disadvantages to this shift. Disadvantages include that it arguably removes accountability of those debtor’s directors (and encourages “phoenix-ism”).

The UK has a business culture which already seeks to maximise business rescue, and statistics show that a higher proportion of businesses have been rescued in recent years. The administration process is effective at enabling businesses and assets of a company to be sold; even if the company which entered administration is subsequently wound-up having sold its business and assets, the process results in the continuation of the business and jobs being saved (via TUPE employment laws). The CVA process could be enhanced, so that is more fully utilised and successful, however more analysis in needed to assess whether it is best for the new restructuring process to sit alongside CVAs or be an extension of them (for larger companies), and also how these processes will sit alongside existing Scheme of Arrangement provisions in the Companies Act, and existing consensual restructuring tools such as debt-for-equity swaps.

We think that the impact assessment has significantly under-estimated the anticipated costs of the new proposals being introduced, particularly as all the proposals involve the courts, and additional time-consuming processes. In some cases, the extent of court involvement is significant, and the UK court system would require significant overhaul to ensure it is able to cope with the additional demands as a result of the proposals.

Other (non-insolvency) legislation (including company, tax, pensions and employment laws) would need amendment too, to be integrated with the new procedures.

Because the proposals are so broad-reaching and fundamental to the insolvency law regime in the UK, we think that they need to be fleshed out in much greater detail, with considerable analysis and further consultation undertaken as regards each of the constituent elements of
the proposals in terms of the pros and cons for different parties, including different types and sizes of debtor companies, creditors and suppliers. For example, there are different types of debtor-in-possession financing; the benefits and risks of these need to be analysed in further detail.

At the current time, in view of the recent result of the UK referendum, and the uncertainty generated by this and wider international economic, political and geo-political risks and uncertainties (including in the US and Europe), we suggest that it would be prudent to wait a little longer (at least until the outcome of the "Brexit" negotiations is clearer) before introducing such whole-scale changes to the corporate insolvency regime in the UK. Existing secured lenders in particular are likely to have legitimate concerns about some of the proposals, and it would be important to take these into account. In any event, we believe that some of the proposals are not feasible as they currently stand (see below).

The provisions to extend the essential supplies legislation are perhaps the least controversial of all the proposals and likely to be welcome by the majority of debtor businesses, although note that there needs to be the right balance to ensure that SME suppliers are not themselves adversely financially impacted as a consequence of the proposals.

It seems clear that the rest of the EU are keen to progress with plans for EU Capital Markets Union (with or without the UK, post the UK referendum), and alongside this, plans to harmonise insolvency laws and procedures across Europe. If the UK is to maintain its international finance and restructuring reputation and World Bank rankings, it is important to ensure that the UK is not left behind with national insolvency and restructuring procedures which are at odds with those applicable in EU Member States, and with no seat at the EU table to influence the development of EU laws. It is also important to take into consideration the importance of the secured lending market in the UK and the concerns of existing secured lenders.

If the EU continues to move in the direction of EU Capital Markets Union, i.e. so that more companies (including SMEs) access funding via a more diverse mix of bank lending, capital markets funding and alternative sources of finance (i.e. so that the EU funding landscape becomes more aligned to the US model), it makes sense that the restructuring world will move in the same direction, because of the nature of the debt being restructured. US investors understand the Chapter 11 debtor-in-possession system of restructuring, and they are increasingly investing in the EU. The US debtor-in-possession style process can also work well where there is a diverse investor base with different classes of creditors and different voting rights (which is more usual with debtors that are funded via a mix of bank debt, forms of capital markets finance, and/or alternative finance).

Relying on non-statutory consensual restructuring agreements and standstills gives flexibility but doesn’t give the benefits of a cram-down mechanic or statutory moratorium. The best route (for larger companies with complex debt arrangements) may well be in the middle, i.e. to keep court involvement to a minimum and keep flexibility (between debtor and creditors) to reach agreement (without too much process imposed by legislation), but have a statutory procedure which enables a cram-down of junior secured creditors (as well as unsecured), the protection of a statutory moratorium, and the continuation of essential supplies and priority rescue finance during the moratorium period. Steering such a middle path will take time, is a difficult balancing act, and needs to occur alongside the shift in the finance markets generally.
The Introduction of a Moratorium

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

In principle, we agree with the proposal to introduce a preliminary moratorium for larger UK companies with complex debt arrangements, other than those which are subject to a special administration regime. Companies which are subject to a special administration regime should be considered separately.

We believe that companies which would utilise, and benefit from, the preliminary moratorium the most are larger companies with more complex debt arrangements. We therefore propose that the eligibility criteria (for a company to enter a preliminary moratorium) should include certain minimum thresholds. We believe that further analysis and consultation is required to ascertain the nature and level of these thresholds, because there are likely to be several factors which might put a company in the "large company with complex debt arrangements" category. We question whether the moratorium should apply at all with respect to companies which do not meet such thresholds. There are costs as a consequence of a company entering the moratorium, and these need to be proportionate to the potential returns to creditors.

Further analysis is required to develop the detail of the proposals surrounding the preliminary moratorium, including the statutory purpose of the preliminary moratorium, a cost v. benefit analysis for different types and sizes of debtor company, and the processes and exits involved.

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?

Yes. The process should be regulated and streamlined to mitigate the risk of potential abuse, keep costs to a minimum, and increase the likelihood of business rescue. The process will involve additional court time and resource, which will need to be made available to ensure the process is as efficient as possible.

We believe that the preliminary moratorium (which should be available only for larger companies with complex debt arrangements) should be for a period of three months. Any shorter period is unlikely to be long enough to enable meaningful actions and decisions to be taken (particularly bearing in mind all the proposed actions to be taken during the moratorium by the supervisor / creditors / court etc – see below).

We believe that the company should provide five business days’ notice (of its intention to appoint a supervisor) to any qualifying floating charge holder, and that this notice of intention (and subsequent notice of appointment) should be filed at court (in a similar process to the current appointment by a company of an administrator).
In order to best protect secured creditor rights, there should also be opportunity for a qualifying floating charge holder to be able to appoint a supervisor (in a similar way to the existing administration procedure).

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

We do not agree that eligibility should not be restricted according the size of the company. As set out above, we believe that larger companies with more complex debt arrangements are most likely to benefit from the preliminary moratorium.

We do not think that companies should be able to use the moratorium unless they are in significant financial difficulty, and there need to be objective tests and statutory guidance put in place to determine what this means.

We agree with the companies proposed to be excluded from the moratorium as set out in the Consultation document (i.e. insurance companies, banks and other companies involved in specific financial market transactions).

We note that the proposed eligibility test requires the company to show that it is already or imminently will be in financial difficulty, or is insolvent. This test is easily met as it extends beyond “insolvency” to “financial difficulty”. In order to prevent potential abuse and ensure that directors remain accountable to creditors in the run-up to insolvency, we suggest that the “financial difficulty” must be shown by the Company to be “significant” (with objective tests and statutory guidance provided as to what “significant” includes).

The qualifying conditions are that a company applying for a preliminary moratorium must show that:

(a) “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”, and

(b) “there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors”.

As such, the proposed qualifying conditions are very subjective and will be easily met by a company applying for a moratorium (as the conditions require only a likelihood of sufficient funds during the moratorium period, and a reasonable prospect of compromise or arrangement, with no time limit).

We suggest, giving greater comfort to creditors and suppliers, that:

Condition (a) should be amended, so that the company must show that it has sufficient funds to meet current obligations as they fall due during the moratorium, and that it is likely to have sufficient funds to meet any new obligations that are incurred during such period; and

Condition (b) should be amended, so that the company must show that there is a reasonable prospect that a compromise or arrangement will be agreed with its creditors within the next 12 months.
The proposed amendment to condition (a) is important if the proposal that directors are protected from wrongful trading liabilities during the moratorium period proceeds (see below).

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?

Creditor rights:

The proposal in the Consultation is that there is no grace period / interim moratorium during which creditors can challenge the application for a moratorium prior to the granting of the moratorium – and instead that creditors can apply to court within 28 days of the moratorium (to challenge it). We do not agree with this.

As set out above, we believe that holders of qualifying floating charge holders should receive five business days “notice of intention” by the company to appoint a supervisor in advance (in a similar process to the current administration procedure), and have the opportunity to appoint their own supervisor (instead of the one proposed by the company).

We do not believe that all creditors should have a right to apply to court within 28 days of the moratorium to challenge it. This would result in potentially significant costs and burden to the supervisor (to manage such applications) and courts (to hear such challenges), and could encourage potentially spurious applications by disgruntled unsecured creditors. If any initial “challenge” period is permitted, this should be restricted to senior secured creditors (with fixed or qualifying floating charges only).

Directors’ powers and responsibilities:

We think it needs to be made clear in legislation what directors’ duties are during the preliminary moratorium. The Consultation document proposes that directors need (under observation of the supervisor) to ensure the conditions for the moratorium are maintained. To incentivise directors to make use of the moratorium to develop a rescue plan, directors are to be protected from wrongful trading liability under s214 of the Insolvency Act, however exposure for such liability resumes if the conditions for a moratorium are not met and the moratorium fails. As mentioned, the qualifying conditions specified above for the moratorium are subjective and easily met. We suggest making the amendments to the qualifying conditions set out above to better protect creditors.

The protection from liability under section 214 during the moratorium period is potentially open to abuse by directors, as it will arguably reduce their accountability to creditors during such period. It should be clarified by legislation that directors continue to act in the best interests of creditors during the moratorium period (if the company is approaching insolvency), notwithstanding that they may not be liable for wrongful trading during such period. Directors should not be protected from liability in respect of fraudulent trading or misfeasance claims during such moratorium period.

We agree with proposals to introduce sanctions for actions by directors such as:
(a) obtaining credit without first disclosing that a moratorium is in force;
(b) failing to send creditors a copy of the application; and
(c) failing to supply information reasonably requested by the supervisor, or that is reasonably relevant to the supervisor’s assessment of the qualifying tests (this should be subject to reasonability).

We agree that any breach by directors’ of their duties will cause them to be liable for potential disqualification.

We agree with the proposed obligation on directors to disclose information relating to the qualifying conditions to the supervisor. We note that it is proposed that directors must agree with the supervisor what further information is required and how often it should be provided. It should be clarified what the latter words mean - this may be difficult to legislate for, as the directors and supervisor may be unable to reach such agreement.

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

**Duration:** If the preliminary moratorium is only applicable for larger companies with complex debt arrangements, we agree with the proposal to limit the moratorium, initially, to a period of three months.

**Extension and cessation:**

*Conditions for extension:*

We agree that the moratorium may be extended:

(a) if more time is required to agree or implement a non-statutory proposal (in which case, the moratorium would end after the extended period if a proposal had not been agreed); or

(b) where the restructuring proposal involves a Scheme of Arrangement (in which case, the moratorium could be extended to cover the period required for formal approval).

We think that the moratorium should also be capable of being extended where the restructuring proposal involves a CVA (see below).

As regards (a) above, we note that, with respect to large companies with complex debt arrangements, it is highly likely that more time will be required to agree and implement a non-statutory proposal.

Also, as regards (a) above only, we suggest that any extended period would be for limit of a further three months.

We note that it is proposed that any extension of the moratorium requires a vote in favour by all secured creditors, and greater than 50% of unsecured creditors by value who respond to a request for an extension from the supervisor.

We think, in practice, obtaining this vote will be difficult to achieve in a time and cost efficient manner (particularly in cases where there are many secured and
unsecured creditors of different classes) and note that there may well be situations where not all secured creditors will vote in favour.

We think that some consideration needs to be given as to how this vote works vis a vis the cram down restructuring plan proposal – i.e. does it make sense to introduce such a "cram-down" approach here as well to ensure such extension requests are not hindered by a minority of junior secured creditors?

We agree with proposals that a company, which has entered into a moratorium, administration or CVA in the previous 12 months or is subject to a winding up order or petition, would be unable to apply for a further preliminary moratorium (until the expiry of such 12 month period), however may request an extension to the preliminary moratorium period (during such initial period). We agree that this would mitigate the risk of abuse by companies which are not viable, or are only seeking to frustrate creditor enforcement action. However, we think there may be merit in permitting application by a qualifying floating charge holder for a further preliminary moratorium within such 12 month period.

We note that it is proposed that a company which has been subject to a preliminary moratorium may enter into administration after the preliminary moratorium period, and that the length of the administration will be one year, minus the period the company has spent in the preliminary 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). We do not agree with the aggregation of the preliminary moratorium and administration moratorium periods for several reasons, including:

(a) The purpose of the preliminary moratorium is that it is provide a breathing space in which to assess which restructuring plan or insolvency procedure is most likely to result in business rescue and best returns to creditors as a whole. As such it is "preliminary" to whatever restructuring or insolvency process follows. The (tri-fold) statutory purpose of administration is different.

(b) It is proposed that the supervisor in a preliminary moratorium is different to the insolvency practitioner appointed in respect of any subsequent administration (so that the supervisor retains its independence and is not conflicted). We agree that this makes sense, however it will require a hand-over by the supervisor to the subsequent IP of various information and tasks at the end of the preliminary moratorium, which leads (potentially) to delays and inefficiencies. The new IP appointed as administrator will only commence the administration once the preliminary moratorium ends, so the administration period should remain at 12 months (with ability to extend it as at present).

(c) If the preliminary moratorium is extended (say to 6 months in total), this leaves a much shorter period in which to complete the administration (or request an extension to the administration), which puts pressure on the IP appointed as administrator to complete the administration in a shorter time period (which may not be in the best interests of creditors). In the case of large companies with complex debt arrangements, it is likely that the administration period will need to be extended.

6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?
It is proposed that a supervisor must be an insolvency practitioner, solicitor or accountant with relevant experience in restructuring. We think it is most appropriate for the supervisor role to be performed by an insolvency practitioner (and not by a solicitor or accountant).

The supervisor is to ensure that the qualifying conditions are met throughout the moratorium - and, if not met, to make creditors aware and report this to court. It is proposed that supervisors should be able to attend board meetings, request information from directors and sanction transactions not in the ordinary course of business. We agree with these proposals in principle, although the relationship between the supervisor, and debtor (who remains in control) needs to be made clearer, particularly as regards the potential liabilities of each to creditors.

It is also proposed that if a company enters a formal insolvency process after the moratorium, that an IP who had previously acted as supervisor would be prevented from taking the appointment (to ensure the supervisor acted independently and free of any potential conflict of interest). We agree that this makes sense. However, note our earlier comment about the necessity for a hand-over from the supervisor to the IP taking a formal insolvency appointment. It would need to be clear that the IP taking the later appointment would not be liable in respect of duties of the supervisor, and the supervisor would not be liable in respect of duties of the later IP. Furthermore, there may be some inefficiencies and delays caused by such a hand-over. Also note our earlier comment about not aggregating the moratorium periods in the case of a subsequent administration procedure.

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

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 i.e. they will be repaid first by the company as an expense of the process. We agree with this in principle.

Unpaid debts incurred during a moratorium and the supervisor's costs should remain payable as an expense of the process (beneath fixed charge holders in the insolvency waterfall).

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

We do not think this is feasible in many cases i.e. where there are several creditors of the same class, and in the case of large companies with complex debt arrangements, several classes of creditors, and potentially listed securities.

Creditors of the same class should be treated equally (with no preference to one over another), and if information is requested by one (and made available to one), it should be made available to all other creditors of the same class (and potentially, depending on the information, to all other creditors).

For companies which have listed securities, they must also comply with applicable listing, transparency and market abuse requirements, and ensure that such information is provided in a way which meets such requirements.

The supervisor would need to play an intermediary role here, and the process and systems to be put in place to enable such requests, and response to such requests,
would need careful consideration. For example, would such requests only be made through a creditors committee (rather than individually)? The administrative cost and burden of establishing such committees needs to be factored in. There may also be concerns (and disputes) in respect of providing information which may be considered confidential or privileged.

Any information requests by a creditor may need to be made available publicly to other creditors - in writing or by email / publication on a website. Responses may similarly need to be made available. There may need to be some centralised system set up to enable this information exchange – all of which will take time and incur costs.

All information which is relevant to creditors should be made available to them in any event by the company / supervisor, so there should be no need for creditors to request further information during the moratorium period.

We note that the Consultation states that the Government is considering extending this creditors’ right to request information provision to administration, liquidation, CVAs and the new restructuring plan proposal to improve their transparency and provide a further safeguard to creditors. For the reasons set out above, we recommend a cautious approach here. The additional time and cost burden, and potential for disputes, could result in a counter-productive result in terms of maximising business rescues and returns to creditors.

### Helping Businesses Keep Trading through the Restructuring Process

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

We agree that suppliers of essential supplies should continue such supplies during any preliminary moratorium.

We agree that, for such purpose, the existing statutory list of essential suppliers (including utility and IT services) should be maintained, however extended to include suppliers which are essential to the company, according to its particular business, location and the sector in which it operates. The onus should be on the company to show (reasonably) that a particular supplier is an "essential" supplier to it.

We also believe that the rules as regards "essential supplies" should be extended in this way for companies entering administration or CVAs.

We believe that the continuation of essential supplies does, and will, result in a higher number of business rescues, although there needs to be the right balance to ensure that suppliers themselves (and other businesses further down the supply chain), particularly SME suppliers, do not themselves suffer financial distress as a consequence of increased protections for debtors.
10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We believe these give larger suppliers sufficient safeguards, alongside the existing protections they have under the Insolvency Act legislation. However, we note that smaller suppliers may need further safeguards to ensure that they do not themselves experience financial distress as a consequence of the proposals.

Further, we note that enabling suppliers to challenge the decision by the company of the "essential" nature of its supply, will result in a further time and cost burden to the restructuring / insolvency procedure and to the courts, as well as to such suppliers. We would therefore recommend statutory guidance is provided as to when supplies may be designated as "essential" by companies, and approved as such by the courts.

**Developing a Flexible Restructuring Plan**

11) Would a restructuring plan including these provisions work better as a standalone procedure or as an extension of an existing procedure, such as a CVA?

We believe that it may make most sense for the flexible restructuring plan to be an extension of the CVA procedure, albeit only for larger companies with complex debt arrangements. It seems overly complicated to introduce a new procedure into the mix, with several restructuring and formal insolvency procedures already in existence in the UK. The existing CVA procedure is not as successful as it could be, and could be made more fit for purpose.

We think that CVAs would work better, and be utilised more, if they apply a voting system which enables different classes of creditors to vote according to their class (and include a cram-down mechanic, so that senior secured creditors can bind junior secured creditors to the restructuring plan (as well as bind unsecured creditors)).

We suggest enabling the preliminary moratorium to be capable of being extended to cover the period of a subsequent flexible restructuring plan.

However, we note that many of the proposals with respect to the flexible restructuring plan (eg constructing a class system, with classes to be approved by the court), are similar to the existing Scheme of Arrangement provisions, and therefore question what an extended CVA will achieve which a Scheme of Arrangement doesn't already (other than providing for such flexible restructuring plan under Insolvency Act legislation, rather than Companies Act legislation, and enabling such procedure to be recognised as an insolvency proceeding under the EU Insolvency Proceedings Regulation)? We think further analysis is required here, to assess how the extended CVA (or flexible restructuring plan) will sit alongside existing Scheme of Arrangement provisions in the Companies Act, and existing consensual restructuring tools such as debt-for-equity swaps.

12) Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?
For larger companies with complex debt arrangements, we agree, in principle, with the proposal to introduce a statutory restructuring plan, including the use of a cram-down mechanism with ability to bind junior secured creditors (as well as unsecured creditors), thus preventing a junior secured creditor from thwarting a restructuring procedure which is otherwise agreed, purely to maximise its own interests.

It is proposed that the cram down-mechanic would allow the company to force "out-of-the-money" creditors to accept a plan, and that (as currently with Schemes of Arrangement), if a class of creditors votes in favour, all members of that class would be bound by the plan.

We agree in principle with one of the tests to be applied by a court, to determine whether a class can be crammed down, ie: the plan is in the best interests of creditors as a whole (recognising economic rights of "in the money" creditors, and all other creditors being no worse off than they would be following liquidation.

With respect to the other test (ie at least 75% (by gross value of debt) and more than 50% of each remaining class of creditors agree to the plan), we think more analysis is needed here, particularly as larger companies with complex debt arrangements are likely to have different classes of secured creditors as well as unsecured creditors, with complex inter-creditor arrangements.

It would be necessary in any such voting procedure to ensure that each class of creditor is grouped according to its rights on a case by case basis. The construction of these classes should be filed with, and approved by, the court (as it is currently with Schemes of Arrangement) – see below.

It may be necessary for each class of secured creditors to be able to vote as a class in order of seniority (as well as for all secured creditors to be able to vote in aggregate), in order for a majority of the senior class(es) of secured creditors to bind a junior class of secured creditor. The application of the cram-down to unsecured creditors and to shareholders should also be considered.

This is a complex and controversial area, particularly if legislation imposes a test which overrides a prior contractual agreement between a debtor and its creditors. Going forwards, any legislative test would be considered by parties prior to funding, and could be priced into secured (and unsecured) finance transactions, although this may result in constraints in certain businesses (particularly SMEs) from being able to access such finance on acceptable pricing terms.

We agree that if the court approves the plan, this should be binding on all creditors –although creditors have a right to appeal.

As with other proposals, this will result in an additional time, administration, and cost burden for the courts.

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

We agree with the proposed introduction of court approval of the construction of classes (for the purpose of class voting rights), whereby classes are proposed by the distressed company, and filed with court, and creditors then have a window to apply to court to challenge their class.
We agree that the company must provide creditors with an overview of the class structure and their position within it (before the plan is submitted to creditors for approval).

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?

Yes, we agree with this in principle. There should be guidelines surrounding this to ensure that the costs and methodology of any such valuation are reasonable and proportionate to the size of the company, and anticipated returns to creditors.

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?

We believe that there is merit in the concept of "super-priority rescue finance", however there needs to be the right balance between achieving business rescue and protecting existing secured creditors. Any actual or perceived loss of creditor protection by secured creditors is likely to result in potential constraints on access to finance by SMEs, as the additional risks will be priced into secured finance transactions going forwards.

There are several different types of debtor-in-possession financing used in the United States, and we think that further analysis is required as to the pros and cons to different parties of the different forms of this finance as it might apply in this jurisdiction.

We would suggest that such "super-priority rescue finance" would typically only be utilised during either administration, or a CVA (as extended by the new proposals), and that the costs would rank alongside expenses of the administration or CVA. The purpose and profile of the super-priority rescue finance needs careful consideration. Eg, should this be just to fund working capital during the period of the administration / CVA?

We do not agree with the proposal to enable legislation to "override" an existing contractual negative pledge. Most secured creditors will require some form of negative pledge from a debtor to be included in finance documentation prior to funding, and the strength of the negative pledge will impact on their credit and pricing decisions in making such funding available. Negative pledges may carve-out particular security being granted over certain assets, in particular situations, however this is very much a commercial decision between the parties, and such carve-outs will generally impact on pricing. Secured creditors often also rely on other covenants (e.g. restrictions on secured borrowings) which achieve a similar level of creditor protection as the negative pledge. We would recommend that any re-negotiation of negative pledge (and other covenants) remain subject to commercial discussion and agreement between debtor and secured creditors during any restructuring process.

We do not agree with the proposal to notify existing charge holders (where they are not providers of the proposed rescue finance) of the proposed new security and
request their consent to it, with the result that, if they don’t consent, the rescue finance will go ahead anyway. Although the proposal states that the IP would need to show that the existing charge holder was not being disadvantaged, and the existing charge holder would then have 14 days to apply to court to challenge the financing proposal, we think this places an unfair burden on existing charge holders, and is likely to result in disputes and a reluctance by such existing charge holders to engage in a constructive consensual restructuring process (as well as a further time, cost and administrative burden to the courts).

We think it may be possible to enable certain types of "rescue" finance to be provided during a restructuring process, if this is not expressly prohibited by existing contractual documentation. This could be negotiated and priced into contractual finance documentation at the outset of such financing, so that it could, for example, be carved out from usual negative pledges or restrictions on secured borrowings.

The Consultation document states that (in order for any secured rescue finance to be obtained), the company's creditors or the court must be satisfied that:
(a) the granting of security for the rescue finance is necessary to obtain that finance;
(b) the interest of existing charge holders are adequately protected; and
(c) obtaining the rescue finance is in the best interests of creditors as a whole.

We think that it would be difficult, in practice, to obtain approval from existing creditors on the basis of the above.

In practice, it would be usual for a debtor to approach its existing secured creditors first to discuss whether such secured creditors could provide the rescue finance (and thus retain a first ranking security over assets) in such a distress scenario.

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

We think it would make sense for charged property to be valued by an independent valuer on a current market value basis.

We note that it may be a feature of particular secured finance transactions for there to be over-collateralisation, and / or for funding to be provided (and priced) on the basis of projected future values of the charged property.

Any requested release of security (in order to release equity in the charged property so as to be made available for super-priority secured finance) would need to be negotiated as part of the overall debt restructuring with existing secured creditors, and should not be imposed on existing secured creditors.

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

We are not sure what is meant exactly by this question. However, we assume that the purpose of the super-priority rescue finance is to enable short term finance to be made available during the period of the administration / CVA to fund working capital payments, which are required in the ordinary course of business, so as to enable the business to continue trading during such period. This could be provided by means of a super-senior working capital facility or receivables financing arrangement or other funding method (provided that it is for the purpose of funding such payments during such period), although it may well be necessary to re-
negotiate existing finance (including working capital) facilities to enable such finance to be made available.

**Impact on SMEs**

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

Legislative provisions which enable the assignment of receivables (eg making it clear that restrictions on assignment of receivables in commercial contracts will be invalidated, particularly in financial distress situations) will be valuable in opening up receivables finance markets, enabling distressed businesses to access such finance.
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.

We think that the potential exits from the preliminary moratorium need to be clarified. We understand that these may include (following any agreed extension period):

(a) a non statutory consensual restructuring plan;
(b) a statutory restructuring plan, such as a CVA or Scheme of Arrangement;
(c) the company entering administration;
(d) the company being wound-up.

It should be clarified how the rules relating to the preliminary moratorium affect receiverships (including administrative receiverships).

It should also be clarified how the rules relating to the preliminary moratorium affect companies subject to a special administration regime (other than banks and insurance companies, which the Consultation specifies are to be excluded).

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
A review of the corporate insolvency framework – a consultation on options for reform

We are pleased to submit our response to this consultation and welcome the opportunity to comment on whether proposed legislative changes would improve the existing corporate insolvency regime and enable more viable businesses to be rescued.

We set out below our comments on the proposals generally as well as our answers to the specific questions raised.

The Introduction of a Moratorium

General comments

We welcome the possibility of strengthening the restructuring tools available to companies in the UK and the proposal to introduce a moratorium. However we are concerned that as outlined the proposals are not workable in practice.

We note that it is hoped that if implemented the proposals will contribute to an improvement in the UK’s position in the World Bank’s Doing Business rankings. Whilst this is a laudable intention, it should not act as the driver for rapid change without sufficient research and evidence about the likely impact. The proposals have similarities to aspects of the US chapter 11 process but it is not clear that they would translate well into the very different UK environment.

We would support the introduction of a short moratorium in order to give companies a breathing space in which to consider their options and make a decision as to the appropriate way forward, which might be an insolvency rather than a compromise or arrangement.

In our view a three month moratorium, obtained simply by filing documents at court, is too long. Despite the safeguards envisaged we think that there is too much scope for abuse, and the longer the moratorium period, the greater the risk of the business deteriorating and/or the company running out of cash. Experience in central and eastern Europe (CEE) serves as a reminder of this.

We understand that experience in CEE shows that there is often abuse of a moratorium with debtors in possession. Assets may be dissipated in an elongated moratorium followed by filing for liquidation, or the plan against which the moratorium is granted by the court is unrealistic and the report to court on the plan (supported by the company's financial advisors) is not objective. As a result there are moves for change from some EU members in CEE with the four drivers for change being:

1. an elongated moratorium giving the opportunity for abuse
2. lack of skilled objective opinion (on the part of the financial advisor and the court) on the debtor’s plan against which the moratorium is granted
3. lack of power (and sometimes objectivity and skill) of the supervisor to intervene during the moratorium
4. lack of sanction against directors and/or the supervisor for failed restructurings.

In most cases, particularly for SMEs (for which the risks associated with a longer moratorium are perhaps greatest), a short moratorium period should be sufficient to identify the appropriate restructuring or insolvency option. In this respect we agree with R3 (the Association of Business Recovery Professionals) in their paper “A Moratorium for Businesses: Improving Business & Job Rescue in the UK” (April 2016) that a short (initial) moratorium of 21 days is appropriate. This shorter
moratorium will help to mitigate at least to some degree most of the risks we have identified with the proposals.

However we recognise that this will not be sufficient in every case and further time may be needed to implement the chosen option and we therefore agree that the initial moratorium period should be capable of extension. See our further comments in response to question 5 below.

**Effects of a moratorium**

The consultation paper refers at paragraph 7.11 to arrears owed to creditors being frozen. We assume that this is not intended to impact on the calculation of interest.

Whilst it is clear that this will mean that creditors may not take action to enforce payment of existing debts, it is not clear that the company cannot choose to pay an existing debt, although we assume that is the intention (including for supplies designated as essential).

Retaining an ability for directors to exercise some discretion in making payments for pre-moratorium debts could lead to abuse, both on the part of directors and creditors. Directors may seek to pay connected parties and other “preferred” creditors where that is not justified for the purposes of the moratorium. Creditors may seek to hold the company to ransom by requiring payment of pre-moratorium debts as a condition for continuing supply during the moratorium, unless that was prevented by designating the relevant contract as an essential supply.

However there could be real difficulties if the company is unable to pay any pre-moratorium debts. Essential suppliers may not have been paid for some time prior to the moratorium and might themselves fail and be unable to continue supply if their pre-moratorium debt remains unpaid.

In any event we think that some consideration should be given to the position of employees and possibly self-employed contractors, who may in practice withdraw their services if they are not paid their arrears. Currently it is not uncommon for employees to be paid their arrears in an administration to maintain their goodwill. Is it intended that the Redundancy Payments Service (RPS) will pay arrears of wages in a moratorium?

One solution might be for such debts to be payable where that is for the benefit of the moratorium and approved by the supervisor or perhaps designated as essential payments at the outset of the moratorium, but in either case we think there is still a significant risk of inconsistency, abuse, and possible failure.

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

As indicated above we agree that it would be helpful to introduce a short preliminary moratorium to give companies in financial distress a breathing space to enable them to make the right decision as to the most appropriate restructuring or insolvency option.

We agree that (subject to eligibility exceptions as described in paragraph 7.19 of the consultation) it should be available to all businesses, whatever their size. We note that it is envisaged that the moratorium is likely to be used in only 10-20 cases a year, mainly by larger businesses with more complex financing structures. However we anticipate that if introduced,
the moratorium would be used much more widely by small and medium sized trading companies.

We also agree that it should be available as a single gateway to different forms of restructuring, although as indicated below, we think that there are difficulties in making it necessary to show that there is a reasonable prospect that a compromise or arrangement can be agreed with creditors as a condition for obtaining the moratorium.

How to apply

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

We agree that a requirement for a court hearing to sanction a moratorium would involve greater cost and court resource than simply filing documents at court. So in that sense the proposal that filing documents at court will trigger commencement of the moratorium is more efficient. But even with the proposed safeguards, in particular the requirements in respect of the supervisor, and the ability of creditors to challenge the moratorium in court, there is scope for abuse.

Although creditors will have the right to apply to court if their interests are not protected, this is not efficient from their point of view, as it will mean greater cost for them, and the need to obtain a court hearing themselves.

We have expressed the view below that the proposed 3 month duration for the moratorium (with the possibility of extension) is too long. The ease with which the directors can obtain a moratorium, and thereby restrict the rights of creditors, without a court hearing, is another reason for keeping the initial moratorium as short as possible. We consider that this is an important safeguard for creditors.

Please see also our response to question 3 below in respect of companies subject to an outstanding winding-up petition.

Eligibility and qualifying conditions

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

We agree that the aim of the proposed moratorium should be to help companies whose business might be viable and not to delay an inevitable insolvency for companies. However we believe that a short initial moratorium to give a company the breathing space to determine properly whether it may be viable is appropriate.

**Eligibility tests**

Generally we are in agreement with the proposed eligibility tests.
We agree in principle that to be eligible for a moratorium the company should already or imminently be in financial difficulty or insolvent. Whilst early restructuring before crisis hits is desirable, that should be possible without a moratorium if the company is not yet in a crisis situation. Furthermore if, as is proposed, all creditors will have to be given notice that the moratorium is in place, companies would be reluctant to enter a moratorium at an early stage when they are not yet in financial difficulty or insolvent, given the damage that in itself could do to the business.

We agree that any moratorium should be available to companies of all sizes, and with the proposals as to the companies to be expressly excluded from the moratorium as described in paragraphs 7.19 and (with one exception) 7.20 of the consultation.

However we do not agree that an outstanding winding-up petition should automatically render a company ineligible for a moratorium for the following reasons. First, we do not agree that a potentially viable company should automatically be denied the opportunity to restructure if it meets the qualifying conditions. Secondly, there is a risk otherwise of winding-up petitions being used as leverage by hold-out creditors, and thirdly the alternative for such a company may be a pre-pack administration which creditors may view as less desirable. Indeed an outstanding winding-up petition does not currently prevent a company from qualifying for the small company CVA moratorium.

Where there is an outstanding winding-up petition, there is more of an argument for requiring the court to sanction any moratorium to ensure that it is an appropriate case for a moratorium and not just an attempt to frustrate the petition.

**Qualifying conditions**

We agree that a company should have to demonstrate 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 and new obligations incurred during the moratorium. In demonstrating this, companies will have to take account of the fact that suppliers whose contracts have not been designated as essential supplies may seek to withdraw previously agreed credit terms.

However there are risks inherent in this. In particular it is likely that companies will seek to ensure that they have enough cash to fund a moratorium period by ceasing to pay creditors for a period prior to applying for the moratorium, creating debts that will then be subject to the moratorium. And for supplies designated as essential, the suppliers whose debts have not been paid will be forced to continue supplying.

The position of landlords will also need to be considered. Unless the legislation is drafted in such a way as to ensure that rent is to be treated as apportioned for the period of the moratorium, companies with leasehold property will seek to ensure that the moratorium begins on the day after a rent payment date, to achieve the maximum amount of credit, as was prevalent in administrations prior to the decision of the Court of Appeal in *Pillar Denton Ltd and others v Jervis and others* [2014] EWCA Civ 180.

As previously indicated we would not support a moratorium being used as a means to continue trading and incurring more credit when there is no realistic prospect of avoiding insolvency. However we have concerns about the proposed condition that a company must demonstrate that there is a reasonable prospect that a compromise or arrangement can be agreed with its
creditors. Greater clarification is required as to what “a reasonable prospect” means in practice.

At one level, almost any company could reasonably say that it has a good chance that its creditors will agree to a deal, even without discussing it with them, if the only alternative is liquidation.

However the proposal clearly has in mind something more than this, including as a minimum consultation with major secured creditors. We would suggest that in many cases a company could not properly say whether it has the necessary “reasonable prospect” without also consulting with its major unsecured creditors (eg HMRC, pension scheme, key suppliers), and they may require some idea of the proposed terms of a compromise or arrangement before indicating whether they would support it in principle.

The obvious difficulty of having these discussions before the moratorium is in place is that the discussions themselves may precipitate action by creditors, including termination of contracts, issuing winding-up petitions and withdrawing credit.

We therefore consider that it would be much more workable to have an initial short moratorium during which such discussions could take place free of the risk of triggering creditor action. If the discussions indicate support for a compromise or arrangement, the moratorium could be extended to enable that to be put in place.

Creditor rights, essential goods and services and directors’ powers and responsibilities

Qu 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?

As currently envisaged, we do not consider that the proposed rights and responsibilities for creditors and directors strike the right balance between safeguarding creditors and deterring abuse.

Creditor rights

The consultation proposes that creditors will have a general right to apply to court within the first 28 days of the moratorium, and the right (presumably at any time during the moratorium, although this is not confirmed expressly) to challenge in court the actions of an officer of the company where these unfairly prejudice the interests of a creditor or creditors.

This puts the onus onto creditors to challenge a moratorium which will have come into effect automatically. If they do not challenge the moratorium it will continue for up to 3 months (or more if extended) until successfully concluded or terminated by the supervisor. If they do apply to court, presumably the moratorium will continue until the application is heard. It will therefore be important for the court to have sufficient resource to deal with creditor applications quickly.

For creditors of companies at the smaller end of the market, which as indicated above we think will use the moratorium most and where abuse may be more likely, we do not think this is a realistic protection. Such creditors often lack engagement, and even where they are aware of
their rights or obtain appropriate advice, they may be unable or unwilling to incur the cost of applying to court.

In our view, a much better safeguard for creditors is to keep the initial moratorium short (we are suggesting 21 days). The right to go to court then becomes much less relevant.

**Essential goods and services**

We note that it is not intended to be too prescriptive, but we think that further clarity is required as to the detail of what is proposed.

For example, is it intended that employee contracts, and those with self-employed contractors, could be designated as essential, or is this only intended for services that are not personal? How could employees and contractors be forced to provide their services in practice, even if designated as essential, if they would prefer to seek alternative employment? This may be linked to the questions we posed above as to whether arrears can be met during the moratorium, or whether arrears will be met by the RPS during the moratorium.

The consultation does not state that “essential supplies” would not extend to overdrafts or financial products including factoring and invoice discounting facilities, although we assume that is the intention.

We will also be interested to see the comments of providers of credit insurance, but if they are not prepared to insure debts incurred during a moratorium it seems that the proposals will leave essential suppliers exposed. Essential suppliers will be compelled to supply, even if their credit insurance arrangements will not cover the supply, and in accordance with current terms and conditions the supplier would be obliged to apply payments received in the moratorium (for uninsured debts) against the earlier pre-moratorium (insured) debts.

Whilst the continuation of supply of essential goods or services will be dependent on payment of debts on time and in full throughout the moratorium, this does not give much protection to the supplier if the debts are not in fact paid in full. There is nothing in the consultation to suggest that such debts would be treated any differently from other debts incurred during the moratorium which are not in fact paid, even though the suppliers of non-essential goods or services would have been free to impose contractual terms giving them more protection.

However we do not consider that it would be appropriate for either the directors of the company or the supervisor to be required to give a personal guarantee for payment of debts arising under a contract which has been designated an essential supply. Such a requirement would probably deter them from designating supplies as essential.

Please also see our comment below on the designation of essential goods and services more generally.

**Directors’ powers and responsibilities**

We have no particular comments on the proposals outlined in paragraphs 7.31 to 7.33 of the consultation.
However we do not think there is any need to make any special provision in respect of directors’ liabilities as proposed in paragraph 7.34 of the consultation.

It is not clear whether this proposal is intended to apply just to wrongful trading, or other liabilities as well, and if so, which ones. Insofar as wrongful trading is concerned, the proposal does not seem to add very much. Except where an administration is being used as the vehicle for a restructuring after a successful moratorium, even without any new protection it is difficult to see how a director might be liable for wrongful trading as result of trading during a moratorium when the conditions for a moratorium (as envisaged by the consultation) continue to be met, as the reasonable prospect of a compromise or arrangement being agreed must mean that there is a reasonable prospect that the company will avoid entering insolvent administration or going into insolvent liquidation. We acknowledge that this may not be the case if, as we have suggested, an initial short moratorium can be entered into in order to determine whether there is a reasonable prospect of agreeing a compromise or arrangement, but in that case there seems to be no reason why the current provisions, which are now well understood, should not continue to apply.

If however it is still considered that a special provision is required, we would suggest, instead of that outlined in paragraph 7.34, a similar provision to that suggested by R3, namely that any trading during a moratorium would not qualify as wrongful trading unless the company fails to meet any new debts created in the moratorium.

Anything more than that runs the risk of abuse, particularly at the lower end of the market. Smaller unsophisticated companies will want to use the moratorium, and may seek to manage the process themselves without advisors, which they are unlikely to be equipped to do properly. Although the supervisor will be monitoring the position, he will be reliant on the directors. So it will be very difficult for the supervisor to monitor effectively continuing compliance with the conditions.

**Duration and extensions and cessation of a moratorium**

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

In our view a three month moratorium, obtained simply by filing documents at court, is too long. Despite the safeguards envisaged we think that there is too much scope for abuse, and the longer the moratorium period, the greater the risk of the business deteriorating and/or the company running out of cash. The requirement to notify all creditors of the moratorium will potentially exacerbate this risk as it will mean that the company’s financial difficulties will become public knowledge, with the perception likely to be that the company is insolvent. This is likely to damage the business, as customers and suppliers will be nervous of dealing with it, particularly on credit terms (unless forced to do so by being designated as an essential supply).

In most cases, particularly for SMEs (for which the risks associated with a longer moratorium are perhaps greatest), and given the requirement in practice to consult with major creditors before filing for a moratorium, a short moratorium period should be sufficient to identify the appropriate restructuring or insolvency option and devise the necessary plan. In this respect we agree with R3 (the Association of Business Recovery Professionals) in their paper “A Moratorium for Businesses: Improving Business & Job Rescue in the UK” (April 2016) that a short (initial) moratorium of 21 days is appropriate.
However we recognise that this will not be sufficient in every case and agree that the initial moratorium period should be capable of extension up to three months in total. It is open to debate whether such an extension should require an application to court, or a vote in favour by creditors. A vote by creditors would require a sufficient notice period to be given and might be susceptible to abuse, but a court application would entail additional cost and court resource.

However if an extension is to be decided by a creditors’ vote we would question the proposed voting majorities required to approve the extension. We agree that for unsecured creditors, a threshold of more than 50% of those who vote is appropriate. But we do not agree that unanimous consent from all secured creditors should be required. We acknowledge that this is in line with paragraph 76(2)(b) of schedule B1 to the Insolvency Act 1986, but we have taken issue with this repeatedly in other consultations and discussions with the Insolvency Service. It gives rise to very real practical issues where a secured creditor does not engage and does not vote, and in the context of a moratorium it seems inequitable if a secured creditor with no economic interest because they are out of the money can derail the chance of rescuing the business. We recognise that to align voting rights with value breaking points gives rise to difficult issues of valuation, so perhaps where it is not possible to obtain consent from all secured creditors it should then be possible to apply to court to extend the moratorium (with the moratorium automatically extended if necessary until the hearing date).

If a company enters administration after the moratorium, whether as a restructuring tool after a successful moratorium, or following a failed moratorium, we do not agree that the normal 12 month administration period should be reduced by the time spent in the moratorium. The administrator may still need the full 12 month period to conduct the administration, and if not is under a duty to bring it to an end before then in any event.

**The role of the supervisor**

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

We note that it is proposed that a supervisor must have relevant restructuring experience and be a member of one of the specified regulated professions (insolvency practitioner, solicitor or accountant). We agree that a supervisor should have relevant restructuring experience and we consider that it is important that this new role should be regulated effectively, given the significance of the role in safeguarding creditors’ interests. This may mean that mere membership of one of the specified professions is insufficient if the level of regulation is not increased. Except in respect of insolvency practitioners the regulators are unlikely currently to have sufficient expertise in the area of activity that they would be regulating.

Whilst other jurisdictions require an insolvency practitioner to act in roles similar to the proposed supervisor (for example the examiner in Ireland) we acknowledge that a requirement for the supervisor to be an insolvency practitioner might mean that creditors perceive the moratorium as an insolvency process, which could be unhelpful when it is seeking to enable a rescue process.

We note that paragraph 7.45 of the consultation states that an insolvency practitioner who has acted as a moratorium supervisor would not be able to accept appointment in a formal insolvency process which follows a moratorium. We assume that this is not just referring to a
situation where a moratorium has failed to result in a rescue, but also where a rescue is to be achieved via a CVA or administration. We do not object to this, although it does mean that the need to bring in additional professionals to plan and implement the rescue proposals, will lead to increased cost. If the supervisor is to be truly independent, the role should not extend beyond monitoring the moratorium, and the supervisor should not be a “friend” of the directors. This would mean either that other professionals engaged first to advise the company would advise the company to enter into a moratorium with someone else as supervisor and with the original advisors advising on options and implementation and assisting with brokering the deal, or the supervisor would be engaged first and other professionals (who might be from the supervisor’s own firm) would then need to be brought in to advise and assist with negotiation and implementation of any restructuring.

So far as the supervisor’s powers and duties are concerned, they are described at a fairly high level in the consultation paper and much will depend on the legislative detail if the proposals are taken forward. For example, as stated in paragraph 7.42, the supervisor will need to be satisfied that the company is eligible on commencement of the moratorium, but it is not clear whether the supervisor will be expected to report to court as part of the application process. If, as we suggest, the initial moratorium is a short one to enable the company to discuss the possibility of a compromise or agreement with its creditors, such a report would not be appropriate at the initial application stage, but might be if approval of an extension is sought in order to put in place a restructuring.

It is not clear that the proposed powers and duties of the supervisor will be significantly different from those of the nominee in the current schedule A1 small company moratorium. That has not been an attractive role for insolvency practitioners, although of course that is not the only reason why take up of the small company moratorium has been very low. It appears that the proposed new role will still give the supervisor little real power, other than to bring the moratorium to an end. However it is not clear what potential liability the supervisor may have, particularly as the supervisor will be dependent on information provided by the directors.

Paragraph 7.43 of the consultation suggests that the supervisor should sanction transactions not in the ordinary course of business. We think that without detailed guidance, this could place the supervisor in a difficult position. Does he need to ensure that any disposals are made for full value? Or might he sanction a disposal at less than full value to assist with cash flow during the moratorium? What potential liability would the monitor have if his decision to sanction a disposal was challenged by creditors? We would therefore suggest that instead of requiring supervisor sanction, either transactions outside the ordinary course of business should be prohibited, or there should be no specific restrictions and the usual duties and liabilities of the directors would continue to apply in the same way as if the company had not entered a moratorium.

In summary, in our view, in a short moratorium such as we are suggesting, the supervisor’s role should be limited to a relatively light touch monitoring role.

Costs incurred

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

It is not clear what is intended by the first sentence of paragraph 7.46 of the consultation. If this is simply saying that moratorium debts must be paid in full during the moratorium, or
following a successful moratorium, then we agree with that. However it is not clear if this is what is intended by “an expense of the process”.

Presumably the supervisor’s fees will be a matter for agreement between the company and the supervisor, or are there intended to be rules prescribing the basis and manner of approval of the supervisor’s fees?

We are sympathetic to the notion that any unpaid debts incurred during a moratorium, and the supervisor’s costs, should be given priority in a formal insolvency process which immediately follows a moratorium in order to ensure that those who continue to trade with the business during the moratorium are adequately protected. As mentioned above, there is currently no proposal to treat unpaid debts incurred during a moratorium under contracts designated as essential supplies any differently from other debts incurred during the moratorium. Some additional protection may be justified, such as providing for debts arising from essential supplies to rank above other unpaid moratorium debts in a subsequent insolvency.

However we anticipate that secured lenders will have major concerns about this proposal, if it would mean that unpaid moratorium debts and costs would rank above their security. If the moratorium is as proposed, 3 months’ costs could have a significant impact on a secured lender, compared to our suggested 21 day moratorium period. We would be concerned if the proposals were to lead to a change in lending behaviour resulting in the cost of funding being increased and lenders becoming more risk averse.

We also have a concern that in a prolonged moratorium where the resources of the business are used to fund ongoing losses while options are explored, there is a risk that on failure of the moratorium there will be insufficient resources left to fund an administration, resulting in liquidation and the consequent collapse of the business, loss of jobs and reduced return for creditors.

**Creditors’ rights to request information**

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

We agree that creditors’ should be given sufficient information in a moratorium or any insolvency procedure, but we do not agree that this should extend to any information that can be legally provided, at any time.

In a moratorium (and a CVA) the directors remain in control of the business. It may not be reasonable to expect the supervisor to obtain information he does not have and which he does not consider he needs to fulfil his monitoring role. Constant requests for information will be a distraction for the directors from what will inevitably be a very difficult and busy period managing the business and negotiating a possible restructuring with creditors. Instead, we suggest that, in a short moratorium such as we have proposed, the supervisor should provide a report to creditors at the end of the initial moratorium if an extension is proposed to enable creditors to make an informed decision as to whether to vote for the extension, or make representations to court, depending on how the extension is to be approved.
That is not to say that the directors or supervisors should not provide information voluntarily if that will assist the moratorium, but there should be no absolute obligation.

Similarly, in other insolvency procedures, in our experience creditors frequently inundate the office holder with requests for information. When information is provided currently, this frequently prompts further questions, and ultimately in the context of an insolvency where creditors are going to lose money, whatever information is provided is unlikely to satisfy them, but will not change the outcome for them. Whilst such requests are understandable (and may not amount to unreasonable requests) an obligation to provide all the requested information would impose an unreasonable cost on the process, and an excessive burden that would risk the whole process grinding to a halt.

Helping Businesses Keep Trading through the Restructuring Process

General comments

We have already commented above on the proposals for designating contracts as essential supplies in a moratorium, and many of those comments apply equally to the designation of essential supplies in other insolvency or restructuring processes.

As the consultation paper indicates, the Insolvency Act 1986 was amended with effect from 1 October 2015 to ensure continuity of supply of utilities and IT goods and services to insolvent businesses. It is still too early to know what the impact of those changes is, whether they have helped companies to continue trading in insolvency, and whether they have led to suppliers changing their terms and conditions to limit the risk of being forced to supply.

When the Government consulted on those changes in 2014, we argued strongly against requiring a personal guarantee from the insolvency office holder as a condition of supply being continued, but to no avail. There is no mention of any requirement for personal guarantees in the current proposals, and we would strongly urge the Government not to introduce any such requirement. We do not consider it appropriate in a progressive debtor-in-possession moratorium for the directors to be expected to give a personal guarantee – they should remain protected by the company’s limited liability status, subject to any potential liability for wrongful trading. If that is accepted, it is difficult to see why an insolvency office holder, who unlike many directors has no financial interest in the company, should incur personal liability for essential supplies. In practice, if office holders are required to give personal guarantees they will be reluctant to do so and would therefore be unlikely to make use of powers to designate essential supplies.

How to apply

It is proposed that for a moratorium any application to court to designate essential supplies is to be made at the same time as the papers are filed in court to enter into the moratorium. That may be workable, given that the directors of the company who will determine which contracts are essential will be sufficiently familiar with the business to know which contracts those are (although prior to the moratorium being put in place they may not be able to determine whether an alternative supply can be found within a reasonable time frame at a reasonable cost, as they will not know the alternative suppliers’ attitudes to beginning a new supply to a company in a moratorium).
However it is not clear when it is intended that an office holder would have to designate contracts as essential. Is this also at the beginning of the process, and if so, within what period after appointment, or could they do so during the course of the process? In an administration, for example, the administrator may not be familiar enough with the business at the outset to know which contracts are essential.

Qu 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?

Whilst we understand the desire not to be too prescriptive, we have already commented in our response to question 4 above on the need for greater clarity around the types of contract that can be designated as essential.

We agree that contracts should not automatically be deemed essential, and that a contract is unlikely to be essential if an alternative supply can be put in place in a reasonable time and at a reasonable cost. However, as mentioned above, it may be difficult to determine that at the outset, without making enquiries of the alternative supplier as to whether they are prepared to supply a company in a moratorium or insolvency process, and if so whether they will seek to charge more than their usual rates.

It is difficult to know whether the continuation of essential supplies would result in a higher number of business rescues. We think it probably would help manage the supply chain process in an insolvency, although there is a risk that it would simply add complexity to the current situation.

There is also the risk of unintended consequences, in particular that suppliers will change their terms and conditions of business, for example by reducing their normal credit periods, to limit the risks in the event of being designated as an essential supplier.

Qu 10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?

We agree that the court should only be required to approve which contracts are essential in the event of challenge by the supplier, and that otherwise the designation as essential takes effect on the filing of the paperwork at court.

However even if the court were to approve the designation of all essential contracts, that would not provide a safeguard to ensure that the essential supplier is in fact paid for the essential supplies. That is probably more of a risk in a moratorium or restructuring process where the directors remain in control of the business, than in an insolvency process where an insolvency practitioner is in control. We have already suggested above that it may be appropriate to provide additional protection, such as providing for debts arising from essential supplies to rank above other unpaid moratorium debts in a subsequent insolvency.
Developing a Flexible Restructuring Plan

General comments

We welcome the proposal to introduce a new restructuring plan with cram down provisions which will enable dissenting junior classes to be bound.

We believe that this will be of particular benefit in financial restructurings for larger companies with complex debt and capital structures. It will inevitably give rise to difficult valuation issues and scope for legal dispute (paragraph 9.35 of the consultation acknowledges that valuations in a restructuring can be particularly contentious), even if the proposed minimum liquidation valuation is adopted. (As we explain in more detail below, we do not agree with that proposed valuation basis.)

The potential for dispute, and the need for two court hearings, mean that this is likely to be a relatively costly procedure, and less well suited to SMEs. The consultation recognises at paragraph 11.6 that SMEs are unlikely to require access to a cram-down mechanism but suggests they may benefit from the proposals insofar as they allow them to bind their secured creditors. We do not agree that the underutilisation of CVAs, or the high failure rate of CVAs, is due largely to the inability to bind secured creditors, but rather because they fail to address the underlying operational issues.

Currently schemes of arrangement are hardly ever used by SMEs. They do, of course, have advantages, such as their non-insolvency status. However, a lot more thought needs to be given as to how a scheme-type cram down procedure could be used in a typical SME trading company, for example, how creditors could be compromised without damaging the underlying business and its goodwill. We would be happy to discuss these issues further.

We note that it is proposed that the new procedure be time-limited to 12 months. We do not understand the thinking here and would welcome more of an explanation of the relevance of imposing a time limit, assuming that this would run from the date the plan becomes effective following court confirmation. Currently, in most financial restructurings using a scheme of arrangement the transactions are completed very quickly following sanction, and if the plan involves a sale of assets, the timing will be commercially driven and subject to the approved terms of the plan. It is unlikely that this sort of plan would need to be used for a contributions based compromise over a specified time period as is currently seen in many CVAs.

It is not clear what the position and role of shareholders will be in the new process. The consultation refers to their right to request documents and voting papers in hard copy, and to appeal a court’s decision to declare a procedure binding, but is otherwise silent as regards shareholders. Presumably they will get to vote on the plan, but it is not clear whether they can be crammed-down. The power to cram down shareholders or alter their rights would assist debt/equity solutions.

So far as voting generally is concerned, we note that it is proposed that relevant information will be provided electronically and that voting will take place electronically. In the bigger cases, where creditors are generally sophisticated, there will already have been discussions with the creditors about the proposed plan and they are likely to be engaged in the process, so electronic voting should be workable.

However at the smaller end of the market (if the new process is made available to SMEs) that may not be the case. Whilst we acknowledge that it is intended that decisions in insolvency proceedings generally will no longer be made at physical meetings by default, we think that for smaller companies in particular a meeting may be appropriate. This will help from a transparency point of view, may
mean better creditor engagement and understanding, and will enable modifications to be discussed and voted on (if modifications are to be permitted).

**Qu 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?**

We think that such a plan would work better as a standalone procedure. For the sort of large complex financial restructurings that it is aimed at it would be preferable for it not to be regarded as an insolvency process, and therefore it should not be made part of a CVA.

In any event, it is not clear how it would work if such a plan were to be made an extension of a CVA? Would the intention be to introduce voting by classes into CVAs even where no cram-down was required?

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

We agree with the principle that a restructuring plan should be universally binding in the face of dissenion from some creditors, but have concerns about some of the proposed details.

We agree that voting should be by classes and that the court should approve the construction of the classes. We have no objection to classes being determined on a case by case basis rather than being predefined in legislation. We assume that the proposal that classes be grouped by “similar rights or treatment” is intended to mean that classes will be constructed by reference to existing case law in relation to class composition in schemes of arrangement. We would have concerns if this was intended to mean something different.

So far as voting is concerned, we would advocate that a vote by 75% or more of creditors or class of creditors by value should be sufficient for approval, without also requiring a majority by number. Whilst we acknowledge that both are currently required in schemes of arrangement, the dual requirement can lead to a small minority of creditors being able to reject the scheme and has led to problems in practice – so for example, it would not seem to be fair and equitable in a company with 3 creditors if the creditor holding 90% of the value of the debt wished to approve a plan, but was effectively outvoted by the remaining two creditors who held only 10% of the debt between them.

With regard to the second of the tests set out in paragraph 9.20 of the consultation, to be applied by the court to determine whether a class can be crammed down, we do not agree that the test should be whether the creditors are no worse off under the plan than they would be in a liquidation. Whilst this has the merit of simplicity we do not think that it is necessarily fair. Of the possible alternatives to the plan, liquidation is always likely to provide the worst outcome for creditors. It would be more appropriate to consider other realistic options and look at what the relevant creditors would have received under the best alternative option to the scheme (for example a pre pack administration), rather than the worst.
Qu 13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

Please see our previous comments.

Qu 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?

Legislating for the use of a liquidation valuation would have the merit of simplicity and might avoid some disputes as to the appropriate valuation basis to use, but even on a liquidation basis differing assumptions can be used so this would not avoid all valuation disputes.

However we have already expressed the view above that we do not consider that the right test to determine fairness and whether creditors should be crammed down is whether they will be no worse off than in a liquidation.

Moreover, the proposal is that the liquidation valuation would be a minimum valuation basis and that other methods of valuation could still be used “where appropriate”. So the potential for dispute as to what is appropriate will remain, and if some other method of valuation is appropriate, then that is what the court should look at when determining fairness.

Rescue Finance

Qu 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?

The consultation recognises that there are significant differences between the UK and other jurisdictions where the availability of super-priority rescue finance has been established and that what works in one jurisdiction may not work in another.

In our view the key difference is the existence and prevalence of lending against floating charge security in the UK, so that frequently a company has no unencumbered assets.

The risks of legislating for super-priority rescue funding could be very serious. Any significant change in lending behaviour generally which might be triggered by such a change, whether as to the availability, or the cost, of lending could have a material effect on the wider economy.

We therefore think that it is important for the Government to consider very carefully the responses to this consultation from secured lenders and to carry out further research as to the likely impact before proceeding further.

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

No comment
Qu 17) Which categories of payments should qualify for super-priority as ‘rescue finance’?

No comment

Impact on SMEs

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

Please see our previous comments as to the impact of the current proposals for SMEs.

PricewaterhouseCoopers LLP
5 July 2016
A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK (JULY 2016)
R3 RESPONSE

ABOUT R3

R3 is the trade body for the UK insolvency profession. From senior partners at global accountancy and legal firms to practitioners who run their own small and micro-businesses, our members have extensive experience of helping businesses and individuals in financial distress. Contact details:
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EXECUTIVE SUMMARY

- The UK’s insolvency regime is one of the best in the world according to the World Bank. It is ranked 13th in terms of overall insolvency performance, but better than other major economies when judged on key outcomes such as speed, cost and returns to creditors.

- R3 welcomes the government’s focus on restructuring and business rescue. This mirrors the focus of many of the UK’s insolvency practitioners. The UK has a well-established restructuring and turnaround culture: over the last six years there has been a dramatic fall in the number of formal insolvencies1 and a shift to restructuring and business rescue2.

- It is suggested that the proposed tools would improve the UK’s World Bank ranking, and R3 therefore understands the political motivation to introduce the measures as outlined in the consultation. After careful reflection and much discussion within R3 and with other stakeholders, R3 does not believe all the tools proposed in the consultation would lead to a significant positive improvement to the UK’s business rescue landscape, regardless of their impact on the UK’s World Bank ranking. However, there are merits in many aspects of the proposals and these ideas should be developed further. R3 looks forward to supporting the Insolvency Service as it does this.

- R3 encourages the government to focus on improving the current business rescue tools, such as Company Voluntary Arrangements (CVAs). R3 members strongly believe that government departments (such as HMRC) engaging more with business rescue within the existing insolvency framework and efforts by the government to encourage struggling companies (particularly SMEs or micro-businesses) to seek early advice would have more of an impact on business rescue than the changes proposed in this consultation.

- Rather than introducing new tools, combining improvements to the existing regime with efforts by government departments and agencies to support business rescue is likely to facilitate not just improvements to the UK business rescue regime but stability too; an important factor given the economic and political uncertainty following the outcome of the EU referendum.

- However, if the proposals are implemented as drafted, R3 would urge the government to introduce a number of safeguards (with input from the insolvency profession and other stakeholders) to ensure there is a balance between the rights of creditors and debtors. R3 is also very concerned that, without the introduction of additional safeguards, there would be potential

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1 Corporate insolvencies in England & Wales peaked in 2009 at 24,011 and have since fallen to 14,647 (2015)
2 In 2013-2014 the insolvency profession rescued 41% of insolvent businesses and saved 230,000 jobs.
for abuse. R3 fears SMEs and unsophisticated business owners would be the victims of this potential abuse.

- **R3 is disappointed with the short six week timeframe given for this consultation. The proposals outlined would involve significant changes to the UK’s insolvency regime and six weeks is not enough time for the insolvency profession, creditor community or financial institutions to thoroughly review such far reaching proposals or make detailed recommendations. R3 was also disappointed to see that the Impact Assessment’s calculations were based on out-of-date statistics and some of the assumptions made (such as the reasons for CVA failure) are not based on the best available evidence.**

**Key points on the four proposals**

- **Moratorium:** R3 supports the government’s plans for a moratorium but has considerable concerns about its proposed three-month length and its supervision. R3 believes that a moratorium should only be introduced on the basis that:
  
  o It is 21 days in length (extendable to 42);
  o It is supervised by an insolvency practitioner;
  o The responsibilities on the supervisor are not too onerous or vague (as is the case with the existing moratorium in CVAs) to make it workable.

- **Extending ‘essential suppliers’:** We understand that the proposal would have a restricted application to businesses which have supplier agreements for a 12 month period. The consultation document does not make this distinction but it is extremely important. Having discussed the consultation document proposal further, in particular at an Insolvency Service workshop held on 20 June 2016, R3 has considerable concerns over how the government’s proposals could be applied in practice without adversely affecting the suppliers nominated. We believe that there are relatively few situations where the government’s proposal could assist business rescue. R3 believes that the extension of essential suppliers beyond utility companies and IT suppliers would also require new legislation.

- **Restructuring tool:** R3 believes that the tool may be a useful addition to the UK insolvency framework but that, as drafted, there is significant potential for abuse, particularly when small companies are involved. Proper safeguards will ensure that the tool is used for legitimate purposes but may limit its use to a very small number of complex restructurings per year: in the short time available for R3 to consult with the profession and others, opinion has been divided on the likely demand for the tool. To prevent abuse, R3 recommends that the tool should only be introduced with the introduction of a specialist insolvency court or that the tool should not be available to the SME market.

- **Options for rescue finance:** R3 does not believe legislation is needed to encourage more rescue finance lending: secured creditors already make funding available for viable businesses, relying on their existing security, and administrators already have the ability to borrow on a ‘super priority’ basis. Any changes made to the ‘order of priority’ will also have an impact on the UK’s lending environment. There are many alternative lending sources in the UK market such as peer-to-peer lending and private equity. The comments from many of those R3 has consulted, including the financial institutions, are that there is no shortage of rescue funding for viable businesses in distress.

*R3’s recommendations for business rescue*
• **Reform of CVAs:** R3 believes that the Impact Assessment which accompanies the consultation is flawed in its assessment of the reasons why CVAs fail. R3 believes that the most common reasons why CVAs fail is not because there is a problem with secured creditors but because the management is overly-optimistic in its financial assessment of the company, or the environment in which the company operates changes during the CVA. The proposal for the flexible restructuring tool is, in part, made in response to CVAs failing. A better response might be to consider whether a reform of CVAs might assist. R3 would be very happy to work with the government to consider reforms.

• **Government departments (such as HMRC) should engage more on business rescue.** 65% of respondents to an R3 members’ survey\(^3\) identified this issue as the top proposal which would have the most significant, positive impact on business rescue in the UK. In a members’ survey focused on insolvency practitioner’s work with HMRC in February 2016\(^4\), 49% of respondents stated that HMRC is not helpful when it comes to business rescue; only 10% think it is helpful. In addition, 54% of respondents said that HMRC makes it harder to rescue businesses than to wind them up. Anecdotal evidence from R3’s members support these survey findings, with comments that HMRC often does not agree to informal agreements or CVAs despite the fact that they are the best ‘deal on the table’. Creditor support is very important when businesses face challenges in a CVA and HMRC could play a leading role in this regard.

• **Efforts by the government to encourage struggling companies to seek earlier advice.** 65%\(^5\) of respondents to the June 2016 R3 members’ survey stated that this would have the most significant, positive impact on business rescue. By comparison, the government’s proposals attracted lower rates of support: 28% supported the moratorium proposals, 15% the ‘essential supply’ proposals, 13% the restructuring tool, and 10% the new rescue finance proposals.

**Macro issues to consider**

R3 has identified a number of macro issues in the consultation which the government should take into account when considering whether to take forward any of its proposals:

• **Loss of creditor rights:**
  
  o While the proposals impose restrictions on secured and unsecured creditor rights in an effort to encourage business rescue, they do not include sufficient safeguards to offset the loss of these rights. Improved safeguards in the moratorium, for example, would include R3’s proposals for a shorter moratorium period and the presence of a licensed insolvency practitioner with a specific role to oversee the moratorium. The loss of creditor rights is at odds with recent government attempts to improve creditor engagement in the insolvency regime and confidence in the regime could be undermined as a result.

• **Increased pressure on the courts:**

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\(^3\) 319 R3 members responded to an online survey on the consultation in June 2016. Respondents were asked to identify the top three proposals which would have the most significant, positive impact on business rescue in the UK.

\(^4\) 347 R3 members responded to the online survey on HMRC in February 2016.

\(^5\) 64.6% of respondents compared to the 65% who supported more engagement from government during business rescues.
• All four proposals are likely to lead to significant amounts of extra work for the UK court system and appear to move our restructuring and insolvency framework towards a court-based system as seen in other jurisdictions, such as the US. The UK insolvency regime has traditionally relied on out-of-court decision-making, which speeds up the insolvency process and reduces costs. The courts may not be ready to take on an expanded role in insolvency, particularly with recent funding cuts. Many of the proposals made by the government would require the creation of a specialised insolvency court.

• Reliance on the World Bank indicators and the US ‘Chapter 11’ system:

  o A key driver for the proposals is the UK government’s ambition to be 5th in the World Bank’s ‘Doing Business’ rankings. The UK ranks 13th in the World Bank insolvency rankings overall but performs better than other major economies when judged only on key outcomes such as speed, cost and returns to creditors. The World Bank’s insolvency ranking criteria are based on the US ‘Chapter 11’ system – a court-based system which operates in a very different economy and legal system than the UK’s, with a specialist and active ‘bankruptcy court’. It should also be noted that the American Bankruptcy Institute’s 2014 review of Chapter 11 highlighted several weaknesses, including its lack of suitability for smaller firms. Despite the acclaimed quality of the judiciary in the Chancery Division and County Courts, the current UK court system does not provide for the courts actively supervising insolvency cases: courts rely on regulated insolvency practitioners to do this instead. There are also budgetary pressures on the judiciary, which is looking to reduce its workload, not increase it. R3 would encourage the government not to make changes unless they are suitable for our economy and legal system, irrespective of how they may improve a statistical ranking.

• ‘One size fits all’ approach:

  o The government has said its proposals will benefit both large firms and SMEs. R3 believes, however, that, for many of the proposed changes, a ‘one size fits all’ strategy will not work. The restructuring tool in particular only has a realistic prospect of helping large, complex businesses given the cost and financing implications. The areas addressed by the other proposals are not considered to be significant problems faced in large restructuring situations. The moratorium and essential suppliers proposals could benefit medium and smaller businesses but only with carefully considered safeguards backed up with penalties for abuse. The rescue funding proposals could expose SMEs to abuse by unregulated advisers.
THE INTRODUCTION OF A MORATORIUM

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

1. R3 agrees with the proposal to introduce a standalone preliminary moratorium for companies and believes it could become a very useful business rescue tool. Respondents to R3’s survey estimate that an average 22% of businesses they worked with in the past year could have used the moratorium (approx. 2,000 businesses).

2. R3 has already called for a moratorium to be introduced (a ‘business rescue moratorium’) in order to give businesses time to negotiate or implement a rescue, recovery, or restructuring without the uncertainty of possible adverse creditor action. The moratorium will also allow struggling companies to be much more transparent with their creditors than is possible at the moment. This could lead to more comprehensive, and sustainable, rescue plans or restructurings than are currently feasible. Importantly, the fact that company directors remain in control of the company during the proposed moratorium may encourage directors to take earlier action when financial problems arise.

3. By preventing individual creditors from taking (legitimate) self-interested action, it will become easier to generate higher returns to all creditors by increasing the chances of company rescue. However, while a moratorium should give a company a reasonable chance of recovery that it would not otherwise have had, it must not worsen the creditors’ position and therefore must strike a careful balance. This makes the aspects of the moratorium that protect creditor rights, such as the length of the moratorium or the role of the supervisor, particularly important.

4. While R3 supports the principle of a moratorium there are concerns around the government’s moratorium proposal, including: the length of the moratorium, the lack of detail regarding the purpose of the supervisory role, and the pressure the proposal may put on the UK court system. As drafted, the moratorium proposal would not achieve the correct balance between creditors and the company using the moratorium and could undermine trust and transparency in the UK’s insolvency regime. At worst, parts of the proposal could turn the moratorium into a ‘rogues’ charter’, particularly as far as small companies are concerned. Further, as drafted, the moratorium will introduce aspects of overseas insolvency regimes to the UK, without acknowledging the UK system’s unique ‘out-of-court’ nature. These concerns, and R3’s alternative proposals, are outlined in more detail below.

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?

5. R3 agrees that a court filing represents the most efficient way of starting the moratorium. While the court system is already stretched in terms of resources, a filing (rather than an application) should only have a small impact on the court. R3 agrees that creditors should be provided with a window to challenge the moratorium in court, although there are practical difficulties in allowing such challenges to take place (see below).

6. R3 believes that the need for creditors to seek to dissolve the moratorium would be minimised if a licensed insolvency practitioner was to supervise the moratorium because the practitioner would fully appreciate the need to balance the interests of the creditors within the moratorium. The practitioner could be expected to bring the moratorium to an end if it is clear that creditors’
interests are not being protected. At present, the proposal simply envisages that the supervisor will make the creditors and court aware if the qualifying conditions are no longer met.

7. The speed at which a hearing could take place where a creditor seeks to dissolve the moratorium would be extremely important because the uncertainty which such an action would create would be damaging to the business and it would be important for any perceived prejudice to be addressed at a very early stage.

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

8. R3 agrees that eligibility tests and qualifying criteria are needed for the moratorium to ensure the rights of creditors are balanced against those of the company in the moratorium.

9. However, the proposed controls are too ambiguous to properly protect creditors from abuse of the moratorium. As drafted, directors of the company filing for moratorium protection would be the initial arbiters of whether their company qualifies or not. This invites litigation and added pressure on an already stretched court system. R3 believes that the proposed supervisor of the moratorium should be involved in the initial application, having reviewed the eligibility and qualifying criteria and being satisfied that the company involved meets these criteria. The proposed supervisor should also consent to act as supervisor.

10. The primary eligibility test that “the company must demonstrate that it is already or imminently will be in financial difficulty, or is insolvent”. The definition of ‘financial difficulty’ is open to interpretation and a more prescriptive list of criteria would be useful to avoid the cost and distraction of the eligibility of a moratorium being challenged in court.

11. R3 agrees that the company must be able to show it will have sufficient funds to carry on its business during the moratorium, although, again, more prescriptive criteria would be useful. This could include a requirement to provide cash flow forecasts for the moratorium period. Although it can be difficult for companies to predict how the announcement of a moratorium will impact on its working capital, this requirement is essential.

12. In the current moratorium within the Insolvency Act, the proposed supervisor is required to provide their opinion on the availability of working capital – in practice, the degree of risk that this requirement exposes the proposed supervisor to is seen as the primary reason why the current moratorium legislation has not been used more widely for small companies. However, it may be feasible for the directors of the company to provide such an opinion provided that the matters they are required to consider before providing such an opinion are clearly stated.

13. R3 recommends that directors be required to make a statutory declaration that their company meets the eligibility tests and qualifying criteria to enter the moratorium as a deterrent to misuse.

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**Existing or previous insolvency procedures**

14. R3 disagrees with the proposal in paragraph 7.20 of the consultation document that companies subject to a winding-up petition should not be able to enter a moratorium. A very common situation which triggers a company to have to seek protection is receipt of a winding up petition from one creditor while other creditors have been content to work with the business and give it breathing space to effect a rescue.
15. Preventing companies subject to a winding-up petition from using the moratorium could see a rise in petitions from creditors hoping to prevent a moratorium from being initiated. This could put struggling companies under pressure at an even earlier point.

16. Moreover, the proposal would allow an individual creditor to ‘trump’ the creditor body as a whole, whose interests might be best served by the company entering a moratorium.

17. Companies with a winding-up petition against them should be allowed to enter a moratorium (providing they have met the entry criteria) but should be required to give three working days’ notice to the petitioner.

18. Companies that have issued a Notice of Intention to Appoint an Administrator in the previous 10 business days however should be barred from entering a moratorium. This would prevent companies from artificially extending a moratorium length.

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?

19. R3 agrees with many of the proposed rights and responsibilities for creditors and directors, although the listed rights and responsibilities alone are not the only factors that contribute to finding a balance between safeguarding creditors and increasing the chances of business rescue. Factors such as the length of the moratorium and the identity and role of the supervisor are also key for achieving the balance between safeguarding creditors and boosting business rescue.

Role of the courts

20. Creditors should be given the opportunity to challenge the moratorium in court once it has begun, but consideration needs to be given to the most effective way to do this.

21. There are practical concerns: the likelihood of creditors being able to get a court hearing within the 28 day time period is low, and creditors, particularly smaller businesses, will be concerned at the cost of submitting an application. It appears the onus will be on creditors to challenge the moratorium filing, which could lead to several different creditors launching their own applications to challenge, creating multiple sets of application costs. Without action to improve the court’s ability to process such cases quickly, the right to challenge may be perceived by those wishing to abuse the system as just a notional right rather than a practical right. There is little evidence in the Impact Assessment that the impact of these proposals on the court system has been fully considered.

22. From the moratorium company’s perspective, there is a danger that court applications from different creditor groups would distract it (in terms of attention and funding) from progressing a rescue plan. A more prescriptive set of eligibility criteria (as opposed to the subjective opinion of a company that it was in financial distress) and a clearly defined role for a licensed insolvency practitioner as supervisor could reduce the number of cases where a challenge might be necessary.

23. Court challenges to the moratorium should be a last resort. The UK’s insolvency regime has developed to operate outside the court system as much as possible and a number of recent
reforms such as the Red Tape Challenge have been designed to move insolvency work out of the courts; as such, the government should avoid creating a burdensome role for the courts in the functioning of the moratorium. Moreover, given funding cuts, the court system may not have the capacity to deal with a significant amount of extra insolvency-related work.

24. The length of the moratorium provides a key safeguard for creditors and a short moratorium could reduce the need for court challenges. The moratorium should be much shorter than proposed to reduce the risk to creditors and any extension of the moratorium should be clearly justified and the reasons for doing so communicated clearly to creditors.

**Essential supply**

25. R3 has campaigned for improved protections for the terms of supply between an insolvent company and its essential suppliers since at least 2011. As such, R3 welcomes the government’s focus on exploring further ways that essential supplies can be protected.

26. However, R3 is concerned about how the proposals for essential supplies have been drafted. A significant extension of the essential supplier category could do more harm than good to the UK’s insolvency regime and creditor community.

27. Our detailed concerns and recommendations are outlined in questions 9 and 10 on pg. 14-17.

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

28. R3 disagrees with the proposed length of the moratorium: three months without creditor approval followed by an open-ended extension is far too long and outweighs any creditor protections included in the proposal. R3 proposes a 21 day moratorium extendable to 42 days.

29. Additionally, there are a number of practical concerns that come with a minimum three month moratorium.

**Protection for creditors**

30. The longer the moratorium continues, the more likely creditors’ interests could be damaged either by directors’ actions or external influences.

31. By comparison, a shorter moratorium is much more predictable in terms of planning cash requirements, and there are far fewer things that could go wrong in a shorter space of time. The effect of an early, unplanned end to an unsuccessful moratorium would be relatively smaller, too: fewer moratorium debts will have been able to build up.

32. Although R3 is hopeful that companies would use the moratorium period to engage in an open dialogue with their creditors, the consultation proposal may mean that creditors must wait potentially for an entire financial quarter before decisions are made about what will happen to the debtor company. Again, a much shorter moratorium period would be more palatable to the creditor community.

33. It should also be noted that smaller companies and sole-traders, who are creditors, are likely to be disproportionately affected by a debtor company entering a moratorium. Smaller creditors
would also be less capable of dealing with three months of uncertainty or restrictions on their ability to pursue debts and its effects on their own business.

34. According to R3’s survey, 64% of respondents believe that the proposed moratorium is ‘too long’ (including 22% who said it is ‘far too long’); only 31% felt it is the right length; just 6% want a longer moratorium. 59% believe that the length of the moratorium is ‘unfair’ (45%) or ‘very unfair’ (14%) to creditors; just 14% thought it is ‘fair’ or ‘very fair’ (27% think it was neither fair nor unfair).

Building up a ‘war chest’

35. In order to be able to fund a three month moratorium, businesses could decide to stop paying their suppliers for some time ahead of the moratorium. This ‘war chest’ could then be used for the business during the moratorium period. Creditors could therefore suffer by not receiving payment in the months leading up to the moratorium and then endure a further period during the moratorium where they would not be paid for these arrears. A shorter moratorium would reduce the need for a ‘war chest’ and therefore acts as a protection for creditors.

Barrier to entry – how do you fund a three month moratorium?

36. R3 agrees with the proposal that companies must show they have enough liquidity available to continue to trade for the period of the moratorium. However, it is difficult for an insolvent or near-insolvent company to arrange funding for three weeks (R3’s originally proposed moratorium length), let alone three months or however long an extended moratorium may end up lasting.

37. Requiring companies to arrange three months of funding before entering the moratorium creates such a significant barrier to entry that only a handful of companies will be able to use the moratorium. The moratorium could have much wider, positive use if it was introduced with adequate safeguards, including a shorter, more appropriate time-frame.

What size of business will use the moratorium?

38. While a three-month moratorium could work for large companies who have complex affairs to resolve, designing the moratorium with large companies in mind means that in practice it will not be suitable for smaller companies. In order to make the moratorium work for smaller and medium-sized companies too, the initial moratorium should be much shorter than three months. Larger companies could always apply for an extension if one is needed.

39. According to R3’s survey, 40% of respondents believe that the proposed moratorium will only be used by businesses larger than a small business; 31% believe it will be used by all businesses; 9% believe it will be used by no businesses.

Purpose of the moratorium and the danger of ‘drift’

40. The consultation paper makes reference to the purpose of the moratorium as being to allow companies to ‘explore options’ or to ‘develop’ a plan rather than to actually implement a restructuring or rescue.

41. While there is no need for the moratorium legislation to prescribe the exits from the moratorium, R3 believes the moratorium will be most successful when it is being used with a
particular outcome in mind. As such, it should not be designed to be used as a means of allowing a company simply to take shelter from creditor action while it works out what to do, with no guarantee of any actual remedial action. The focus should instead be on using the moratorium to present plans to creditors or to implement sensitive aspects of a restructuring or rescue while protecting the company from individual, opportunist creditor action.

42. The moratorium may prove particularly useful for those companies considering a CVA: it will provide a breathing space in which CVA proposals can be put forward and discussed openly.

43. A three month moratorium period would in all but the most complex cases be far longer than would be required by a company with a plan ready to implement. Indeed, a long moratorium may encourage companies to apply for it without a clear idea of what they want to achieve by doing so: they may see the three months as ample time to work out what to do. The risk, however, is that providing companies with an entire financial quarter free from creditor pressure could lead to ‘drift’ rather than action.

44. A short moratorium would require concentrated effort and a clear direction of travel. The moratorium period should be regarded as a company’s ‘last chance’ to avoid an insolvency procedure and must not be treated as a period of ‘business as usual’.

An open-ended extension?

45. The prospect of companies staying in the moratorium for months at a time, with no clear end in sight, would seriously harm confidence in the UK insolvency and restructuring regime.

46. While the proposed moratorium may only be extended by consent from all secured creditors and the majority of unsecured creditors, this could still leave large numbers of small business creditors frustrated at being left in limbo for an extended period of time. Alternatively, the lack of clarity over the moratorium’s termination date might prevent creditors from ever approving an extension. A moratorium with no clear end date would be completely unsatisfactory from a creditor’s perspective.

47. Even if the government opts for a longer moratorium period, it is crucial that the extension is only available for a finite period.

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

48. R3 supports the government’s proposals for a moratorium supervisor given the significant restrictions imposed upon creditor rights.

49. R3 does not support the role and qualification requirements of the supervisor as described in the consultation and believes that only licensed insolvency practitioners should be a supervisor.

The identity of the supervisor

50. Aside from the requirement to be a licensed insolvency practitioner, a lawyer, or an accountant, the only requirement for the moratorium supervisor is that they have ‘relevant expertise in restructuring’. It is not clear exactly what would qualify as relevant expertise or who would decide whether the supervisor possesses such expertise. While licensed insolvency practitioners
could be assumed to have such expertise, it is not clear how the expertise of others would be determined.

51. Indeed, R3’s conversations with other stakeholders have met with universal agreement that the moratorium supervisor should be specifically regulated and a clear preference for licensed insolvency practitioners to undertake this work has been apparent.

52. Legal and accountancy regulatory structures may not be ready for the extra work required by a loose drafting of the supervisor requirements. The Solicitors Regulatory Authority and the Law Society of Scotland have recently ceased regulating insolvency licences; allowing solicitors to become moratorium supervisors would force legal regulators to cover a specialism that they no longer regulate. And while the chartered accountancy bodies do have experience of regulating insolvency practitioners effectively, ‘accountant’ is not a protected term in the UK. Anybody could claim to be an ‘accountant’ and offer their services as a moratorium supervisor.

53. It is also very important that the moratorium supervisor is committed to protecting creditors’ interests, rather than those of the company in the moratorium. As drafted, however, the proposal would not prevent a struggling company’s own in-house lawyer or accountant from fulfilling the role of moratorium supervisor. Their commitment to protecting creditors’ positions would be compromised in this situation. Licensed insolvency practitioners, on the other hand, are used to operating with an obligation to work on behalf of the creditor body as a whole.

54. These proposals are particularly disappointing in light of the work R3, the Insolvency Service and other regulatory bodies have carried out together to tackle the problem of so-called ‘ambulance chasers’ or unregulated ‘insolvency advisers’ who do not work in the interest of the distressed business or its creditors but only for their own gain.

55. Small companies would be most vulnerable to unscrupulous advisors. R3 is concerned that by taking financial or debt advice from an unregulated adviser (often for a fee), a director may receive misleading or incorrect advice about how to resolve their financial problems and the duties or responsibilities that they owe to their creditors or their company. This could potentially make their financial situation far worse and could even result in company directors not fulfilling their legal obligations and duties.

56. Given the risks posed to creditors and suppliers during the moratorium, their interests must be represented by an individual who can be held accountable should things go wrong. The UK already has a system in place for regulating and assessing individuals’ restructuring and insolvency expertise: the insolvency licence. Restricting the moratorium supervisor role to an insolvency licence holder would be a way of guaranteeing that the moratorium supervisor has not just relevant restructuring expertise, but a commitment to protecting creditors’ interests, too. This approach would not add additional costs to the moratorium process in terms of additional regulatory structures.

57. An alternative would be to consider introducing a new licence for moratorium supervisors to ensure those taking on the role are effectively regulated, but this would entail additional compliance and regulatory costs, largely duplicating a regime that already exists and works.

The role of the supervisor

58. The role of the supervisor must strike a balance between having enough power to properly protect creditors and not being over-burdensome on the person in the role. One of the main
reasons why the existing Schedule A1 moratorium is not often used is because the requirements of the supervisory role are too burdensome and the government should avoid repeating this problem with this new version of the moratorium.

59. It is also important that any supervisory role is well-defined so that it is clear what rights and responsibilities the supervisor has.

60. While R3 understands the reasoning behind preventing a supervisor from becoming the office holder of the same company at a later date, we would strongly caution against a blanket ban on this. Insolvency practitioners should be able to act as supervisor and then office holder of the same company provided there is majority creditor support for them doing so. The supervisor’s work with a company during a moratorium will give them a good understanding of the company, its market, and its creditors, leaving the supervisor well-placed to act as the office holder in a subsequent insolvency. This would also keep the costs of a subsequent insolvency down.

61. Moreover, insolvency practitioners are subject to strict codes of ethics which already deter or sanction unethical behaviour with regards to conflicts of interest. The codes of ethics for other professionals obviously do not address the issue of sequential appointments in such distress situations as they are not required to do so.

62. The supervisor’s role is also not a decision-making role: they would only have as much influence over the decision or need to enter an insolvency procedure after the moratorium as any other advisor to the company.

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

63. Debts incurred during the moratorium should be given priority during the moratorium itself.

64. However, any unpaid debts from a failed moratorium should not be treated as a first charge in a subsequent insolvency. There is a risk of abuse under such a system: a company in a moratorium could run up debts with connected parties, to whom the company’s assets would then go in a follow-on insolvency procedure. Whereas the moratorium is supposed to protect the positions of a struggling company’s creditors, allowing moratorium debts to become a first charge would undermine creditors’ positions. Therefore, unpaid debts incurred in a failed moratorium should be treated the same as existing debts in a subsequent insolvency.

65. The ability of the moratorium supervisor to resign and bring an end to the moratorium should things go wrong should prevent unpaid moratorium debts from building up to a significant degree.

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

66. There is a benefit in providing information to creditors, although R3 believes it would be much better for the provision of information to be initiated by the company itself in conjunction with the supervisor. A regular update of the purpose of the moratorium and its progress, subject to sensitive commercial information, could be provided to creditors on a dedicated web page.

67. Companies should only be required to provide information which is related to, and necessary for creditors to consider, the rescue proposals. In addition, companies and office holders should
be allowed to withhold information in response to a request if the information is of a commercially sensitive nature (which could affect the rescue of the company or its business) or if the directors of the moratorium company already intend to provide creditors with the information requested at a later date.

68. There is also no reason why, in a moratorium, it should be the supervisor that is expected to provide information: creditors should be able to request the information directly from the company directors themselves. This would save time and cost (information would not have to be provided twice, once from the company and then once from the supervisor) and would reduce the regulatory burden that comes with the supervisor role.

69. It is important that the company be given a reasonable length of time to respond to requests for information. One of the reasons for the moratorium is to give companies time to put together a rescue plan; having to make responding to creditor requests for information a priority could distract from progressing a rescue plan. Thought needs to be given to how vexatious requests for information should be treated.

70. While the above stands for the proposed moratorium, R3 does not believe the proposal should be extended to other insolvency processes without further consultation.
HELPING BUSINESSES KEEP TRADING THROUGH THE RESTRUCTURING PERIOD

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?

71. R3 has long called for the reform of the rules on the continuation of essential supplies to ensure the success of business rescues.

72. R3 was therefore very pleased to see the government respond to R3’s campaign on the issue and extend the types of supply deemed essential in October 2015. According to R3’s June survey, an average of approximately 15% of businesses with whom respondents worked in the last year could not be rescued because they could no longer access an essential supply or service (approx. 1,400 businesses). 53% of survey respondents agree (or strongly agree) that an extension to the types of supplier deemed ‘essential’ could improve the chances of business rescue (31% disagree or strongly disagree).

73. The government’s focus on exploring further ways that supplies can be protected is therefore welcome and R3 looks forward to working with the government to develop some of the ideas from its consultation further.

74. R3 does have some concerns about the specific proposal outlined in the consultation document. As drafted, the government’s proposals may not increase business rescue but could increase the cost and litigation involved in insolvency processes instead (see Question 10). R3 also has practical concerns with the proposal and with the amount of risk to which it would expose suppliers. There are also important questions over the scope of what may constitute ‘essential supplies’.

Treating suppliers fairly

75. The proposal is risky for suppliers, especially smaller suppliers or those for whom the provision of goods and services comes with high unit costs. An internet, telecoms or energy provider would incur relatively low marginal costs were it to continue to supply a company during a moratorium, and would not be left significantly out of pocket if the company was unable to meet its moratorium debts; on the other hand, a manufacturer supplying a moratorium company with essential parts could potentially be exposed to a significant loss. For example, suppliers of more complex products or services may have to buy in raw materials or employ labour sufficient for a period of supply beyond the capability of the company in distress to maintain the moratorium. The residual raw materials or termination costs for the employees may be a consequential loss which is not recognised or paid for in the moratorium or a subsequent insolvency if the company is unable to be rescued.

76. Requiring a supplier to continue supply on its usual credit terms may create hardship for the supplier itself, particularly where it has utilised trade credit insurance or debt factoring/discounting. In each case the insurer or finance provider may modify or terminate those arrangements creating liquidity issues for that supplier.

77. Importantly, the extent to which it is intended that this proposal is applied is not clear from the consultation document. At one of the workshops hosted by the Insolvency Service on the consultation in June 2016, the point was raised that the provisions could only apply in a situation where a company has a supply agreement with the supplier over a period, rather than
what is probably a more normal trading relationship of ad hoc purchases. This distinction makes
sense and is very important.

78. The question of whether the arrears owed to a nominated supplier would be discharged or
suspended is also a key question. R3 understands that in other jurisdictions, the arrears to the
supplier would be discharged but that the proposal by the government is that the arrears
should be suspended. Commercially, it seems appropriate that an essential supplier would,
where it is envisaged that the business would continue to operate, have an opportunity to
recover arrears if it is to be expected to supply through a moratorium period but the payment of
arrears raises the spectre of preference payments and potential manipulation of the
essential supplier regime. Requiring suppliers to continue to supply without discharging the
arrears may be seen as unfair and could damage confidence in the insolvency regime.

Practical concerns with continuation of supply

79. In most cases, there is little a company in a moratorium could do to force an ‘essential supplier’
to continue to supply if it chose not to. A company facing significant up-front costs associated
with continuing to supply may decide there is a greater chance of the company being unable to
pay its moratorium debts than the moratorium company taking court action to force the
supplier to continue to supply (especially since the moratorium company may become insolvent
and unable to afford legal action if a supply is withheld).

80. Allowing a company to identify essential suppliers and then allowing those identified to
challenge this designation in court will repeat some of the difficulties outlined in earlier sections
of this consultation response: further litigation and extra costs.

81. It is also important to remember that essential supplies extend beyond goods or services. It can
be the case that businesses may have licences or trade body memberships suspended once
they enter an insolvency procedure; this can be just as problematic for a business rescue
attempt as the loss of IT supplies or materials. As such, the definition of supplies needs to take
into account such licences or trade memberships.

82. It is difficult to see how the proposals would apply and be enforceable in relation to an
international supplier. This would result in an uneven playing field between the UK and non-UK
suppliers.

Possible solutions

83. The proposal could be simplified to prevent the variation of the terms of a fixed-term contract
or its cancellation by the supplier purely on the grounds of the customer’s insolvency or the fact
that the customer has entered a moratorium.

84. In the moratorium, the requirement for the insolvent or near-insolvent company to show it is
able of trading through the moratorium may encourage suppliers to continue trading.

85. Payment for goods and services (whether contracted or ad hoc supplies) by a company in a
moratorium or one of the insolvency procedures listed in the consultation should be made on a
pro forma basis.
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?

86. R3 agrees that those who continue to trade with a business during a rescue procedure require protection to ensure their position is not worsened by continuing to trade and that the insolvency regime remains fair.

87. However, R3 disagrees that the proposed role for the court would be the best way to offer such protections and outlines a number of alternative safeguards below. 49% of respondents to R3’s June survey disagree or strongly disagree that allowing suppliers to challenge their designation as ‘essential supplier’ in court is the best way to protect their interest (32% agree) while 49% disagree or strongly disagree that court challenges are an acceptable ‘price to pay’ for a company’s right to designate its own essential supplies; 33% agree or strongly agree.

88. Under the government’s proposals, suppliers will face increased costs using the courts as they launch court applications to challenge their designation as an essential supplier; insolvent companies will see added costs as they defend the position. The added costs and the increased time demands involved in dealing with litigation for insolvent companies will significantly reduce the chances of its business being rescued (in a moratorium, CVA, or administration) and will significantly reduce the amount of money available to be repaid to creditors.

89. The extra costs created by court applications will be proportionately more significant for smaller businesses which may not have the capability or experience of using the courts to defend their interests. Some small businesses, particularly the very smallest, may not be able to afford to challenge an ‘essential supply’ designation in court, or know how to make such a challenge.

90. The UK’s insolvency regime operates on an out-of-court basis. The UK court system, already subject to budget constraints, would not be ready to deal with an increase in insolvency litigation. Insolvency practitioners are already very concerned about delays in court cases being heard: these proposals would inevitably add more cases which will likely mean more delays and more uncertainty in insolvency procedures; 92% of respondents to R3’s June survey believe court challenges will add time and cost to insolvency procedures and 82% believe that allowing court challenges by essential suppliers could lead to less money being made available to creditors.

91. 65% of respondents to the June survey agree that suppliers’ interests could be protected in other ways, rather than allowing court challenges. R3’s recommendations for supplier protection are outlined above in paragraphs 83 - 85.

92. In a moratorium, there should be further protections for suppliers and creditors. There must be objective criteria for companies to meet to show they can trade for the duration of the moratorium. The ability of the moratorium supervisor to bring the moratorium to a close if creditors’ positions are threatened is also important. Above all, the moratorium must be for a short period, to minimise suppliers’ exposure, while the moratorium must be overseen by a properly regulated, independent supervisor who has a primary commitment to creditors and suppliers whilst assisting the company during the moratorium.

93. R3 also notes that the October 2015 changes to essential supplies required a personal guarantee by the office holder in return for the continuation of supply on the same terms. It is not clear from the consultation proposals whether such a guarantee would still be required in
future, nor, in the case of the moratorium, who would be giving this guarantee. During the moratorium, R3 suggests that suppliers could ask directors for a personal guarantee that supplies will be paid for, provided the length of the moratorium is short. As R3 has argued before, the requirement for insolvency practitioners to offer a personal guarantee in exchange for the continuation of supply when they are an office holder makes business rescue more difficult to achieve.
DEVELOPING A FLEXIBLE RESTRUCTURING PLAN

General comments

94. R3 understands the political motivation to introduce the ability to ‘cram down’ creditors in a restructuring deal. Adding an extra feature to the UK’s insolvency regime in terms of ‘cram down’ may see the UK rise in the World Bank rankings. R3 members believe that there may be a benefit of this feature in the UK insolvency toolkit and this extra tool might encourage restructuring. However, opinion on demand for the tool is split. Some insolvency practitioners believe that this restructuring tool would only be used in a very limited number of cases per year given that there will be a relatively small number of businesses which have such complex finance structures that the expense of going to court twice is warranted, whereas others believe that it may be used more widely. Importantly, this tool has the ability to be abused, particularly at an SME level. Therefore, R3 believes that this tool should only be introduced with a number of additional safeguards: either the establishment of a specialist insolvency court (as in the US) or that this tool should not be available to SMEs.

95. The consultation document and associated Impact Assessment points to CVAs as a restructuring tool but highlights the lack of successful CVAs. R3 believes that CVAs are a worthwhile tool and with some further development, could be more widely and successfully utilised. R3 encourages a review of the existing insolvency tools – specifically CVAs – to ensure that there is the ability to successfully restructure all businesses. CVAs are useful in terms of financial and operational restructurings (‘cram down’ in most instances just addresses financial-type restructurings where there are multiple classes of creditor) and their use should be developed further. At a time of huge economic and political uncertainty in light of the EU referendum, a review of the existing tools rather than introducing new ones may also be more appropriate for the UK’s insolvency regime.

96. The proposed restructuring tool makes reference to using a ‘liquidation basis’ when establishing where the value ‘breaks’. The realistic alternative to the restructuring tool is an administration rather than liquidation and the valuation should be based on this assumption instead.

How many businesses could use this tool per year?

97. In the short time available for R3 to discuss the proposals with its members and other stakeholders, including creditor groups and financial institutions, opinion on the likely uptake of the tool has been mixed. Some believe it may only be used in a handful of cases per year (especially if anti-abuse safeguards are introduced) and others believe there may be more demand, or that, even if little-used, the option of the restructuring tool may incentivise creditors to accept a consensual restructuring instead. R3 believes that this tool would only be used by large businesses with a degree of sophistication in the company’s finances, for example those with multiple secured lenders, leasing and ABL agreements. There also may be a limited number of businesses per year who have a significant number of ‘over-rented’ properties where this tool could be useful. The costs and complications involved in the two-stage court process are significant and appear to be neither appropriate nor accessible (in terms of cost) for SMEs.

98. It should be noted that despite the fact that ‘cram down’ exists in the US, it is not often used as the process is very litigious. R3 accepts that simply having the option to use the tool may be a factor in achieving an entirely consensual restructuring.
What might be the impact on business rescue and the courts?

99. According to the findings of R3’s June 2016 members’ survey, the plurality of members (45%) believe that the new tool would neither hurt nor boost business rescue, with 29% of members stating that it would hurt business rescue in the UK but an almost equal proportion of members (26%) believe that it would boost business rescue in the UK. The possible introduction of this tool into the UK insolvency toolbox is clearly not met with universal enthusiasm from the insolvency profession in terms of the difference it could make to business rescue.

100. R3 believes that the proposed two-stage court hearings is appropriate for those large businesses which are seeking to restructure given the impact on creditors whose rights are being compromised, although this will be an added burden on an already over-burdened court system in the UK.

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?

101. R3 believes that the proposed restructuring plan should be introduced as a standalone procedure.

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

102. R3 appreciates the desire to introduce this type of restructuring plan in the UK and agrees that in a limited number of cases, the ability to make the plan universally binding in the face of dissenion from creditors may be useful.

103. However, the introduction of a restructuring plan as proposed in the consultation document has consequences on creditor rights and returns to creditors.

104. In many respects, the proposal for a flexible restructuring tool is similar to a Scheme of Arrangement in terms of the identification of the classes of creditors and voting thresholds. However, a Scheme of Arrangement falls outside of the insolvency process whereas the proposed restructuring tool would become part of the insolvency tool-kit.

105. R3 asked members to comment on what impact the new tool could have on creditor rights. R3 members are clear that the proposed restructuring tool would be a very unreasonable or unreasonable interference with creditor rights, with 49% of members stating this view – as compared with 23% who believe that it is neither reasonable nor unreasonable and 28% who state that it is a very reasonable or reasonable interference with creditor rights.

106. We also asked R3 members to share their views on the potential impact on returns to creditors as a result of the introduction of the new restructuring tool. R3 members state that this tool would deliver worse or much worse returns to creditors (44% of members) as compared to 23% of members who believe that it would deliver better or much better returns. 33% felt that there would be no change.

107. The ability to ‘cram down’ has the most significant impact on secured lenders. This could have a potentially negative impact on the general business lending environment. Again, the potential drawbacks of introducing this tool should be carefully considered in the context of the potential benefits for a small number of businesses per year.
13. Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

108. R3 believes that the safeguards as proposed in the consultation are not sufficient protection for creditors.

109. R3 has worked with the Insolvency Service over a number of years to highlight the problem of ‘ambulance chasing’ firms who promise that they will act in the interests of the directors, rather than the creditors (and unlike qualified and regulated insolvency practitioners who are obliged to act in the interest of creditors). Such firms typically leave the creditors in a worse position, with the advisers themselves paid a hefty fee by the business. With the introduction of this new tool (with the safeguards as currently proposed), R3 can see the potential for a significant number of small and medium-sized businesses targeted by those firms, with the potential for increased business failure and creditors losing out.

110. The proposal as currently outlined would see the courts sanction the classes of creditors and the courts also taking a role to ensure that cram-down only takes place when ‘it is fair and equitable and leaves impaired creditors no worse off than they would be in the case in liquidation’. R3 can anticipate a number of scenarios where the courts, especially at county court level, grants approval because a case meets the ‘criteria’ as stated above, wholly unaware that the use of the restructuring tool is wildly inappropriate for the size of business. This is where the benefit of a specialist insolvency court as per in the US comes in: these courts have the knowledge and expertise to ensure that the abuse as outlined would not be sanctioned. The UK courts currently do not have the knowledge or expertise to ensure that this ‘rogues’ charter’ could not take place.

111. Therefore, R3 believes that either a specialist insolvency court should be introduced or this tool should not be available to small and medium-sized businesses.

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?

112. Establishing the ‘value’ of a business in order to restructure is necessary but plagued with problems. Looking to the US where this tool is already in existence, there is a huge amount of litigation regarding value and the fairness of choosing to use current value or future value as the appropriate benchmark. As above, an ‘administration’ value may be the most appropriate benchmark as it is the likely alternative to the restructuring tool, although the administration outcome may be economically similar to what may be achieved in a liquidation. However, R3 does warn that should a ‘minimum valuation’ basis be introduced, there will be a significant amount of litigation on both the fairness of this measure and also on the valuation itself.
RESCUE FINANCE

General comments

113. R3 does not believe reforms to rescue finance are needed, particularly at a time of huge economic and political uncertainty and turmoil in light of the EU referendum outcome.

114. The government rightly points out in its consultation that the issue of rescue finance is complicated and any reforms will have risks, advantages, and disadvantages. Reforms to financing will always have an impact on the lending environment and wider economy and so the views of the financial institutions on the proposals should be carefully considered by the government. The government should work closely with the financial institutions to understand in detail the potential impact of the proposed options, not only to understand the impact on business rescue but also the wider impact on ‘normal’ business lending.

115. Unlike the US, the UK has not developed a sophisticated specialist rescue finance sector, primarily because rescue finance has typically been provided by the large existing lenders or sponsors. R3 believes that there is no shortage of rescue funding (if a business is viable there will always be rescue finance available) and that the current consensual approach between the lender(s) and existing secured creditor and/or sponsor providing rescue finance to ensure ‘super-priority’ works well.

116. Administrators also have the ability to borrow on a ‘super-priority’ basis if they negotiate with current lenders/stakeholders. Negotiation in both these areas helps to ensure a rescue deal maintains momentum and can progress. Any proposal that alters the ability to negotiate could stall a rescue deal and lead to litigation.

117. The government should also carefully consider the impact of changing the ‘order of priority’ on existing creditors, whose rights may be diluted under these proposals. If the rescue proposal is unsuccessful and rescue finance has ‘super priority’, unsecured creditors in particular are likely to receive even less than they currently do and so therefore see their rights eroded. This must be an even higher risk in SME situations where the abilities of general managers to effect change is inevitably less than specialist financial experts employed in larger businesses. The cost of lending to SMEs in such circumstances could be even higher than normal.

118. At the smaller end of the market, new sources of finance such as crowd funding and private equity could also provide rescue funding.

119. Any new rescue finance proposals introduced must also include safeguards for existing creditors to prevent any potential abuse, for example, preventing the charging of high exit fees.

15. Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

120. Negative pledges are a key protection for lenders, and whilst trying to facilitate rescue finance it is important not to impair the availability of traditional finance.

16. How should charged property be valued to ensure protection for existing charge holders?
121. It is for professionally qualified and regulated valuers to comment on how this would be achieved.

122. An important point to note, however, is that unlike in the US, there is no court protection in the UK of valuations and so no safeguard for the lender.

123. The proposal could therefore lead to a significant amount of litigation which would in turn harm any prospect of business rescue.

124. R3 is also concerned that the proposals as currently drafted do not set out clearly the responsibilities of the insolvency practitioner who is expected to persuade the court that the requirements to obtain rescue finance through the above proposal have been met should it be challenged in court.

125. The insolvency practitioner is also expected to deal with any court applications in the event that disputes arise. R3 encourages the government to provide more detail on the role of the insolvency practitioner and to ensure that if they are given these new responsibilities that it comes with appropriate protections for the practitioner.

17. Which categories of payment should qualify for super-priority as ‘rescue finance’?

126. R3 does not believe the current system needs reform.
IMPACT ON SMEs

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

127. R3 does not believe the government’s proposals outlined in the consultation will significantly benefit SME recovery and as currently drafted actually have the potential to harm SMEs, both those in financial distress and their creditors.

128. As outlined throughout the consultation, R3 would like to see significantly more safeguards put in place around the proposals to prevent abuse of the proposals by unregulated advisers. The reliance on the court to protect creditors’ rights is also not practical for SMEs who will simply not have the time or the money to be able to go to court.

129. The most effective way to rescue a business is to encourage it to seek advice as soon as it runs into financial distress. R3’s January 2014 member survey found that 22% of R3 members who work on corporate insolvency say that it typically took businesses more than a year to contact them from the point at which they first showed signs of financial distress. The government should work with the insolvency profession, financial institutions and creditor community to seek ways to encourage directors to deal with financial issues at an early stage.

130. R3 would also encourage a review of the existing insolvency tools (specifically CVAs) rather than introduce new ones for SMEs, particularly at this time of huge economic certainty following the referendum. As a ‘debtor in possession’ tool that aims to rescue a business, a review of CVAs would sit within the government’s objectives for the corporate insolvency framework.

131. In its Impact Assessment, the government says that CVAs are underused and limited in their functioning as they do not bind secured creditors. R3 does not believe the lack of binding secured creditors is the reason CVAs fail. As the government goes on to point out, a CVA can fail for a number of reasons such as unforeseen changes in the business environment and changes of opinion by directors/shareholders. R3 encourages the government to work with the insolvency profession and creditor community to find ways to improve CVAs so that they can become a much more effective business rescue tool for SMEs.
• **A Review of the Corporate Insolvency Framework response form**


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

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:** Rachel Lai MIPA and John Cullen MIPA

**Organisation (if applicable):** Menzies LLP
• 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

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

There is an obvious risk of serious abuse but a moratorium can be very helpful as a rescue mechanism. However, the proposals in the consultation for a moratorium do not apply to all businesses, but only those able to enter administration or a CVA, i.e. not sole traders. Sole traders are generally very small businesses and are less likely to require a moratorium to allow for restructuring. The consultation refers throughout to companies but presumably the moratorium is available to partnerships too, as administration is open to them.

• 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?

There is a definite date upon filing at court for the commencement of the moratorium and this is helpful. The lack of a court hearing means that there will be no review by the court of whether the conditions are met unless the moratorium is challenged. I believe this disadvantage is outweighed by the
advantage that comes from an immediate start to the moratorium upon filing at court.

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

What is “financial difficulty”? Whilst “insolvent” will presumably be defined as “unable to pay its debts” per section 123 Insolvency Act 1986, there is no definition provided for “financial difficulty” and it is unclear how a company would show this, and at what point a company is deemed to be in financial difficulty.

I am unclear as to how we would show there was sufficient funds for the moratorium. Is a cash flow forecast required for the succeeding three months? I presume, although it is not clear, that the costs and fees of the supervisor would be included in this calculation.

- 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?

There is some uncertainty regarding the viability of the imposition of an essential service contract. For instance, what happens if the contract is due to end imminently? In addition, where essential supplies are not subject to an ongoing contract but rather individual contracts as and when required, how would that work? What happens if one or either party wants to change the terms of supply or has to change the terms? What happens if there cannot be supplies? It seems unfair to impose this on suppliers, who themselves may be dependent on their own suppliers. There is a risk that the moratorium would lead to the insolvency of the supplier and this could have a domino effect on other businesses in the same way that formal insolvency can.

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

It is unhelpful that the administration period is shortened by the moratorium. The administrator will be a different person to the supervisor and it can be challenging to complete the role in one year. Completing it in nine months or less is likely to be even more challenging. Administration is frequently followed by liquidation or dissolution, and I cannot see a significant disadvantage to creditors if the moratorium extends beyond one year in total.
Cessation appears to be a problem. One of the effects of the moratorium is that the directors and the floating charge holder cannot put the company into administration. Does the Service believe it should be a company appointment only (currently not a restriction during the moratorium)?

Is there a procedure for application to court if the company and the supervisor disagree on cessation and exit from moratorium?

The supervisor has to use judgement as to whether the company continues to meet the criteria for a moratorium. What are the penalties for getting that wrong?

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

If it is intended that the accountant must be a member of an IFAC body, then yes.

Will an insolvency practitioner be in a position to review the actions of a supervisor and what penalties may be imposed?

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

It does make sense for the costs of the moratorium to be paid first. However, what if the assets of the company are primarily subject to fixed charges? Are fixed chargeholders to be paid in priority to the costs of the moratorium? In addition, what if the costs are high in comparison to the realisable value of the assets, and the assets are not sufficient to meet costs? Is there a pari-passus distribution amongst, say, the supervisor, the suppliers and the employees?

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

Yes but there is a significant cost implication here to all types of insolvency. There are commercial and pre litigation sensitivities and this is open to abuse. The concern, which should be measured against transparency, is one creditor increasing the cost for all creditors vexatiously.

**Helping Businesses Keep Trading through the Restructuring Process**
• 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?

This passes the risk to the supplier. What if there is no contract? What mechanism would be used to dictate terms? What if the supplier cannot supply? See also responses to question 4 above. There is a risk that the requirement to continue essential supplies results in a higher number of business failures of the suppliers who are faced with a double whammy of not being able to pursue debts and being forced to continue to make supplies, no doubt at a cost to them.

Taking the example of the printing company, the specialist paper supplier may be a small family business and the printing company may be its largest customer. The paper supplier may not be able to purchase the materials it needs to continue the supply without payment of the printing company’s outstanding debts. The supplier then fails to supply and/or enters an insolvency procedure. This would surely have the opposite of the intended effect of this consultation for reform.

Could a contract state that the customer would not designate the supply as an “essential supply” in the event of a moratorium? This could be a loophole for suppliers.

It is likely that there would be a higher number of business rescues of the companies entering moratoria, as it may be a means of avoiding formal insolvency, but I would be unable to determine how many.

• 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?

My concern is the time between dispute and resolution. If there is no supply, what can be done to protect the company’s (and the supplier’s) position until the court hearing?

What powers would the court have to enforce supply practically? Would the court recognise the difference between “can’t” and “won’t” supply?

If the administration were extended, I would have thought you would want your essential supplies extended accordingly.
Developing a Flexible Restructuring Plan

• 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?

It works as a standalone procedure but are there many differences between this and a scheme of arrangement? I wonder the costs of creating a new procedure outweigh the benefits, when the similarities to a scheme of arrangement may make it more sensible for the two to be combined.

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

I do, but if the matter is proceeding to court for ratification regardless of the creditors view, it would be cost-efficient to take the process to court without junior creditors voting. It is hard to understand the purpose of the junior creditor vote when the court will decide whether the plan should be binding or not.

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

Yes, provided creditors have the right to be heard by the court if they wish to challenge any aspect of the plan. The high level of involvement by the court should ensure protection and prevent abuse.

• 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?

Is the minimum liquidation value actually break up value? Given the increase in value of non tangible assets in companies, would this really assist in any event? Particularly for intangible assets, it seems that in some cases a minimum liquidation valuation may be zero or completely out of proportion to the likely realisable value.

It would be difficult to appropriately legislate as to how an asset is to be valued. The onus should lie with the valuer.
Rescue Finance

- Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?

No. There is a risk that finance would become onerous or unavailable outside of a formal process and therefore it would cause more failures. The general market for business finance would be less attractive to financiers in the knowledge that a rescue financier could “trump” their position at a later date. Does it not defeat the purpose for financiers of holding security?

If it is introduced, Administrator's costs should be met prior to rescue finance. Otherwise, again, there is a risk that insolvency practitioners will not be willing to take appointments because the company has no means to pay their costs once the financiers have been paid.

What safeguards would there be to prevent companies with no future incurring additional rescue finance debt at a disadvantage to all creditors and chargeholders other than the rescue financier?

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

It would be difficult to appropriately legislate as to how an asset is to be valued. The onus should lie with the valuer.

- Which categories of payments should qualify for super-priority as ‘rescue finance’?

None. As mentioned above, super-priority is likely to damage the existing market for business finance.

Impact on SMEs

- Are there any other specific measures for promoting SME recovery that should be considered?
No. I am content with the lack of restrictions as to size, allowing all companies to take advantage of the proposals within this consultation should it be in their interests to do so.

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.

The small company moratorium should be made less onerous for nominees and therefore brought into play in the CVA market. This would be a big step forward. A major reason that the small company moratorium is not used is the requirement placed on the nominee, who is not even in control of the business. Schedule A1 to the Insolvency Act should either be amended or combined with the existing proposals for a moratorium within this consultation.

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
A Review of the Corporate Insolvency Framework
response form


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

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I want my response to be treated as confidential ☐

Comments:
Questions

Name: Simon Harris on behalf of all the Principals

Organisation (if applicable): ReSolve Partners Limited

Address: One America Square, Crosswall, London, EC3N 2LB

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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?

Generally we are in agreement with the proposal to introduce a preliminary moratorium. We do however have concerns about how the drafting of the necessary legislation will be interpreted. The devil will always be in the detail.

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?

Yes this is most likely to be the most efficient means of gaining relief for a business. Our concern is how much preliminary work and supporting information will be required to gain the relief when time and cash constraints may mean a company has to act quickly.

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

The eligibility and qualifying criteria are probably at the right level. Again however we question whether time and cash constraints may impact on this. For example, the requirement for directors to sign a statutory declaration that the company can support itself during the moratorium period. This implies that finance and/or funding may need to be arranged ahead of a moratorium period in order for the stat dec to be signed. The company may not have the time to do this but would still ultimately benefit from a moratorium.

It might therefore be necessary to relax this requirement. Directors in such situations already have a fiduciary duty not to make the position of creditors materially worse than they already are so perhaps this just needs to be emphasised. The Supervisor can then monitor and if matters deteriorate or funding cannot be found then a moratorium can be terminated with a move into CVA, administration or liquidation.

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?

The devil will be in the detail of the drafting to determine if the right balance is struck. If drafted properly then yes the right balance will be achieved. Get it wrong however and the process will either be completely unusable, much like the A1 CVA moratorium for small companies or it will be open to abuse by unscrupulous directors and/or advisers.
5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

We believe 3 months to be too long, however R3s proposal of 21 days is probably too short. An alternative might be for the intended supervisor to set a case specific time frame based on discussions with management capped at say 3 months. In this circumstance extension would have to be for exceptional circumstances only. We like the idea of approaching creditors in the event of an extension being required.

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

Our view is that the Supervisor absolutely must be a qualified IP. The powers and responsibilities of the Supervisor at present are open to debate. For example should a supervisor be completely independent or can the supervisor also act as a company’s adviser regarding a sale or the sourcing of finance during this period.

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

In general yes although we can see issues arising. For example would another IP take on a subsequent liquidation or Administration if they knew the Supervisors fee and costs incurred in the moratorium had to be paid first (or that there were costs outstanding which ranked as an expense of administration). The moratorium will therefore most likely result in a lower return to creditors in any subsequent process. Creditors may well have to accept this on the provision there was a very real prospect of a successful outcome following 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?

While we are all for greater transparency there will inevitably be situations that require confidentiality so as not to prejudice a situation. This is something that must be looked at on a case by case basis. Perhaps wording along the lines of Supervisor to deal with all reasonable requests for information at his discretion, or, Supervisor is not to unreasonably refuse a creditors request for information. We would also be concerned about the increased costs in dealing with a variety of requests.

**Helping Businesses Keep Trading through the Restructuring Process**

9) Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?
We can see this being difficult to manage and control. Our belief is that many suppliers will continue to seek to influence or improve their own position particularly as the intention is for directors to retain control. This is an area that in our view is open to abuse. It may be extremely difficult and costly to enforce.

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?

Do the courts want to be dealing with every single individual creditor challenge, or would this be better dealt with by a Supervisor in the event say more than 10 per cent of creditors by value call for a meeting or for an application to terminate the moratorium. The question is whether suppliers are prepared to take a longer term commercial view. In many cases suppliers are themselves cash constrained and any delay in payment whether due to a moratorium or another process is going to impact regardless.

**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?

A cram down mechanism could be of use in situations where a class of creditors that are effectively out of the money have the ability to block a restructuring plan agreed by a more senior class of creditors.

Until we see more detail on the proposal it is not possible to say whether this would work better as a stand-alone mechanism or as part of a wider restructuring scheme. Perhaps incorporation into some form of a CVA structure would work best so as not to introduce too many options.

As always the devil will be in the detail of the drafting.

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

The sentiment is noble, however we can foresee difficulties in setting the class of creditors on a case by case basis rather than it being defined in legislation. Particularly if certain classes of creditors are to be crammed down. Is the court the best body to determine how the classes are to be defined? We just cannot see this working at a practical level.
13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?

Do the courts really want to be getting involved in what are effectively commercial decisions? Allowing a company to set its own creditor class system which is then ratified by the court just introduces another area of contention. It would be far better to stick to the already defined and trusted creditor hierarchy.

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?

It is correct and fair that any arrangement plan should be judged against the likely recovery in a Liquidation and/or Administration.

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?

In principle we agree that rescue financiers should have priority security. This principle already applies in Administration where funders rank ahead of creditors as an expense of the Administration. We are of the view the same should apply to rescue financiers which fund a company during the moratorium period.

In practice, however this may be difficult to administer as existing charge holders, whether they have negative pledges or not are likely to want to protect their own positions.

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

Not sure there is a way to answer this. We see no reason for any change in the way charged assets are valued. At present assets are typically valued on a going concern or forced sale basis. Other valuation bases include enterprise value or for property a perceived market value.

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

Again this is subjective. For example would a supplier offering extended credit terms during the moratorium constitute providing rescue finance. Or does rescue finance have to be limited to the direct provision of funding.
Impact on SMEs

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

There are occasions when secured lenders and their advisors can be too quick to appoint administrators and thus missing the opportunity for a rescue financier to step in with funding that might de-risk the secured lenders position and provide much needed working capital to turnaround a situation. The exercising of a moratorium would help companies at least explore this as an option which might actually avoid an insolvency event.

Theoretically this should result in more companies avoiding insolvency.
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.

As noted throughout this response, we believe a moratorium period to be a potentially useful tool in the corporate rescue armoury. However our concern remains that while the concept is a good one, it may well become too difficult to get the right balance in the legislative drafting. Our fear is that such an option will either be so burdensome as to be completely impractical and unworkable or it will be so open to abuse that companies and the wider public will simply lose trust in it as a rescue mechanism.

In summary the devil will be in the detail of the drafting and we look forward to seeing this and being able to comment on this.

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 X

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?

X Yes    □ No
A Review of the Corporate Insolvency Framework response form


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

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I want my response to be treated as confidential ☐

Comments:
Questions

Name: Kate Garth

Organisation (if applicable): RWE npower

Address: Wetherby Road, Scarcroft, Leeds, LS14 3HS

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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

Q1) Do you agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses?

As a leading energy supplier to non-domestic customers, npower is already familiar with the use of and potential benefits of a moratorium.

We believe there is a risk that we (and other suppliers) will be faced with more smaller businesses in financial difficulties because they are not able to adequately protect their interests as a result of the proposed changes, or there is a detrimental impact on all business if prices increase to cover losses incurred or to mitigate against that risk (through insurance / additional risk premia).

Following the change to the Insolvency Act in 2015 regarding the removal of reliance on termination clauses in the event of insolvency – we, as an energy supplier are particularly concerned with the potential ease with which a business could enter into these new moratorium arrangements, and in particular, how effectively the eligibility tests will be enforced.

We conditionally agree with the proposal to introduce a preliminary moratorium as a standalone gateway for all businesses, as we believe it would support business rescue. However, in order for this to work as intended, sufficiently robust protection (in addition to the proposals included in this consultation) must be provided for creditors and greater clarity provided, so that the process cannot be abused.

We are particularly concerned as to how restructuring could include contractual workout (7.7) and how this ‘contract’ could be impacted if a further moratorium is sought (after a 12 month period).

Furthermore, we are concerned at the proposals that would limit the creditor’s ability to apply to court to challenge the moratorium during the first 28 days, given the lack of clarity with regards to how quickly (and by what method) creditors will be informed of the application. Please also see our comments relating to our response to question 2.

Finally, greater clarity regarding the arrangements for the post-moratorium period must be set out, in the event that an insolvency doesn’t occur; particularly with regards to the payment of outstanding debts / arrears.

We would welcome further clarification on these points and proposals to address the issues raised following the closure of this consultation.
Q2) 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?

Please also see our response to question 1). Whilst there are eligibility criteria and qualifying conditions, we are concerned at the relative ease with which a business could enter into a moratorium under the proposals outlined in the consultation.

We agree that a court hearing to ‘sanction’ the moratorium would result in unnecessary cost, however the cost for a creditor to challenge in court – and the delays in obtaining a court date – seem unreasonable. In particular we note the estimated cost of ca.£4000 (as stated in the Impact Assessment) to raise a dispute at court. This may prove prohibitive for some smaller Creditors who can or do not wish to risk incurring further costs, should the court find against them.

Since, under the current proposals, a business could be able to place itself into moratorium at any time (meeting the eligibility criteria) we would highlight the potential risk that an unintended consequence of these proposals would be for essential suppliers (as defined in the Insolvency Act) could become less lenient in supporting those business not in moratorium, or other some types of formal insolvency; given the prohibition of changing contractual terms etc following the 2015 Order; in order to mitigate their exposure to debt.

We would therefore suggest that in addition to sending a copy of the application for the moratorium to creditors, that it is also advertised in the Gazette to ensure the information is in the public domain, negating the risk of breaching requirements laid out (such as those highlighted in paragraphs 7.14 and 7.31).

We believe the proposals, as stated, do not provide sufficient clarity to suppliers as to when the application for the moratorium is expected to be made (likely court date) or post the application’s approval, the actual date that the moratorium comes into effect. We would therefore recommend that Government tightens the definition of the timescales required for the copy of the moratorium application to be sent to the businesses’ creditors, as the consultation does not clarify this issue, despite placing the onus on the creditor to lodge an appeal within 28 days.

Without this clarity, it will be very difficult for creditors to effectively manage their existing collections processes, including the need to trigger additional actions (such as a contesting the moratorium application.

Q3) Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?

No – we do not believe that the eligibility tests and qualifying criteria as stated in paragraphs 7.21 – 7.24 provide sufficient levels of protection for suppliers and creditors. We would request the following additional means of protection be included in any final response:
The business seeking the moratorium must be able to justify the timing of their application for the moratorium, particularly in relation to the timing of ongoing or anticipated bills. For energy suppliers, (already deemed to be essential supplies) it is not possible to simply disconnect [de-energise] the site to minimise their exposure.

We would also expect, (given para 7.21) that there should have already been contact with creditors in advance of the moratorium being sought, given the presumption that that creditors are prepared to support the restructuring of the applicant company’s debts, (as is noted in para 7.27). If this is not the case, then the application should not be deemed eligible.

In relation to para 7.22 where it states that a primary qualifying condition is that “the organisation has 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”. Greater clarity regarding this qualifying condition – particularly regarding definition is required as to how the business will continue to fund the obligation. As the proposal is currently set out, it does not allow an energy supply to rely on any existing termination clauses with the supply contract (as per 7.30) and the supplier remains obliged to continue to supply in accordance with the original terms. In this case, it should be set out clearly in the Act (if amended) that the organisation seeking the moratorium has an obligation to ensure payments are made against products and services provided throughout the moratorium period.

For example, it is common within the energy industry to bill on a quarterly basis, and / or if a business were billed monthly on 60 day terms - it could mean that the business might not have any payments ‘fall due’ during the initial 3 month moratorium period, potentially meaning nothing is paid to the supplier. It is therefore imperative that any amendments to the Act ensure that ongoing supplies need to be paid for, to ensure a creditor is indeed ‘no worse off’. To ensure this outcome, of the supplier being “no worse off”, payments would need be accrued for and made to the supplier, even if billing or the original contractual payment terms fall outside of the three month moratorium.

We are also very concerned that para 7.23 states: 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.

We would prefer clear guidance and a definition as to what “satisfactorily demonstrating” will mean. Furthermore, we do not believe that the role of the Supervisor (at the point of the application for the moratorium) is sufficiently well-defined.

We would strongly recommend that the role of the supervisor is clarified to ensure that the proposed Supervisor is both independent of the business seeking the moratorium and is suitably qualified to assess the genuine likelihood of the business becoming a viable business in the future. This must (as an absolute minimum) include providing evidence of funding for all on-going business costs, particularly those from essential suppliers (including utilities).
Our concern is clearly to ensure that if a moratorium is granted (and then the business goes into administration) that the ongoing costs of the energy consumed during the moratorium period are treated in the same way as the ongoing business costs in an administration.. This is particularly important for suppliers deemed to be “essential services suppliers” – given that we are already prevented from relying upon contractual changes (due the 2015 amendments). Within the new rules, we (as an essential supplier) have the right to request a personal guarantee from the Insolvency Practitioner (IP) for the ongoing cost, which if the IP doesn’t provide this within the specified timeframe, enables suppliers to be released from the rules preventing the termination of contract and to be able to undertake the next steps towards termination of supply.

We believe it would be unacceptable for suppliers to be required to hold the additional risk of 3 months or more unsecured consumption, which would then be written off following the formal instigation of the business going into administration.

For the many smaller SME customers, who may already be engaging and working with non-domestic debt charities, we see the appointment of a Supervisor from such a debt charity as a natural extension of their existing support framework.

If these additional areas of clarification and process are adopted, we believe the proposed eligibility test and qualifying criteria would be adequate, given that the proposed supervisor must be a regulated and competent professional with current expertise in restructuring. (Please also see our response to question 6).

**Q4) 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?**

As noted previously, as a licensed energy supplier, we are already deemed to be an essential supplier (and therefore would not be impacted by the right of the organisation seeking to apply for the moratorium to designate additional goods or services as essential.

We would however note that again the onus is put on the creditor to apply to court to challenge a moratorium and being deemed to be an essential supplier (if they are not a supplier of IT or utilities) at potentially a significant cost, that may not be recovered (even if it is recoverable).

We believe (as noted in our response to question 2) that the in additional to sending a copy of the application of the moratorium to creditors, that the proposed date of the court application, and thereafter the date the application for the moratorium is granted be included in the Gazette, to provide a central, timely and accessible public data source regarding the business.
We also question the wording of para 7.31 – we would suggest that in order to safeguard the creditors’ and other stakeholders’ interests, Government will absolutely have to introduce new sanctions to ensure that Directors are required to act within the framework of these proposals For the avoidance of doubt, this would include sanctions for the actions listed in the consultation, shown below:

- Obtaining credit without first disclosing that a moratorium is in force,
- Failing to send creditors a copy of the application (note we believe this should be extended to creditors and existing suppliers and that the sanction could specify the timeframe within which this notification must take place.
- Failing to supply information required by the supervisor, or that is relevant to the supervisor’s assessment of the qualifying tests

We would also add the following actions to this list:
- Providing false or misleading evidence to the Supervisor in support of a moratorium application
- Failing to notify creditors and suppliers of the proposed court date for the application of the moratorium.
- Failing to pay the ongoing costs (or accruing for the costs) of ongoing supply

We support the proposal for the personal liability for wrongful trading (as in para 7.34) if the Directors breach the moratorium rules. This clarity is required to reduce the risk of abuse.

We believe there should be a similar professional sanction for any Supervisor, who fails to terminate the moratorium for any business that does not continue to meet the eligibility criteria of the moratorium, in particular the requirement that the business can meet its ongoing operational costs (even if a bill has not yet been issued etc).

**Q5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?**

No, as the proposals currently stand, we do not agree with the proposed the duration, extension and cessation of the moratorium. In particular we believe that proposals for the cessation of the moratorium (on the basis that the business fails to continue to meet the qualifying standards) must be clearly defined and set out, to ensure creditors remain protected and are “no worse off” than if the company had gone into administration.

If the proposals we have outlined in our earlier responses to provide additional clarity and protection are enacted, then we would agree. However, we would still remain concerned regarding the process for voting on extensions to the moratorium, as the proposal as currently outlined would be administratively burdensome, and would heavily rely upon paperwork being sent, received and processed, as well as the reliance upon a majority decision that might not happen.
More clarity is required regarding the proposals for any potential extension to the moratorium, i.e. at what stage would this be assessed, in order to ensure that all creditors and stakeholders are aware if, and when a moratorium has been further extended.

**Q6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?**

We agree with the proposals relating to the powers and qualification requirements for a supervisor, but we believe these should be strengthened to ensure that any supervisor to be independent of the business (to avoid any conflict of interest, should the accountant be the internal accountant etc).

Furthermore, the Supervisor must have proven and current expertise in restructuring. We would also like to see debt charities be able to perform the role of supervisor for smaller SME’s, with whom they may already be working, given they would be best placed to advise on potential restricting / insolvency routes, as well as helping to assess in a neutral and expert way whether the business has any realistic opportunity to become a viable, going concern.

We also support the proposal that any Insolvency Practitioner acting as supervisor would be prevented from taking an appointment for that company entering a formal insolvency process after a moratorium.

We also reiterate our request that the means and timing relating the supervisor’s responsibility to inform the court and creditors that the qualifying conditions for the moratorium are no longer being met are clearly defined and set out in any amendments to the Act, or enabling legislation.

**Q7) Do you agree with the proposals for how to treat the costs of the moratorium?**

We believe it is essential for costs of the moratorium to be treated the same way as costs in administration and for unpaid debts incurred during the moratorium to be treated as a first charge, otherwise it will not be possible to ensure that the creditor / supplier will be no worse off. In order to reduce the risk of unpaid debts during a moratorium period, however, clarity is required in any amended legislation on the payment of debts (please also note our response to question 3).

**Q8) Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?**

We believe that Creditors will benefit from increased transparency and there should not be any exemptions to the swift provision of the requested information; providing the request is reasonable, (through justification if necessary) and in accordance with legal requirements.
The provision of timely information would also support the potential challenge a creditor may have, either by providing further clarity and avoiding costly challenge, or reinforcing it as the necessary course of action. We note that the provision of a range of information, particularly for a recovering business, would be very helpful in supporting a positive outcome, particularly for those companies in recovery, it would be helpful to understand where (and to whom) dividends are being paid.

We note the current Companies House Service (Beta) version, which is piloting the availability of all relevant documents. We believe the development of such a system must be considered in the context of the moratorium process, to enable the provision of timely and accurate data being available to all current and future creditors of the company.

**Helping Businesses Keep Trading through the Restructuring Process**

**Q9) Do you agree with the criteria under consideration for an essential contract, or is there a better way to define essential contracts? Would the continuation of essential supplies result in a higher number of business rescues?**

We agree with the criteria; (as set out in para 8.15), under consideration for an essential contract. As npower, an energy supplier is already deemed as an essential services supplier within the Insolvency Act (as amended), this proposal does not impact us directly.

We believe that the scope of which businesses could be determined to provide ‘essential’ service is so varied that it would be most suitable for a business to determine who their essential service providers in conjunction and in agreement with their supervisor prior to the application. As we noted in our response to question 6, in order for this to work, it is essential that any Supervisor is officially appointed and is capable of providing an independent and dispassionate appraisal of the businesses chances of restructuring and ongoing viability.

**Q10) Do you consider that the Court’s role in the process and a supplier’s ability to challenge the decision, provide suppliers with sufficient safeguards to ensure that they are paid when they are required to continue essential supplies?**

We agree with the Court’s role in the process and the ability for a supplier to challenge.

We believe that if a supplier is determined to be an essential supplier, sufficient safeguards must be put into place (subject to clarity on payment as noted in our response to question 2). Clarity is required with regards to the consequences of any challenge made by a creditor being upheld by the court, for example, would the
assessment of a business’ ongoing viability (and likelihood to become a viable, going concern) need to be reassessed, given the potential knock on impacts to other suppliers, including the timescales for action.

However, as in our response to question 6, if an independent Insolvency Practitioner (or other certified professional with relevant experience in business restructuring) has been appointed and has legal responsibility for ensuring the application is warranted, the number (and frequency) of challenges through the court should reduce.

**Developing a Flexible Restructuring Plan**

**Q11) 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?**

We are concerned at the potential confusion that could result if the restructuring plan were managed as a standalone procedure, rather than as an extension to an existing procedure.

We would also again highlight that any restructuring plan needs to be carefully managed by appropriately qualified and experienced professionals.

**Q12) Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissention from some creditors?**

We note the proposals for making the restructuring plan universally binding in the face of dissent from some creditors. We do however note the following concerns:

- the potential for conflicts of interest from parties linked with the business seeking a restructuring plan. For example; companies within the same group or shared directorships should be in their own class and not in a class deemed as having similar rights or treatments as businesses not linked to the struggling business

- creditors deemed as essential suppliers should be considered a different class, given that there rules already place additional burdens and restrictions upon them.

**Q13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?**

We are comfortable with the proposed safeguards, as per our response to question 12. However, for the avoidance of doubt, it should be made explicit that secured creditors are not automatically giving up their security by class voting in a ‘cram-
down’ mechanism. Similar to previous responses, we note that the onus and cost of appealing to the court falls to the creditor.

We also reiterate our call for greater clarity with regards to the treatment of any debts that were ring-fenced prior to the start of any moratorium being granted.

**Q14) 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?**

We agree that a minimum liquidation valuation be included in the test for fairness. This valuation should also be communicated to creditors to allow for sound commercial decisions to be made when voting.

**Rescue Finance**

**Q15) 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?**

We do not think that ‘super-priority’ is necessary for rescue finance providers, given the specified policy intent of the proposed changes in that it is to rescue viable businesses, therefore we do not accept the proposal for rescue finance providers to have priority over existing charge holders.

However, we believe there is benefit in charge holders with negative pledge clauses being forced to grant permission for new security to be given, if it is clearly evident that their indebtedness (both realised and potential future) could be fully discharged by the sale of the charged assets.

**Q16) How should charged property be valued to ensure protection for existing charge holders?**

We believe the appropriately qualified supervisor (please also note our responses to questions 3 & 6) should arrange for all assets to be valued and clearly stated to all creditors, making it clear which assets already have a charge against them. This is to ensure there is clarity regarding the current value of the assets and to assist with making the restructuring decisions. It should also be used to allow for Creditors to make a decision on making additional charges as a security to providing credit.

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

We do not believe ‘super-priority’ is necessary given the policy intent of the proposed changes (please also see our response to question 15).
Impact on SMEs

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

Please note our previous comments regarding the responsibility to challenge either the moratorium or designation of essential supplies rests on the supplier / creditor (who may themselves be a SME). It will be critical to ensure that the proposals contained in this consultation do not themselves lead to an increase in SME businesses becoming exposed to risk and increased cost.

In order to promote SME recovery, the process needs to be cost effective, accessible and simple to use. It is also critical that the nature of SME businesses are understood. We believe that the costs associated with the process (for SMEs) should be percentage driven rather than fixed value. It needs to be considered that SME will create more volume but less value for supervisors to gain, so it is essential that Government considers how best existing advice agencies (in particular those debt charities, such as Debtline and Step Change) can be incorporated into the process to reduce costs and to provide appropriate and expert support at the start rather than at the end of the process.

Finally, we note that there is a high proportion of SMEs that are sole traders rather than any limited liability companies, and these individuals are not mentioned as part of this proposal. According to the latest business population Statistics published by BIS, there were 3.3 million sole proprietorships (62% of the total) in 2015.

Given the numbers of sole traders and the ongoing growth in this segment, we believe greater clarity should be provided with regards to proposals to this sector.

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.

We do not have any additional comments to make regarding the process as a whole, although we are surprised that suppliers who are already deemed to be essential suppliers as per the Insolvency Act (amended) were not included within Annex B: List of Organisations consulted, given the potential impact on current processes and future commercial arrangements.

We would also seek clarity on when BIS and the Insolvency Service would seek to implement these proposals, and if (similar to the amendments made in 2015) would come into effect for all new contracts agreed post a specific date, or whether it will take effect from the date of the enactment of any enabling regulations.
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

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

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I want my response to be treated as confidential ☐

Comments:
Questions

Name: Sarah Paterson

Organisation (if applicable):

Address: The London School of Economics and Political Science, Department of Law, Houghton Street, London WC2A 2AE

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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?

English insolvency law has no single gateway through which a distressed company must pass before its debts are restructured, its business and assets sold as a going concern or its assets sold on a break-up basis. Instead, this choice is largely left to the directors and (in some circumstances) the creditors. There are currently 7 relevant procedures:

- Scheme of arrangement
- Company voluntary arrangement (CVA)
- Administration
- Receivership
- Where a relevant exception applies in EA 2002, administrative receivership
- Creditors' voluntary liquidation
- Compulsory liquidation

There are currently material differences between the availability of a moratorium, and the way in which it operates, in each of the procedures:

- Where creditors are negotiating a workout out of court, they are left to agree any stay voluntarily in contract.
- Similarly, no moratorium is available during the scheme of arrangement process (although the courts have shown a willingness to grant a moratorium in limited circumstances when a scheme of arrangement negotiation has been well advanced).
- As the consultation notes, the moratorium which is currently available in a CVA is only available to small companies. It also suffers from other deficiencies; for example, it is administratively burdensome, carries significant liability risk for the insolvency practitioner and may raise concerns about the signals which it sends to creditors. There is a question mark about the desirability of a moratorium in an SME case.
- A moratorium is available in administration, but it does not prevent the termination of contracts for counterparty insolvency.
- No moratorium is available in receivership or administrative receivership.
- There is no automatic stay of proceedings in a CVL, although it is possible for a liquidator, creditor or contributory to make an application to court.
- There is an automatic stay of proceedings in compulsory liquidation, but it does not prevent enforcement of security.
These complex differences have emerged for specific reasons. It is suggested that before a new moratorium is "layered" on top, the position in each of the existing procedures should be carefully reviewed:

- There is a question as to whether a statutory moratorium should be available when no legal procedure has been implicated. If a moratorium can be engaged by resort to the scheme of arrangement (or new "insolvent scheme of arrangement") procedure, that would appear to create sufficient incentive to encourage agreement to a voluntary stay. Where this is not possible and a stay is required, arguably resort should be had to one of the "light touch" procedures.

- Consideration should be given to an optional moratorium when a scheme of arrangement or, if it is implemented, any new insolvent scheme of arrangement procedure is being negotiated. The scope of this moratorium should not be fixed, but instead a menu of options should be available, such as a no default provision, a stay of certain classes of creditor or all creditors or continued supply. The benefit of this approach would be that the debtor company would be able to restrict or expand the moratorium to the matters which it considered needed to be covered. In some circumstances, the important issue may be restricting the triggering of cross default clauses or staying dissenting creditors, whilst maintaining (to the maximum extent possible) the functioning of the debtor company in a business as usual manner, whilst in others it may be crucial to mandate continued supply.

- Detailed review of the moratorium position in CVAs should be undertaken. Although it is the case that the moratorium is limited to small companies, there appear to be other difficulties with the current design:
  - For a procedure designed for small enterprises, the cost and complexity of obtaining the moratorium is too great. At the same time, it is not clear that the complex steps provide any real protection for creditors.
  - As above, the costs of compliance once the moratorium has been obtained are too great.
  - Relatively extensive grounds are included for challenging the nominee, who is unlikely to be earning high fees from the engagement, so that she may decide that the personal risks are too high given the level of reward.
  - Informing creditors of a moratorium may be taken to be a signal that the company is facing cash flow difficulties, causing termination of contracts and difficulties in trading.

One option, therefore, would be to strengthen the CVA moratorium so that contractual termination is prohibited, whilst reducing the costs of obtaining and complying with the moratorium and the risks for directors and office
holders. However, there is a real question mark over the usefulness of moratorium protection in SME debt restructuring. Often, the company has a pressing cash need in order to meet the wages bill (so that speed is of the essence) and directors may be extremely unwilling and distrustful of the costs and time involved in taking expert advice. As a result, it is suggested that other reforms to the CVA procedure should also be considered. For example, in many cases the real difficulty during a CVA is lodging of winding up petitions which will engage section 127 of the Insolvency Act 1986 if the CVA is not successful. This requires management time and expense to be spent in obtaining court orders for ongoing payments. One approach might be, therefore, to concentrate on reviewing the operation of section 127 where a CVA is being proposed.

- The significant problem with the moratorium in administration is that it does not prevent contractual termination. This is dealt with below.
- The lack of availability of an automatic stay in a CVL, and the limited stay in compulsory liquidation, should be reviewed. In particular, the consultation appears to suggest that termination rights in contracts for essential supply would continue to be suspended where a restructuring attempt fails and liquidation follows. If this is to be the case, then the rights of other creditors such as secured creditors should be reviewed, as it would seem inconsistent to prevent termination of essential supply whilst permitting secured creditors to recover secured property. Although liquidation is primarily designed for situations in which it is not possible to rescue the company or sell its business and assets as a going concern, it may also occur where no private insolvency practitioner is willing to take a case (perhaps because of reputational concerns, potential environmental liabilities or lack of funding) so that the Official Receiver acts as liquidator in the winding up. In this situation, attempts may still be made to sell the business and assets as a going concern, and the current moratorium provisions should be reviewed in this context.

Overall, unless the decision is taken that there should be a genuine single gateway insolvency procedure through which all companies must pass, the availability and operation of the moratorium in each of the different procedures should be reviewed in detail rather than imposing a preliminary moratorium as a single gateway.
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?

As set out above, in my view the availability and operation of moratoria in each of the procedures needs careful review. First, consideration needs to be given to the proposal to initiate a moratorium where no legal process is in view. Secondly, whilst a court filing would be most efficient as a means of triggering the moratorium in a scheme of arrangement or insolvent scheme of arrangement, there may be benefit in using the initial court hearing as the forum at which the court could make a number of interim orders from a menu of options which debtors could adapt to the particular circumstances of their case, in order to balance the interests of the debtor and the creditors. Thirdly, the role and operation of the moratorium in the CVA requires comprehensive review. Fourthly, the moratorium should be automatic in insolvency proceedings (administration and liquidation), and its scope reviewed.

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

As set out above, in my view the availability and operation of moratoria in each of the procedures needs careful review. The eligibility tests and qualifying criteria set out in the consultation would appear to be appropriate for a moratorium where a large corporate scheme of arrangement or, if implemented, a new insolvent scheme of arrangement is to be proposed. However, they seem rather complex for an SME hoping to enter into a CVA.

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?

Once again, there may need to be a distinction between the availability and conditions for a moratorium in a large corporate scheme of arrangement or, if implemented, new insolvent scheme of arrangement and the availability and conditions for a moratorium in an SME CVA. In the latter case, if moratorium reform is pursued there may be a role for regulation in providing guidelines to nominees and in providing routes for redress for creditors which avoid the expense of the court. Caution needs to be exercised about the risks for the nominee and the directors in these situations, or experience has shown the risks in an application will rapidly outweigh the potential rewards. As discussed above, different approaches to the current challenges with CVAs could be developed, such as a review of the operation of section 127 of the Insolvency Act 1986 where a CVA is being attempted.
Insofar as the scheme of arrangement or new insolvent scheme of arrangement is concerned, it is not entirely clear what the role of the supervisor is intended to be. If the moratorium is implemented by court order at an initial hearing or the leave to convene hearing, it may be possible to dispense with the moratorium supervisor: in reality, this procedure is likely to be used by large corporates who will have the benefit of legal advice and will understand their obligations to the court.

The basis on which creditors could challenge the moratorium would also benefit from further detail. In English insolvency law the approach to the lifting of the moratorium in administration is relatively well-developed in case law:

- Would lifting the stay impede the administration?
- If it would, and the applicant is a secured creditor, the property rights of the secured creditor will be weighed against the rights of the other creditors
- If it would, and the applicant is an unsecured creditor seeking leave to enforce a contract, would the court have granted an injunction or an order for specific performance if the company were not in administration and, if the court would have done so, would enforcement frustrate the administration?
- Where the claim is purely monetary, the stay will rarely be lifted

In its recent report, the ABI Commission recommended that an unsecured creditor should be permitted to compel performance of its contract “if the court determines, after notice and a hearing, that the harm to the nondebtor party resulting from the trustee’s nonperformance significantly outweighs the benefit to the estate derived from such non-performance” (see page 116). This would seem to be similar to the English approach. For secured creditors, the US position is more complex and depends, in part, on the type of security which the creditor has been granted. Thus, if challenge rights for creditors are to be included, thought should be given to the grounds on which an application can be made.

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

To the extent that the proposed moratorium is implemented where a scheme of arrangement/new insolvent scheme of arrangement is to be introduced, the proposals seem broadly sensible. However, the requirement for all secured creditors to agree to an extension of the moratorium may create difficulties in a large corporate debt restructuring, and the reduction in length of any subsequent administration does not seem a necessary step.
6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?

In my view, the appropriate supervisor is a regulated insolvency practitioner. In particular, I see benefit in developing new standard-setting regulatory provisions and, potentially, mediation services which will provide a more cost-effective route for creditor complaint than the courts, particularly in small cases. However, as discussed above, it is not clear to me what the role of the supervisor is in relation to the moratorium. I would see the supervisor more naturally in the role of mediator for the plan proposals. This is discussed below.

The limitation on the supervisor becoming the insolvency practitioner if the rescue fails, and the moratorium ends, would seem to add unnecessary cost relative to the amount of protection which it provides for creditors.

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

This needs to be considered in light of wider discussion on expenses and ranking in insolvency.

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

I think this is better tackled through new regulatory standards than through legislation. As before, it is vital that the costs of the CVA procedure are not increased if it is to become a viable alternative to pre-packaged administration sales to connected parties.

**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?

Insofar as administration is concerned, the proposed concept of essential goods or services seems somewhat complex whilst, given the courts’ general deference
to office holder commercial decision making, providing little real protection for creditors. Moreover, there is a question as to the requirements that the continued provision of a supply will be essential to the successful rescue of the business and its ongoing viability or that an alternative supply can be found within a reasonable time frame at a reasonable cost. In the early days of an administration it may not be apparent which contracts need to be kept on foot, and which can be dispensed with, and the ideal initial position may be a much broader stay whilst the administrator assesses the position. In its recent detailed review of Chapter 11, the ABI Commission recommended that continued performance would be mandated until the debtor company decided whether to assume or reject a contract “provided [the trustee] needs such continued performance and pays for any products or services delivered [after the petition date] on a timely basis as required by the contract or lease. In paying for such goods or services, however, the trustee should not be subject to any modifications or rate changes in the contract or lease triggered by the … bankruptcy filing, insolvency, or prepetition default." It went on to suggest that there should be no obligation to cure defaults before the trustee has reached a decision as to whether to assume or reject the contract. The ABI Commission Report on Reform of Chapter 11 provides a useful and detailed analysis of the promises and pitfalls of this sort of provision – see, in particular, pages 112-138.

As discussed above, insofar as schemes of arrangement or the new insolvent scheme of arrangement procedure is concerned, there may be benefit in a “menu” approach, so that the court is empowered to make a range of continued supply orders. It is suggested that further research into the approach in Canada would be useful here. The operation of continued supply provisions in CVAs and liquidation also requires further work.

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?

In my view, these are too complex. If we are moving beyond a limited class of essential supplies I would favour moving towards the ABI approach outlined above. However, I would limit this reform to the moratorium in administration, and investigate the position in other procedures further.

**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?
As described above, there is currently no single gateway through which all English companies must pass in distress. Instead, there is a complex web of existing procedures. If a new procedure is to be introduced, it is important that we think about where it fits into this complex regime, and any deficiencies which it is intended to address.

As the new procedure is intended as a debt restructuring procedure, it would seem to relate to three existing procedures: schemes of arrangement, CVAs and administration. These are considered below, in turn.

**Schemes of Arrangement**

Schemes of arrangement have been used in the financial crisis to swap the debt of highly leveraged businesses, which is typically secured (so that the CVA route is not available), into equity. Although it is possible to cram a scheme of arrangement onto minority creditors within a class, it is not possible to cram a scheme of arrangement onto a dissenting class. English common lawyers have overcome this challenge by "twinning" the scheme of arrangement with a pre-packaged administration sale of the business and assets to a new company, stranding creditors in the dissenting class in a shell company with no assets (for a fuller description, see S Paterson, 'Bargaining in Financial Restructuring: Market Norms, Legal Rules and Regulatory Standards' 2014 (2) Journal of Corporate Law Studies). Although this has proved a workable solution, it undoubtedly uses the pre-packaged administration sale in a way which was not envisaged by the legislature (see S Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-first Century' (2015) Oxford Journal of Legal Studies http://dx.doi.org/10.1093/ojls/gqv038). Therefore agree that it is time to address the way in which English law permits imposition of a debt-for-equity swap in a large corporate situation on a dissenting class.

The first option would be to reform the scheme of arrangement procedure itself to permit such a cram down. This gives rise to the following considerations:

- Schemes of arrangement are currently found in the Companies Act 2006. This is one of the procedure's great strengths because it reduces stigma and increases certainty (as review provisions of insolvency law relating to avoidance of transactions, directors' duties and the like are not engaged). Some jurisdictions have concluded that it would be inappropriate to allow cram down of a scheme on a dissenting class outside insolvency legislation. However, in other jurisdictions it may be possible to cram a scheme down on a class within a corporate law scheme. Further research would be beneficial here.
- If there is an imperative for recognition for the purposes of the World Bank Rankings, a cram down outside insolvency legislation may not be eligible for ranking purposes.
- We may want to give some thought as to whether the new cram down provisions can be adapted for use with other insolvency procedures.
Overall, this would suggest that one way forward might be a new procedure, based on the scheme of arrangement, but located in the Insolvency Act 1986 and permitting a debt-for-equity swap to be crammed down on a dissenting class. If a new procedure is developed, thought would need to be given as to how it interacts with the existing options. For example:

- Should a mechanism be developed to "convert" a scheme of arrangement procedure into the new Insolvency Act procedure, as is possible currently with some types of liquidation?
- If the new procedure is introduced, should a scheme of arrangement "twinned" with a pre-packaged administration be prohibited if it is merely an attempt to avoid the requirements of the new debt restructuring procedure (as is currently the case for a *sub rosa* Chapter 11 plan)?
- If the new procedure is engaged, should the review provisions of insolvency law relating to avoidance of transactions, directors’ duties and the like be engaged?

There may also be benefit in further research to explore arguments for and against permitting cram down in a corporate law scheme.

**Company Voluntary Arrangements**

The CVA was intended for use by small and medium sized companies to restructure their debts. An SME is not likely to pursue a debt-for-equity swap, (because it is likely to have privately held, illiquid share capital), but the CVA should enable it to compromise its pre-CVA debt liabilities. However, the CVA has not been widely used for this purpose (it has found something of a niche in the financial crisis for the purposes of restructuring rental liabilities, but most of these CVAs have subsequently failed suggesting that they may have done no more than provide a breathing space during which landlords sought to re-let properties). There would appear to be a number of issues contributing to the unpopularity of the CVA:

- First and foremost, it is possible to restructure an SME's debts using a pre-packaged administration sale to management without (even after the Graham proposal reforms) many formalities (for an exploration of this issue, see S Paterson, 'Debt Restructuring and Notions of Fairness' available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2768742](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2768742)).
- Secondly, and related to the first point, although CVAs are procedurally undemanding, it is still necessary to persuade 75% of creditors to agree to the plan, which can be challenging with small, diverse creditors, whilst a pre-
packaged administration can effectively be implemented without the consent of any unsecured creditor.

- Third, there is a continued risk that petitions for winding up are lodged during the CVA negotiation. If the CVA is not successful, the winding up order is backdated to the date of the petition and payments made in the intervening period will be vulnerable to being set aside. A great deal of management and court time can be taken up dealing with this issue. As discussed above, although a moratorium is available, it is only available for very small companies and, even if it is available, is relatively administratively burdensome, has not insignificant liability implications for the nominee insolvency practitioner and may affect trading by giving other creditors dealing with the company pause for thought.

- Fourth, the CVA does not bind secured creditors without their consent.

- Finally, there is a right to challenge a CVA on grounds of material irregularity or unfair prejudice, potentially a long time after the CVA has been completed, if a creditor who did not have notice of the CVA meeting becomes aware of it. This uncertainty makes CVAs unpopular with creditors.

Thus, there are a number of deficiencies which make CVAs unpopular, besides the requirement for secured creditor consent. It is suggested here that the CVA procedure should be reformed in order to make it a viable alternative to the pre-packaged administration for SMEs, but that a number of reforms are needed to the CVA procedure to achieve this.

The ABI Commission to Study Reform of Chapter 11 recently suggested a specific treatment of liabilities in SME debt restructuring. The proposal is complex, but includes:

- Splitting a secured claim which is not currently covered by the value of the company into a secured claim and an unsecured claim
- Leaving all of the ordinary share capital with the existing shareholders (subject to some limitation on voting rights)
- Paying secured creditors for the secured portion of their claim
- Paying excess cash flow to unsecured creditors

There is a great deal more to the proposal than these elements (see ABI Commission Final Report and Recommendations pages 276-302) and there are elements of the proposal not explored here which seem problematic. However, it is suggested that the overall spirit of the proposal moves in the right direction: to provide a simple scheme for SME debt restructurings which can be implemented over the objections of secured and unsecured creditors so that it becomes a viable alternative to a pre-packaged sale of the business and assets to the incumbent management.
An alternative approach, which has been adopted in a number of other jurisdictions, is to mandate a low threshold of unsecured creditor consent in order for the proposal to be implemented. The assessment in these jurisdictions is that the company will generally be financed by secured bank debt, that the secured lender’s ongoing support will be vital to the success of the restructuring, and that the secured lender will assess whether the restructuring ought to be implemented or not. As unsecured creditors are unlikely to receive a dividend in an insolvency procedure, they are not prejudiced, and the low voting threshold makes it feasible for the plan to be implemented with the necessary low cost and speed. Many of these jurisdictions have also recognised the need to keep the owner/entrepreneur engaged (as the ABI report notes), and have made provision for retention of equity. In some of these jurisdictions, advisory centres have also been established to tackle the reluctance of SME directors to spend money on taking legal advice.

Overall it is suggested that the lack of a debt restructuring procedure which permits cram down in large corporate situations and the deficiencies which make the CVA procedure unpopular are addressed separately, and that more detailed reform of the CVA procedure should be implemented to make it a credible alternative to restructuring via a pre-packaged administration sale in SME cases.

Administration

Following the Enterprise Act 2002 reforms, administration was intended to become the rescue procedure of choice in England and Wales. However, increasingly the trading administration has become a quasi-liquidation procedure which is only used when all efforts to sell the business have been exhausted. As discussed above, although to some extent this arises as a result of deficiencies in the procedure, it also reflects a worldwide shift away from trading bankruptcy and toward pre-insolvency procedures wherever possible. This provides certainty of outcome for controlling stakeholders and reflects a shift towards a service economy where companies’ principal assets are people and contracts. In terms of debt restructuring, therefore, it may be the case that other than giving administrators access to the scheme of arrangement and CVA procedure, as at present, and ensuring that the new procedure is available for use by an administrator, no further steps would be needed. It is important, however, that resort to administration remains credible, in order to encourage bargaining during the pre-administration stage. It is for this reason that the ability to terminate contracts in administration requires comprehensive review.

As discussed above, the interaction of (i) schemes of arrangement (ii) any new insolvent scheme of arrangement and (iii) a reformed CVA procedure with the availability of pre-packaged administration should also be explored.

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

Large corporates and the new debt-for-equity swap mechanism
One consequence of the lack of a formal cram down procedure in English law, and the pragmatic use of the Scheme of Arrangement coupled with the pre-packaged administration to fill that gap, is that there has been no legislative debate as to the appropriate valuation standard which should be used when a plan is imposed on financial creditors. Uncertainty creates issues for financial creditors, who are unable to price the risk on default if they do not know which valuation standard will be applied to determine whether they are “in the money” or “out of the money,” and valuation is a thorny issue. The consultation document appears to suggest that a minimum standard is adopted (no creditor worse off than in liquidation), leaving it to the courts to decide whether some other standard should be applied in a particular case. It is suggested here that this is not a matter which should be left to develop through the courts, and that if a cram down provision is to be introduced we must determine which valuation standard we wish to adopt when a plan of reorganisation is imposed on dissenting creditors. The complicated choices around valuation standard are not addressed in the consultation document.

There are two broad approaches to the valuation question adopted in corporate debt restructuring (for more detail see S Paterson, ‘Bargaining in Financial Restructuring’ and S Paterson, ‘Rethinking Corporate Bankruptcy Theory’, both referred to above):

Counterfactual approach

The “counterfactual approach” is the approach traditionally adopted by English law. In short, it requires the court to consider whether creditors are worse off in the proposed restructuring than they would be if the restructuring did not go ahead. This is sometimes described as the liquidation standard, but in fact it is more nuanced than that label would suggest. In the MyTravel case, the counterfactual was a liquidation of the business, because there was evidence that if the restructuring did not go ahead the Civil Aviation Authority would revoke MyTravel’s operating licence so that it would not be able to continue to operate as a going concern. However, these facts are unusual and generally the counterfactual will be a going concern sale of the company’s business and assets by an administrator.

Even where a going concern valuation is adopted, there are nonetheless criticisms of the English approach which concentrates on the market price for the business at the time of the restructuring. Both procedural and substantive criticisms are raised. Insofar as procedure is concerned, the counterfactual value is often established by a short bidding process for the company’s business and assets, but in many cases this may not be a “real” auction process because bidders are unwilling to commit to it if they suspect the process is merely a means to establish a price to benchmark a restructuring, rather than a genuine sale process. Moreover, if senior lenders are confident that they are “in the money” on the counterfactual basis, they have little incentive to reach a negotiated settlement and may prefer resorting rapidly to the legal process.

There are also a number of substantive issues. Restructurings often occur when either the market is depressed, or the particular sector in which the seller operates
is distressed, so that trade buyers in the same sector lack financing to make a bid, or there may be a shortage of bid financing generally, or potential buyers may simply be conserving their reserves. Moreover, the sale agreement will often be drafted on “insolvency” terms, in other words without any representations and warranties, indemnities etc. For both these reasons the price may be lower than the price which would be obtained for the business in a more “normal” market on more “normal” arms’ length terms. Thus, if the business is valued on this basis, senior creditors may take the lion’s share of the equity in a debt-for-equity swap, but as the market and the business recovers, may subsequently recover more than they were owed.

The bargaining and litigation approach

As a result, a different approach is used in US bankruptcy in Chapter 11, sometimes referred to as the bargaining and litigation approach. Here, each creditor class retains its own expert to value the business and assets of the company using standard valuation methodology such as comparable transaction pricing, discounted cash flow (or DCF) and leveraged buyout pricing. If the parties do not reach agreement, there may be a valuation hearing in the Chapter 11 process which the bankruptcy judge will arbitrate.

There are several advantages to this approach. The first is that it is arguably “fairer” because it does more to prevent the situation in which senior creditors grab a significant proportion of the equity when the market is depressed. Although, in a recent paper, I have suggested that “fairness” ought not to be an issue (provided the outcome is predictable) where we are discussing large, sophisticated financial creditors (S Paterson, ‘Debt Restructuring and Notions of Fairness’ above), we may nonetheless, prefer this approach if the money which is at stake in junior tranches of the capital structure has been invested by pension funds, insurance funds etc. so that it is money which belongs to us all. Secondly, we may prefer this approach if we think that it does more to incentivise lending to healthy companies, or has a positive effect on borrowing costs. Thirdly, we may prefer it if we consider it will do more to attract international investors to UK debt structures. Finally, this approach may do more to incentivise a negotiated settlement because all parties fear the litigation risk and expense inherent in a court valuation fight. In other words, senior creditors may be incentivised to give something to junior classes to effectively buyout any ability which they have to hold up implementation of the plan of reorganisation by forcing the matter into a contentious court hearing.

However, the US approach also has serious disadvantages. First, out-of-the money creditors may fear the valuation fight less than senior creditors (having less to lose) and thus capture returns which they ought properly not to be entitled to. Secondly, negotiations can become very protracted, costing significant amounts and delaying rehabilitation of the company. Finally, the approach is very subjective so that the result is somewhat unpredictable, and the judge hearing the valuation dispute may, as Judge James Peck has put it “feel gamed”. Thus it is the subject of much debate in the US at the moment, with some practitioners arguing for the UK approach or, at least, a different approach.
Options approach

The issue has recently been considered in the US as part of the American Bankruptcy Institute (ABI) Commission on Reform of Chapter 11. Specifically, the Commission considered whether some variant of the so-called options approach should be adopted. Several US academics have advanced the idea of the options approach, in which out-of-the money creditors would receive an option with a strike price equal to the debt ranking ahead of them and a defined exercise period which could be traded in the market and which would assume a higher value if the business recovered rapidly following the debt restructuring. The ABI Commission report uses options pricing methodology as a starting point in order to determine whether creditors who are out-of-the money today should receive some consideration in the restructuring. However, the author’s impression is that the idea has not been greeted with much enthusiasm in the market, and it would seem to add to, rather than reduce, complexity. Accordingly, it is not discussed in more detail here.

Overall, it is suggested that the test for large corporate debt restructurings should be framed around either:

The counterfactual standard alone: that no creditor is worse off than they would be if a restructuring were not agreed and the company’s contingency plan implemented (which may be a liquidation standard, for example, on the facts of My Travel, but would more usually be a going concern sale by an administrator); or

The counterfactual standard coupled with a fair restructuring plan standard: that no creditor is worse off than they would be if a restructuring were not agreed and the company’s contingency plan implemented (as above) and that the restructuring plan is not unfair having regard to the anticipated forecasts for the business.

It is suggested that more detailed consultation is required before a choice can be made between these options, particularly asking investors:

- For detail of the type of investor which is responding (fund, pension fund, life assurance, university, family office, bank etc)
- For detail of the type of debt and equity investments which they make (long only fund, corporate bond, equities etc)
- To what extent their decision to advance a senior loan or purchase a senior bond depends on (i) risk of default and (ii) return on default
- To what extent their decision to advance a junior loan or purchase a junior bond depends on (i) risk of default and (ii) return on default
- To what extent their decision to subscribe for equity depends on (i) risk of default and (ii) return on default
• Whether the European "counterfactual" approach to valuation impacts on (i) availability of senior finance and (ii) pricing and, if the answer is that it does, what evidence there is for this?
• Whether the European "counterfactual" approach to valuation impacts on (i) availability of junior finance and (ii) pricing and, if the answer is that it does, what evidence there is for this?
• Whether the European "counterfactual" approach to valuation impacts on (i) availability of equity finance and (ii) pricing and, if the answer is that it does, what evidence there is for this?
• Whether the US "bargaining and litigation" approach to valuation impacts on (i) availability of senior finance and (ii) pricing and, if the answer is that it does, what evidence there is for this?
• Whether the US "bargaining and litigation" approach to valuation impacts on (i) availability of junior finance and (ii) pricing and, if the answer is that it does, what evidence there is for this?
• Whether the US "bargaining and litigation" approach to valuation impacts on (i) availability of equity finance and (ii) pricing and, if the answer is that it does, what evidence is there for this?
• Which approach to valuation they favour and why?

Furthermore, section 9.3.2 of the consultation document seems to suggest a rather curious formulation of what is known in US Chapter 11 as the absolute priority rule. The APR provides that no junior class can recover until a senior class has recovered in full, but no senior class should recover more than it is owed. This raises two issues. First, it requires a determination of how the senior creditors’ consideration in the restructuring plan is to be valued for the purposes of testing the APR. Secondly, it requires a determination of how much the senior creditor should be entitled to recover before junior classes can recover. There is an argument that if the senior class is exchanging debt for equity, it is taking a different type of credit risk and should be entitled to recover more than the par value of its debt. It is not clear what position the consultation takes on these sorts of issues when it states, at 9.3.2, "junior creditors should not receive more on repayment than creditors more senior than them."

Further detail is needed on what is meant by the statement in section 9.3.2 that, "junior creditors should not receive more on repayment than creditors more senior than them."

SMEs and the reformed CVA procedure

As above, it is suggested that the CVA procedure should be reformed to make it a viable debt restructuring procedure for SMEs. This should involve a greater ability to cram the plan onto dissenting creditors. However, it seems unlikely that SME restructuring could withstand much complexity around this from a cost perspective. It is therefore tentatively suggested that a set of requirements around the plan
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(following the approach, although not the specifics, of the recent ABI Commission proposal) should be developed which a creditor could not object to, or lower voting thresholds considered.

**Overall, it is suggested that reform of the cram down provisions of the CVA should be tackled separately from developing cram down in large corporate situations.**

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

One question raised during the ABI deliberations on Chapter 11 is whether some sort of independent mediator could be appointed to help mediate valuation fights between the parties and, potentially, to assist the bankruptcy judge. This is an idea which I have written about in the UK context (see S Paterson, ‘Bargaining in Financial Restructuring’ above), where there is already a party well-positioned to take this role, in the shape of the insolvency practitioner.

There has been some considerable scepticism about the IP as a neutral gatekeeper in English insolvency law. It is suggested here that this scepticism has arisen in part because of the historically close relationship between IPs and the clearing banks which dominated the financial landscape in the UK. However, this landscape has fundamentally changed, and there may be a role for an IP if a new cram down provision is introduced. Indeed (although this would require considerable thought) one solution to mediate between the rather blunt application of the counterfactual valuation standard and the problems inherent in moving towards the US valuation approach may be to provide the IP with a role in deciding on the “fairness” of the restructuring plan, given not only the apparent value in current market conditions, but also the forecasts for the business. This could be bolstered by enhanced regulation setting out how the IP should approach the valuation mediation role, new legal rights which creditors could have to make representations to her, and new challenge rights against the IP’s decision-making (perhaps not pitched as high as the current thresholds to challenge IPs). Indeed, some inspiration could be taken from the field of takeovers and the role of the independent adviser. Reform of this type would be limited, however, to large corporate situations using the scheme of arrangement or proposed insolvent scheme of arrangement procedures.

I have argued (S Paterson, ‘Debt Restructuring and Notions of Fairness’ above) that fairness is a greater concern in SME debt restructuring because, ordinarily, it is not just financial debt which is compromised but also trade debt. This can produce particularly invidious outcomes when the restructuring is implemented via a pre-packaged administration and ill-informed and unsophisticated creditors have dealt with the company in the shadow of the pre-pack whilst sophisticated creditors have taken greater care to protect themselves. We might, therefore, wish to impose greater protection for creditors in an SME debt restructuring implicating trade credit than in a large corporate debt restructuring implicating only financial liabilities. Paradoxically, however, SMEs have fewer resources to cope with a procedurally
demanding cram down procedure. It is for this reason that I have suggested a new approach, involving plan standards which can be imposed without agreement, or lower voting thresholds, and a focus on low-cost regulatory appeal procedures.

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?

In my view, the correct “floor” is not liquidation but whatever the “counterfactual” is: what is the company’s contingency plan if efforts to restructure the debt are not successful. This will sometimes be a liquidation value but will more often be a going concern sale of the business and assets by an administrator (often pre-packaged). This point is explored in more detail above.

**Rescue Finance**

For this section, please see the response to the consultation submitted on behalf of the Secured Transaction Law Reform Project, which reflects the views of the author.

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 x☐

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
Response to Part 10 (Rescue Finance) of Review of the Corporate Insolvency Framework

This response to Part 10 (Rescue Finance) of the Consultation on Options for Reform of the Corporate Insolvency Framework is submitted on behalf of the Secured Transactions Law Reform Project (“STLRP”). Many leading practitioners, academics and policy makers are already involved in the project, as well as representatives of lenders and other financial institutions. The STLRP aims to examine the English law relating to secured transactions and to consider the need for and shape of legal reform, with the object of putting the law in this area into an up to date and coherent form which is easier and simpler to understand and operate than the existing system. One specific issue which the STLRP is considering is whether the current distinction between fixed and floating security in English law should be removed. Many of the questions in Part 10 of the Consultation (Rescue Finance) relate to the work which the STLRP is undertaking on this question, and this response is limited to the questions raised in that part.

As an introductory point, it is important to appreciate that there are two key sources of rescue financing. The Consultation concentrates on the raising of new finance but equally, if not more, important is the ability to use cash within the business to finance the rescue or insolvency proceedings. In many cases, the debtor will have granted security over cash at bank and its book debts, so that a question arises as to the ability to use the cash to finance the rescue or insolvency proceedings without creditor consent.

In Chapter 11 proceedings, a debtor which seeks to use cash which is the subject of a security interest granted to a creditor requires either the consent of that creditor or the consent of the court. Court consent will only be given if the court is satisfied that the creditor has been provided with “adequate protection” of its security interest. Section 361 of the US Bankruptcy Code provides a non-exclusive list of methods for providing adequate protection: (i) cash payments, (ii) replacement security, or (iii) other protection that will result in the realisation of the “indubitable equivalent” of the secured creditor's interest in the property. The way in which these methods can be used, alternative methods which may be available and whether or not adequate protection has been provided is largely decided on a case-by-case basis, and raises a number of difficult issues which different courts have decided in different ways (for an excellent critique, see the ABI Commission to Study Reform of Chapter 11 pp. 69-73). But the key point is that the requirement for the creditor or the court to be satisfied as to adequate protection does provide the creditor with the ability to dictate the terms on which the cash is used, or to force the matter into court with all the attendant litigation risk which that entails.

In contrast, in an English law administration an administrator can use assets secured by a floating charge without the consent of the creditor or of the court. Since the decision of the English House of Lords in Spectrum Plus, security over cash will often be floating. This means that in many cases the administrator will be able to use cash proceeds within the business to continue to trade, and the secured creditor will have no control over the use of charged cash. Of course, in reality the administrator is unlikely to pursue a course which the floating charge holder wholeheartedly dislikes, but this is “soft” and not legal comfort and there is evidence that US (and other overseas)
lenders remain concerned that they do not have a straightforward legal right to restrain the use of cash. Furthermore, there is renewed focus on security issues by UK banks as a result of the demands of the changing regulatory capital regime. The STLRP is working on understanding the various options for reform including:

- Providing the secured creditor with some control rights over charged cash. However, it is important to understand that the US approach developed when it was relatively rare for a lender or lenders to have security over all of the company's assets (a so-called "blanket lien"). As a result of legislative reform in 2005, it is now much more common for such a security package to have been granted in the US, and accordingly there is concern in the US that the ability of the secured creditor to control the use of secured cash provides that creditor with very powerful rights to steer the case in its own interests. Moreover, the US tests of “adequate protection” and “indubitable equivalent” have been the source of litigation expense and extensive ongoing controversy (ABI Commission Report pp. 70-73).

- Providing existing secured creditors with something akin to a "right of first refusal" to provide rescue financing.

- Abolishing the distinction between fixed and floating charges, so that both fixed and floating charged cash may be used.

- Providing a cap on the amount of charged cash proceeds which can be used.

- Abolishing the distinction between fixed and floating charges, but providing that cash proceeds can be used without consent. This would, insofar as rights over cash are concerned, preserve the status quo in England, but would reduce transaction costs in determining which assets fall within the floating charge and can be used and which do not. It also bears some similarity to recent suggestions for further reform to secured transaction law in Australia.

The STLRP has been researching these questions for some time. It is in the process of developing a detailed research paper, and is planning a seminar for the autumn to draw together industry professionals, academics, legal practitioners and other interested parties to discuss this and other issues arising from abolishing the distinction between fixed and floating security.

These questions also impact the issues discussed directly in the Consultation. As before, turning first to Chapter 11, section 364 of the US Bankruptcy Code permits the distressed company to obtain financing after it has petitioned for Chapter 11 on either an unsecured basis, or after notice and a hearing in exchange for priority. Priority may be (i) a super-priority administrative claim, ranking after existing secured lenders, (ii) a secured claim in unencumbered property, (iii) a junior secured claim, or (iv) a senior secured claim which takes priority over or "primes" pre-petition senior secured creditors.

Our initial impression is that the last of these (priming) is relatively difficult to achieve because it requires the company to show that no other financing is available and that the interests of pre-petition secured creditors that would be primed by the new facility are adequately protected. It is, therefore, our anecdotal impression that true “priming” is comparatively rare, and that more usually security is granted over unencumbered property or ranks as an administrative claim. This is something which we are currently exploring as part of our research. Given the difficulties in developing the concept of “adequate protection", it may be that it would only be worth importing some sort of priming mechanism into English law if it transpires that it is relatively widely used in the US.
The Consultation refers to a “broad and long-established market in specialist rescue finance” in the US. However, our impression is that the market for provision of Chapter 11 financing has declined in the US (see p.75 fn 296 ABI Commission Report and accompanying text). It may be that this is a direct result of the growth of the “blanket lien”, so that there are fewer unencumbered assets available for post-petition finance security, or as a result of the financial crisis, or a combination of factors. We also understand that the Chapter 11 financing agreement is now often used to enable secured lenders to gain higher priority for pre-petition debt (see ABI Commission Report pp.74-79), or to impose contractual provisions enabling lenders to better control the case (see ABI Commission Report pp.76-77). We are also aware of a growing body of literature exploring how DIP lenders of different institutional types aim to use the DIP financing contract. We are currently exploring all of these points, in order to inform the UK debate.

Assuming it is the case that Chapter 11 financing in the US often ranks as a super-priority administrative claim or as a junior security interest, as the Consultation highlights it would appear that in many cases a rescue financier may currently be in a better position as a matter of English law. This is because a security agreement entered into by an administrator may rank as an expense of the administration for the purposes of paragraph 99(4) of Schedule B1 of the Insolvency Act 1986, a position somewhat supported by the case law (Bibby Trade Finance v McKay [2006] AER 2666) and in the scholarly literature. In this case, the rescue financier in England has two principal advantages over her US counterpart. First, whilst a US DIP loan which ranks as a super priority administrative expense would rank behind secured lenders, in English law the rescue finance would rank behind fixed charges but would rank ahead of the floating charge holder. Secondly, no court hearing is necessary so that the transaction costs involved in putting the financing in place are lower.

We agree, however, with the implication in the Consultation that the analysis is not easy to understand, is not clearly articulated in legislation, has not been thoroughly tested in the courts and still raises some questions such as the implications of negative pledge clauses. It may be, therefore, that there would be benefit in crystallising the position clearly in the Insolvency Act 1986 so that it is beyond doubt. However, any changes would need to dovetail with other steps taken in the reform (such as the proposal to treat the costs of the preliminary moratorium in the same way as administration expenses), and with the overall policy decision on the relative ranking of insolvency finance and floating charge holders. Any changes may also raise new issues such as the ability to contract out of the statutory scheme (see ABI Commission Report pp.78-79), and we are aware of specific issues around negotiation of invoice financing arrangements in administration which would benefit from clarification. We would suggest that the issues would, therefore, better be tackled comprehensively and in detail, once some of the ongoing research which the project is undertaking has been completed to inform the policy response.
A Review of the Corporate Insolvency Framework

response form


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

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):** Squire Patton Boggs (UK) LLP

**Address:** 7 Devonshire Square, London EC2M 4YH

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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?

Yes. We consider this will introduce a flexible restructuring tool giving companies an ability to restructure without the perceived inference of an inevitable insolvency procedure. During the moratorium, constructive discussions can be held with creditors which should enable more sustainable restructurings. If adequate protections for directors are included, then this should also encourage management to be proactive in seeking early advice prior to and during the moratorium.

We do however have some concerns including:-

a) the proposed length of the moratorium – in our view it should be a shorter initial period but subject to extension(s) with the approval of the court;

b) the lack of detail regarding the role of the supervisor (e.g. will the supervisor need to approve the application for a moratorium and confirm it meets the qualifying conditions? We are also of the view that the supervisor be a licenced insolvency practitioner;

c) the impact of the proposal on the courts;

d) should it be compulsory that secured creditors are consulted and consent to the process?

e) the costs associated with creditors having the right to request information from the supervisor at any stage;

f) that a company subject to an outstanding winding up petition should be excluded from the process – in our view, the existence of a winding up petition should not prevent the company seeking a moratorium;

g) the need for clarity of directors' duties and responsibilities in the moratorium period.

We address these concerns further below.

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?

Yes but creditors must be afforded the opportunity to challenge the moratorium in court.
We would also suggest the establishment of a live central register of moratorium filings, enabling creditors to search to ascertain whether a moratorium is in place. The register must be updated immediately upon a filing.

The filing and service requirements for the moratorium should be clear so that some of the issues which have arisen in relation to Notices of Intention to Appoint under the current administration regime are avoided.

We are of the view that challenges to moratoria would be minimised if it were a requirement that a licensed insolvency practitioner had to approve/verify that a company meets the eligibility and qualifying conditions and supervised the moratorium. The insolvency practitioner will appreciate the need to balance the interests of the company and its creditors and will have a duty to bring the moratorium to an end if it becomes clear that creditors’ interests are not being protected or if the company is not progressing a recovery or restructuring plan.

If a challenge is made to the moratorium, a speedy resolution of the application is necessary because the uncertainty in the meantime would be damaging to the business. Unless additional resources are made available in the courts, this could be a significant problem if court appointments are not available for 2 or 3 months.

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

Strict eligibility tests and qualifying criteria are needed to ensure the rights of creditors are balanced against those of the company and to guard against abuse of process.

We are not of the view that the proposed controls are sufficient. As drafted, directors of the company filing for moratorium protection are the arbiters of whether their company qualifies. This invites litigation and added pressure on an already stretched court system. We repeat that an insolvency practitioner should be required to verify eligibility and the qualifying criteria and be required to consent to act as supervisor before the moratorium is filed at court.

The primary eligibility test states that “the company must demonstrate that it is already or imminently will be in financial difficulty, or is insolvent”. The concept of ‘financial difficulty’ is not defined. We suggest a more prescriptive list of criteria would be useful to avoid the cost and distraction of creditor challenges.

The company must be able to show it will have sufficient funds to carry on its business during the moratorium. We suggest a requirement to provide cash flow forecasts for the moratorium period. In the current moratorium under Schedule A1 Insolvency Act, the proposed supervisor is required to provide
an opinion on the availability of working capital. This has posed significant challenges to proposed supervisors and that is why the Schedule A1 moratorium has not been used more widely. We recommend it be considered whether directors should be required to make a statutory declaration that their company meets the eligibility tests and qualifying criteria to enter the moratorium. The form of this declaration will need to take into account the uncertainty which may follow once a company’s creditors become aware of the moratorium.

We do not agree that a company subject to a winding up petition should be excluded from applying for a moratorium. This policy could result in a rise in petitions from creditors seeking to stymie the ability of a company to apply for a moratorium, thus allowing an individual creditor to frustrate the purpose of the moratorium to the detriment of the creditor body as a whole, whose interests might be best served by the company entering a moratorium and effecting a restructuring. In our view, companies subject to a winding-up petition should be allowed to enter a moratorium (providing they have met the entry criteria) but should be required to serve the petitioner immediately following the filing for a moratorium. The status of the petition should then be the same as in administration (i.e. suspended) and the application of section 127 Insolvency Act 1986 (void dispositions etc) should have no effect whilst the petition is suspended.

**Secured creditors**

Under current insolvency legislation, secured creditors enjoy a right of veto or step in over any insolvency process or creditor arrangement proposed by the Company. We envisage that the proposals will cause some concern in the secured creditor community but they are likely to be less concerned if (1) the length of the moratorium period is reduced and (2) it is made clear that, whilst creditor rights are suspended during the moratorium, if it fails the secured creditors’ rights under the existing legislation remains the same.

Consideration should be given as to whether there should be a requirement that the Company gives secured lenders a period of prior notice before any application for a moratorium, especially where the expectation is that trading will be funded by such lenders. This will ensure secured creditors are kept informed at an early stage and can properly assess the options.

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?

Yes to some extent. There are other factors that contribute to striking that balance, such as reducing the length of the moratorium, engaging early with creditors (including secured creditors), requiring that an insolvency practitioner both verifies and supervises the moratorium and can bring it to an end if in their view the moratorium is being abused.
Role of the courts

Creditors must be given the opportunity to challenge the moratorium in court once it has begun, but consideration needs to be given to the most effective way to do this. In our view the issues are (1) the likelihood of creditors being able to get a court hearing within the 28 day period; (2) how the costs an application will be paid/treated (particularly for smaller businesses) and (3) the fact that the onus is on creditors to challenge the moratorium filing, which could lead to several applications, creating multiple sets of application costs.

Without an increase to court resources, the right to challenge may be perceived as meaningless.

From the company’s perspective, challenges from different creditors may distract it from progressing a rescue plan and place a significant drain on already stretched cash resources. A more prescriptive set of eligibility criteria and verification/supervision by an insolvency practitioner could reduce the risk of challenge. To reduce challenges further (but to ensure a fair balance is maintained), there should be limited and defined grounds upon which a creditor is entitled to make such an application. Once a challenge has been issued by one creditor, this should be filed on the electronic moratorium register (referred to above) and no further challenges should be issued. Later creditors could support the first challenge issued.

A reduction in the length of the moratorium will be a key safeguard for creditors and reduce the need for court challenges. As such we are of the view the initial moratorium period should be shorter than proposed to reduce prejudice to creditors and also, any extension of the moratorium should be limited and clearly justified and the reasons for extension communicated clearly to creditors.

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

We consider that the 3 month proposed length of the moratorium with an open-ended extension (regardless of creditor approval) is too long and outweighs any creditor protections included in the proposal. A much shorter duration is preferable (say 21 days) and should be extensible only in specified limited circumstances (e.g. with court approval and on notice to secured creditors for up to 3 months or longer by agreement with 100% agreement of secured creditors and 50% agreement of unsecured creditors.)

There are a number of concerns if a minimum three month moratorium is introduced:

Costs of funding the moratorium period
In order to be able to fund a three month moratorium, companies may stop paying their suppliers for some time ahead of the moratorium, which will create a slush fund to enable the company to fund its restructuring, but make its creditors worse off as they will not be paid for these debts in the lead up to the moratorium nor during the moratorium itself. A shorter moratorium would reduce the need for such a slush fund and therefore reduces such a risk to creditors.

*Unsuitable for small companies*

A three-month moratorium is more likely to be suitable for large, complex companies but less relevant to smaller companies. In order to make the moratorium work for most companies, the initial moratorium should be much shorter than three months; larger companies could always apply for an extension if one is needed.

*Protection for creditors*

The longer the moratorium, the longer creditors are deprived of their recovery options and the more likely their interests could be damaged, either by actions of the directors or external influences.

A shorter moratorium makes planning cash requirements easier and there are fewer things that could go wrong in a shorter space of time. The effect of an early end to the moratorium would be reduced as fewer moratorium debts will have accrued.

The current proposed length of the moratorium has the effect that creditors wait at least an entire financial quarter before decisions are made about the future of the company. A much shorter moratorium period would be more palatable to the creditor community.

Smaller creditors (e.g. SME trade creditors) would be less capable of being able to absorb the financial impact on them of three months of uncertainty and restrictions on their ability to pursue debts.

*Barrier to entry – how do you fund a three month moratorium?*

We agree that, in order to qualify for the moratorium, the company must show they can fund trading during the moratorium. However, in practice this may be difficult as it is challenging for an insolvent or near-insolvent company to arrange funding for three weeks, let alone three months or more.

The moratorium would have much wider positive use if it was introduced with adequate safeguards and for an appropriate period of time. Early consultation with secured lenders should be encouraged where those lenders are required to continue funding during the moratorium. Lenders are more likely to approve funding where there is a shorter moratorium period and a clear restructuring plan subject to the supervision of a licenced insolvency practitioner.
Purpose of the moratorium

The purpose of the moratorium is stated as being to allow companies to ‘explore options’ or to ‘develop’ a plan rather than to actually implement a restructuring or rescue. To encourage a proactive approach in the moratorium period, there should be a requirement that the company must during the moratorium present a plan to creditors or implement a restructuring or rescue plan. A short moratorium with limited extension rights would require concentrated effort and a clear agenda to be followed.

For those companies considering a CVA, the purpose of moratorium would be to provide a very useful protection enabling CVA proposals to be put forward and discussed openly without the threat of immediate creditor action.

There should not be an open-ended extension

To ensure there is certainty amongst creditors, a shorter initial moratorium period with limited ability to extend should be considered. In our view there should in the legislation be a definite maximum period during which a company can benefit from a moratorium.

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

In our view, a licensed qualified insolvency practitioner should supervise the moratorium process. This will give creditors comfort that an independent, relevantly qualified and experienced professional who is charged with safeguarding their interests, is overseeing the company’s activities during the moratorium. Given the risks posed to creditors and suppliers during the moratorium, their interests should be represented by an individual who can be held accountable should things go wrong. To ensure creditor support, it is crucial that the moratorium supervisor is committed to protecting creditors’ interests, (rather than those of the company) in the moratorium and has a clear obligation to work on behalf of the creditor body as a whole.

The current proposal suggests allowing a solicitor or accountant with relevant expertise in restructuring to supervise a moratorium. However, it does not explain how a solicitor or accountant would prove that they had the relevant restructuring expertise. Licensed insolvency practitioners mostly have passed exams and are authorised by regulated professional bodies which in turn are regulated by the Insolvency Service.

The role of the supervisor

The supervisor’s duties and powers should be clearly prescribed and wide enough to ensure they have the ability to recognise when the company going to anything which is likely to harm creditors’ interests and bring the moratorium to an end to prevent it. Large transactions, those outside of the
ordinary course of business or involving a connected party should require prior approval by the supervisor.

In the event a formal insolvency process follows, in our view the insolvency practitioner who has acted as supervisor should be permitted to act as an Office Holder of the company provided there is majority creditor support for them doing so. The supervisor’s work with a company in a moratorium will give them a good understanding of the company, its market and its creditors, leaving them well-placed to act as the Office Holder in a subsequent insolvency, making it more cost-effective for them to act as Office Holder and keep the costs of a subsequent insolvency down.

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

We agree that (as with the position with post administration debts under the current administration regime), debts incurred during the moratorium period should be given priority although the proposal that any unpaid debts from a failed moratorium should be treated as a first charge in a subsequent insolvency, is likely to cause concern in the creditor community (including with secured creditors). Allowing moratorium debts to become a first charge would undermine creditors’ positions (e.g. secured creditors and unpaid pre-moratorium creditors who do not supply during the moratorium period).

The moratorium supervisor should be monitoring the credit incurred by the company during the moratorium period and should not delay bringing an end to the moratorium should things go wrong. Prompt action should prevent unpaid moratorium debts from building up to a significant degree.

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

We agree that the process should be transparent and that creditors must be given sufficient information to enable them to understand and support the restructuring or take appropriate action should they disagree with the proposed course of action.

It is important for creditors to be able to have access to information but an open ended right to request information may lead to the costs of the moratorium escalating. To encourage transparency and creditor support, it should be a requirement that the company is proactive in providing information at the outset and regularly update creditors. This could easily be achieved in a cost-effective manner by posting regular updates on websites or by email.

To avoid any abuse of this process and preserve value, companies should be allowed to withhold information which is of a commercially sensitive nature (which could affect the rescue of the company or its business). The supervisor
could be the arbiter of whether the information should be provided or could be withheld.

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?

As a general point, the revised Essential Supplies legislation only currently applies to a company which is in administration and does not apply when there is a moratorium arising as a result of filing of a Notice of Intention to Appoint Administrators. As a very minimum, the Essential Supplies legislation needs to be amended to ensure that it applies during an administration moratorium as this is an omission in the legislation which we have seen cause problems in practice.

We have seen a number of cases where a supplier not covered by the revised Essential Supplies legislation has impaired the viability of a restructuring, by refusing to continue supply or, in one case, preventing access to warehouse premises and the operating system to allow the company to access its goods. We therefore agree that (1) extending the definition of what supplies are “essential” will result in greater business rescues and (2) that the criteria as to what comprises an “essential” contract is appropriate. In the absence of a blanket ban on ipso facto clauses, it is the correct approach to permit the company itself to specify what is essential to its business because what is an “essential contract” to them will depend on the nature of their business. However, we fear that the implementation of the proposal as drafted will be burdensome and result in a number of challenges to court and given this, a blanket ban on ipso facto clauses should perhaps be given further thought, provided that relevant safeguards are put in place.

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?

The availability of a challenge to court is not, in itself, a sufficient safeguard for suppliers. In certain cases, the supplier may not have the resources to make such an application and the question as to how the costs of such an application will be met is not addressed in the proposals. The provisions relating to the insolvency related terms of a contract contained in the Essential Supplies legislation introduced in October 2015 provided for the
supplier to request a guarantee from an officeholder but we note reference to a guarantee is absent from the proposals.

**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?

Our view is that the restructuring plan would work better as a standalone procedure offering an additional procedure to existing insolvency options. Given the involvement of the court, it is a quite different procedure from a CVA and the two should be available as separate procedures. Whilst the proposal has certain similarities to a scheme of arrangement, a scheme is implemented under the Companies’ Act legislation and it would be useful to have insolvency legislation which specifically provides for restructuring as part of the insolvency options available.

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

There will be circumstances where, despite certain creditor opposition, the best outcome for the body of creditors as a whole and all stakeholders will be a universally binding restructuring plan, particularly where there are creditors who are already “out of the money”. The involvement of the court to sanction such a plan will be critical in the circumstances given the consequent interference with creditor rights that such a “cram down” will entail.

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

If implemented, the legislation should require that very detailed information must be put before the court to enable it to ensure it is “fair and equitable”. That must involve an in-depth review of the impact of the plan and its comparison to liquidation outcomes, given that it will have the effect of impairing the position of and interfering with the rights of a creditor or group of creditors. It is right that the court has to approve the classes of creditors proposed by the company and the underlying rationale as to why creditors fall into certain classes should also be provided for this purpose. Safeguards should also be built into the legislation to ensure that an affected creditor has a right in a limited timescale to raise a challenge as to the class they are placed in and the impact of the decision upon that creditor (along the lines of the material irregularity or unfair prejudice provisions which apply to CVAs).
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?

This is a challenging question because inevitably, when a company is suffering financial distress it is likely to be market related, which means that the value of its assets is likely to be impaired. As such, valuing its assets at the time of implementation of the restructuring plan is likely to be at a point in time when the value is most detrimentally affected. A requirement should be included that at least 2 valuations should be obtained and that if they result in a range of values, a middle point will be agreed as the minimum liquidation value. We recommend that the views of qualified and experienced valuation experts are also canvassed in this regard as issues of valuation are not within our area of expertise.

**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?

We are not of the view that a “last in first out” approach to rescue funding will encourage business rescue and it is likely that the implementation of such a proposal will impact negatively upon the availability of funding to businesses. In our experience, the existing secured lenders to a company in distress will make available funding (secured by its existing security) to enable the company to continue to trade. Alternative scenarios we have seen are that a rescue funder will (1) agree a position with the existing secured lender to take new security which has priority to a certain extent or (2) buys out the secured lender’s debt and takes an assignment of its security. Further, once in administration the administrators usually agree ongoing lending on a super-priority basis. We have not seen a situation where it was not possible for a business in distress to obtain rescue funding either in the run up to or during an insolvency process. As our experience is that a secured lender will either provide funding itself or negotiate with an alternative funder, negative pledge clauses are not prohibitive to alternative funding.

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

We recommend that the views of qualified and experienced valuation experts are canvassed in this regard as such issues are not within our area of expertise.

17) Which categories of payments should qualify for super-priority as ‘rescue finance’?
See our response to question 15 above.

**Impact on SMEs**

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

We are of the view that the proposed revised moratorium has the prospect of facilitating an SME’s recovery where there is financial distress and a solid underlying business which could be restructured outside of a formal insolvency process. We are not of the view that the proposed restructuring plan is likely to be of great assistance in promoting recovery for SMEs given the costs involved and the fact that most SMEs will have a simple business structure which will not have layers of different creditors. There are existing tools in the insolvency toolkit which are more suitable for SMEs – a wider use of CVAs as a restructuring tool is a cost-effective, time advantageous and efficient way of putting a restructuring plan to creditors which will enable the SME to compromise its debts in a consensual way with its creditors. A well-structured CVA proposal which guarantees a return to creditors whilst enabling the company to cut overheads and continue to trade is a win-win for all stakeholders involved with the SME. The new proposed moratorium would enable the SME to put a CVA proposal to its creditors in a breathing space free from the risk of precipitate creditor action. Alternatively, the small company moratorium under Schedule A1 Insolvency Act 1986 could be extended to apply to all companies seeking to put a CVA proposal to creditors, thus giving the affected company the time free of creditor pressure to take advice and put a well-structured proposal together that will increase its chances of being approved and succeeding in the long run. Our experience with CVAs is that the majority of creditors will participate when they can see that the outcome is better than an alternative insolvency procedure, although government departments such as HMRC will often not engage in the process, meaning that in situations where the debt due to HMRC is more than or close to 25% of the company’s debts, the CVA will not get approved, even if the return under a CVA is demonstrably better than in an alternative insolvency procedure.

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.

Given the recent vote to leave the EU, we consider that government focus should be on reaching agreement in relation to the European cross border insolvency position and ensuring the current recognition and cooperation mechanisms amongst Member States are preserved and, where required, improved.
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  X

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?

X☐ Yes  ☐ No
A Review of the Corporate Insolvency Framework
response form


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

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:

The views given in this response are personal to the writer and not necessarily the views held or adopted by Stephens Scown LLP
Questions

Name: Andrew Knox

Organisation (if applicable): Stephens Scown LLP

Address: Curzon House, Southernhay West, Exeter, Devon, EX1 1RS

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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?

Yes.

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?

Yes, but only if the Court is able to properly engage with the process. For example, the commercial need to put in place a moratorium may not sit with County Court appointment times; assuming that an appointment can be made swiftly. The problem being that outside of the High Court or the Chancery District Registries, the County Courts tend to be unfamiliar with corporate insolvency processes. This increases cost, causes delay and creates uncertainty and confusion – exactly what the moratorium process is seeking to reduce. There will need to resources devoted to properly training Court staff to ensure that the aims of the moratorium initiative can be delivered.

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

Yes, up to a point. A reading of the proposal appears to infer that a proposed moratorium supervisor will step into the role with full information presented in a timely and coherent manner. Unfortunately, it is often the case with a company in financial distress that one cause or symptom of that financial distress is the quality or condition of the company’s accounting and financial information. If the company has to work to “get its house in order” before it can apply for a moratorium it might discourage the up take of the procedure because the commercial pressures on the business does not allow it that time. This is especially so if the company has to demonstrate the prospect of an accommodation with creditors when it may not have been in a position to even start those discussions.

If the company needs to enter a moratorium ‘now’ then it would seem the only real alternative is to file of notice of intention to appoint an administrator notwithstanding that the company may be capable of demonstrating it could exit the moratorium as a going concern. Whilst it is quite right that the moratorium should not be used just to enable failing companies to postpone the inevitable, if too much of a polished plan is needed in order to apply for a moratorium then it is unlikely to be taken up in any great number.

Would it perhaps be better that the moratorium is a two-stage process similar to an individual seeking the protection of an interim order in support of an
IVA? i.e. a short period (say 21 days in line with R3’s recommendation) can be obtained by filing preliminary information and the moratorium is then only extended if it can be demonstrated that there is a reasonable prospect of a compromise with creditors. This way may then allow some evidence to be gathered that creditors are supportive, or at the very least, not in opposition to the moratorium.

I suspect that eligibility tests and criteria will largely be influenced by creditors who have the ability to influence the company’s rescue or otherwise. For example, HMRC tend to be the largest creditor in the majority of SME insolvencies. It is postulated that HMRC might apply a similar policy to moratoria consideration as currently applied CVA’s – namely detailed conditions upon which support is conditional and “standard modifications” to the proposal. It might be that HMRC, or any other large industry specific creditor sets a series of criteria which is adopted as ‘standard practice’ for moratoria proposals thus setting standards by which creditors or suppliers feel protected.

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?

With some further work then yes. For example, the consultation paper says nothing about amending section 240 of the Insolvency Act 1986 to take into account entry into a moratorium in the calculation of the ‘relevant time’ for the purposes of sections 238 (transactions at undervalue), 239 (preferences) and section 245 (avoidance of certain floating charges). It is conceivable that a company spends time in a moratorium and the ‘onset of insolvency’ is delayed past the relevant period so that any subsequent claim by a liquidator or administration is frustrated.

In addition, given the similarity with the CVA moratorium, it would appear appropriate to apply similar provisions to section 6A Insolvency Act 1986 (False representations) and paragraphs 41 and 42 of Schedule B1 to the Insolvency Act 1986. This would help focus directors’ minds and give creditors faith in the procedure.

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

As set out above at paragraph 3, I would suggest that there is a short-term interim moratorium which can then be extended on satisfaction of certain conditions. In addition

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

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

In an administration the assets are under the control of the administrator who has power (subject to restrictions in the Insolvency Act 1986) to deal with those assets in order to meet expenses. The administrator is therefore personally liable to meet the shortfall if the expenses exceed the assets available to meet them. Here it is proposed that the directors remain in control of the company (as with a CVA). However, unlike a CVA where expenses are met through a defined monthly contribution, there appears to be no mechanism to ensure that the company meets these sums (including the supervisor’s remuneration and expenses) as an ‘expense’ within the meaning given in the Insolvency Act. Unless there is some means to secure payment it may discourage Supervisors from taking up appointments.

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

Yes, creditors should be able to request information as the moratorium process envisages co-operation between creditors and the company. Trust cannot be built without communication. However, there needs to be a balance struck between excessive demands (in term of time, quality/detail, and quantity) and allowing the supervisor to get on with the aim of the moratorium. A provision similar to Rules 1.3(4) or 2.30 or 2.33(3) Insolvency Rules 1986 could be included so as prevent disclosure of seriously prejudicial commercial information or information exposing a person to risk of violence.

**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?**

What is essential to one business is going to be less essential to another. Is continuation of an agreed overdraft limit an ‘essential contract’ from a supplier (of working capital)? Equally, if an essential supplier holds a personal guarantee or other security for its debt should that preclude the supplier from given special status?

Without knowing how many businesses have failed because an essential supplier has declined to continue to supply it is very difficult to answer the
second limb of the question. I would say, probably not, because the company is likely to have tried to manage its cash-flow in order to preserve continuation of essential supplies. If it has not been able to achieve this then it casts doubt on whether the company would qualify for a moratorium in any event. Again, I think it will be a commercial decision by the supplier to assist or not over any stipulation as proposed.

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?

A more effective way would be for bonding or insurance to be put in place. The Court procedure would require the supplier to incur legal costs (which it might not recover, even in the event of success) on top of the supplies it has to make.

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?

As understood, the proposals are to engage a swift, but reviewable, breathing space to assess whether or not a company is capable of rescue. To include there provisions into the CVA legislation appears to take away some of the benefits and aims set out. Therefore, to maintain flexibility and benefit to the widest range of companies as possible, the procedure should be standalone.

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

No, because of the likely court time involved in dealing with the inevitable dispute. If the aim is to make Scheme of Arrangement type procedures more accessible and relevant to SME’s then this will keep the matter too cumbersome and cost-prohibitive.

13) Do you consider the proposed safeguards, including the role of the court, to be sufficient protection for creditors?
If the ‘no creditor worse off’ approach is taken and the focus remains on those creditor who are properly ‘in the money’, then yes

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?

Yes.

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?

Yes they should. Making rescue finance more attractive for lenders to offer would increase the market for it and therefore it is likely that it would be used more.

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

It could be valued using the definition of ‘market value’ given in paragraph 111 of schedule B1 to the Insolvency Act 1986.

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

If the proposals relating to essential suppliers are adopted then it would make sense that any funding applied to these creditors attracts super-priority. This may also ease some of the tensions that an essential supplier may bear if it is compelled to supply. It may make suppliers more willing to assist. In addition, wage payments to staff should attach super-priority

Impact on SMEs

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

Nothing that I can presently think of.
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 X

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?

X Yes  □ No
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Comments:
Questions

Name: Jeff Longhurst
Organisation (if applicable): Asset Based Finance Association
Address: 20 Hill Rise, Richmond, Surrey TW10 6UA

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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 ABFA does not offer comment on the Impact Assessment as it does not support the broad thrust of the proposals.

However the ABFA feels that it has an important perspective on these proposals as a whole, given the industry’s role in providing significant funding to SMEs and, in particular, Members’ abilities to provide significant support to client businesses in times of distress, restructuring, recovery or even during insolvency processes. Details of the association, its Members and the products they provide follow below.

About the Asset Based Finance Association

The Asset Based Finance Association (“ABFA”) represents the invoice finance (factoring and invoice discounting) and asset based lending industry in the UK and Ireland. The industry supports businesses in the real economy and has particular expertise in working with SMEs.

The ABFA is a representative association. The ABFA’s objectives are to develop and support professional standards within the industry and to inform and engage with stakeholders on the types of finance provided by the industry.

About Asset Based Finance

Asset based finance products are an important source of finance for SMEs that sell goods and services business to business, and also increasingly for larger corporates. These products unlock working capital tied up in outstanding book debts and other assets, releasing funding for growth and investment.

At the end of 2015, ABFA Members were advancing over £19 billion to over 43,000 clients in the UK and Ireland. ABFA Members supported clients with a total turnover approaching £300 billion. The latest statistics for the industry accompany this contribution and historical information is available at: www.abfa.org.uk/members/statistics.asp.

Invoice finance

ABFA Members provide finance to client businesses against the assets held by the client. For many businesses, the most significant of these will be the debts owed to the business by their customers, as represented by its unpaid invoices, hence the term invoice finance is often used. Around 90 percent of the finance provided by the industry is against debt in this way.

In providing invoice finance, the funder would normally purchase outstanding debts, providing a prepayment of up to 90 percent of the value of the debts immediately with the remainder, less fees, paid to the client on payment by the debtor. The principal invoice finance products are factoring and invoice discounting.

Factoring is the most widely known invoice finance product although it delivers only a small proportion of the total funding from the industry and supports less than half of current clients.
A factoring arrangement normally combines funding advanced against the outstanding debts with credit management services, with the factor collecting the funds owed by the client’s customers. Hence a factoring arrangement would normally be disclosed to the customers of a client and for this reason it remains the most prominent and widely known product.

Factoring is considered to be a good product for smaller businesses that may be experiencing a shortage of working capital and that may benefit from the specialist credit management services provided by a factor.

In an invoice discounting arrangement, funding is also advanced against outstanding debts but the client will normally manage its own credit control. Hence with an invoice discounting arrangement the (client’s) customer (the ultimate debtor) will not always be aware that a supplier is supported by an external finance provider.

The majority of invoice discounting facilities are confidential and it tends to be a good product for larger SME businesses that would benefit from access to greater working capital but do not need the additional credit control expertise provided by factoring.

Both factoring and invoice discounting can be provided in conjunction with credit protection to protect the client against risks of bad debts (it is sometimes referred to as bad debt protection).

The majority of the funding by volume is delivered through invoice discounting facilities, with invoice discounting estimated to account for 80 percent of total funding from the industry. In recent years invoice discounting has also overtaken factoring in terms of numbers of clients supported as well. Nonetheless, factoring remains an essential product in supporting smaller businesses and is often able to do so to an extent not possible through other types of finance.

It should be noted that factoring and invoice discounting will both be normally provided on the basis of debt purchase and, strictly speaking, are not types of lending. The economic function is largely the same but the legal basis is quite different.

**Asset Based Lending**

Some ABFA Members will also provide finance against other assets held by a client business. With an asset based lending (ABL) facility, funding can be provided against a wider mix of assets (additional to debts) which could include plant, machinery, property, stock and also potentially against intangible assets such as brand, intellectual property and forward income streams. (This is normally lending in the true sense.) ABL is the most rapidly developing sector of the industry and tends to be a more viable option for client businesses with a wider pool of assets.

**Product strengths**

The industry is able to support clients businesses during periods of growth and also through more challenging times; it continued to support clients throughout the financial crisis and economic downturn and is providing more funding than ever before, although growth has been relatively modest in recent years.
In making a funding decision an asset based finance provider would consider the financial standing of the client business including, importantly, the strength of its debtor book and other underlying assets.

Whilst the perceived loss of ‘relationship banking’ is lamented, the asset based finance industry is inherently focused on client relationships; by developing a more comprehensive view of the client - based on knowing the business rather than just looking at its accounts once a year - an asset based finance provider can often support the business to a greater extent than might be possible through other types of funding. Indeed, in some circumstances they may be able to provide finance when other sources are unavailable. This is one of the industry’s comparative advantages over other types of finance.

The products can also bring a focus on, and rigour to, the administration of sales and credit control processes that many clients welcome or benefit from.

No form of finance is right for every business and asset based finance will not be appropriate for every business in every circumstance. However if a business requires working capital and support managing its cash-flow, needs sustainable finance that keeps pace with its development or is looking to release cash for growth, there are arguably few better products available.

Because it is finance against an asset, albeit a fluid and changeable one it is comparatively low risk for providers and so is particularly suitable for businesses in distressed situations, in the process of restructuring or even in recovery. It is likely that even in the event of Administration an asset based finance provider can continue to support the business (Administrator) during the Administration.

**Industry landscape**

The industry is defined by the products not the institutions providing them and the membership of the ABFA is varied. It includes the specialist arms of the UK and Irish high street banks, a number of specialist and challenger banks, the specialist businesses of some overseas banks and large corporates, as well as a number of independent non-bank finance providers. A full list of Members is available at: [www.abfa.org.uk/members/memberslist.asp](http://www.abfa.org.uk/members/memberslist.asp).

Some Members such as the larger banks will provide the full spectrum of products from factoring through to asset based lending. Some smaller providers specialise in factoring and invoice discounting for clients that do not wish to, or are not able to, access funding from the high street banks. Other providers will specialise in providing higher-end bespoke funding facilities to larger corporates.

The diversity of the industry is important; whilst around 75 percent of the total funding advanced by the ABFA’s Members in the UK came directly from the ‘Big Four’, the proportion of client numbers is smaller, and the industry outside the UK high street banks is particularly important in supporting smaller businesses. (It

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1 It should be noted that ABFA Membership does not include the peer-to-peer invoice auction platforms which are often described as providers of ‘invoice finance’.
should be noted, however, that many of the banks retain a strong focus on the ‘S’ segment as well.)

The industry and the products are dynamic with technology playing a significant role in enabling new entrants and facilitating the development of composite products. As such it is difficult to provide an exact proportion of the industry represented by the ABFA but it is estimated to be around 95 percent of providers. It is estimated that the ABFA’s Members will be providing a similar proportion of the total funding being delivered by the industry.
The Introduction of a Moratorium

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

No. We question why it is needed and what ills it seeks to redress.

Although the proposals are to assist businesses which are viable, we are concerned that the moratorium will be abused by businesses to buy time with creditors or act for the benefit of specific creditors where there is no prospect of the businesses continuing as going concerns.

As proposed, the moratorium suggests allowing the directors to continue to trade the business with no requirement for court approval of a rescue plan and merely a light touch by any ‘supervisor’. This leaves the use of a moratorium open to abuse by the directors either deliberately, recklessly or carelessly. Incompetent directors must have a qualified insolvency practitioner to control their actions.

If a business has Directors or shareholders who have been involved in insolvency proceedings of any kind in the previous twelve months or who have been previously disqualified it should not be eligible to enter into a moratorium.

A moratorium should be considered only if there is a clear restructuring plan which changes the business model of the distressed company to take it from its evidently current non-viable model into a viable one.

We do not feel that a moratorium should be an option for all businesses – for reasons of abuse, cost and complexity amongst others - and the current proposals may not be the most suitable in all their facets particularly with regard to smaller businesses.

Neither do we agree that three months is the right length of time. It is considered to be far too long - not least because an additional three months on top of the arrears already likely to be outstanding makes a very long time for some smaller suppliers to go without payment. That additional delay might itself precipitate the failure of those suppliers.

Use of the moratorium as proposed increases the risk of failure within the supply chain or becomes unworkable on the basis that the business’ suppliers’ can’t continue to supply because of their own financial circumstances or because their own funders / credit insurers decline support for new debt.

Use of a moratorium by smaller businesses may cause sums available to creditors to be reduced or delay more appropriate options such as prepacks and CVAs.

We are further concerned by the shift in emphasis in obligations and costs under these proposals from a distressed business to its creditors (see 4 below). This seems particularly inappropriate given that creditors are not responsible for the
position in which the distressed company finds itself. Creditors are merely unfortunate enough to be dealing with a business which is in distress but will have their position eroded and diminished by delays, costs of applying to court for enforcement of their rights and removal of the moratorium etc.

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?

No.

Merely filing at court is not sufficient to provide adequate notice to creditors that the distressed business has entered into a moratorium. In addition to notice to all creditors once an application is made, consideration should be given as to whether there should be an obligation on the part of the distressed company, the directors and the supervisor to advise all secured creditors of the intention to enter into a moratorium in advance. This would ensure that these creditors will support the moratorium if approved and will ultimately save court time and expense.

In addition to sending a copy of the application to all creditors, details of the application should also be filed at Companies House which will ensure that credit agencies and insurance companies (providing credit insurance) become aware and circulate information to users accordingly.

And relief should only be granted if the proposal for restructuring the business is prepared by a qualified insolvency practitioner and subject to our comments in 1 above regarding size of business, etc..

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

No.

The proposed eligibility test is too broad and, as the consultation concedes, viability is a commercial judgement dependant on the circumstances of each case. It is not clear from the proposal whether the court would decide on whether the business is viable or merely whether the conditions as to exclusions and filing are met. If the latter the onus seems to be on the business to itself decide whether it is viable and if the latter then the court has to determine whether that conclusion by the business is correct. Is there sufficient court resource and experience to decide on these issues?

Will a recovery/restructuring plan be part of the details filed? It must and the proposed Supervisor must confirm support for the proposal. This would ensure that a person with commercial understanding has assessed the proposal before submission to the court.
We believe that this proposal should be restricted to businesses of a certain minimum size – it is complicated, costly and imposes restrictions on creditors which are inappropriate and unfair to smaller businesses. Restrictions should be imposed based on size of turnover. A starting point could be that the business must be at least a mid-sized business i.e. must have a turnover greater than £25m.

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?

No.

As highlighted above we believe that the rights of creditors are severely disadvantaged by this proposal which fails to safeguard their interests and places the onus on them to challenge the moratorium through the courts which will incur costs which they should not have to bear.

There are no safeguards in place for suppliers which themselves may be forced into insolvency procedures because of the delay in payment. There should be a “means test” available for smaller creditors to show that they can’t survive three months’ delays in payment.

Suppliers of “essential” supplies are forced to continue to trade with the business and although there is a provision that if payment of debts is not made on time they can cancel or alter the contract by then it will be too late as the creditor will have already made additional supplies, thereby increasing its exposure.

Many creditors will have been trading with distressed businesses because they had credit insurance in place. What will happen in a moratorium when credit insurance is no longer available?

There should be additional sanctions as described in the proposal but we have severe reservations whether these would be sufficient to deter unscrupulous or unsophisticated directors from putting creditors in a substantially worse position.

If a business has Directors or shareholders who have been involved in insolvency proceedings of any kind in the previous twelve months or who have been previously disqualified it should not be eligible to enter into a moratorium. There should be additional restrictions too such as there being no overdrawn directors’ accounts at the time of the moratorium proposal.
5) Do you agree with the proposals regarding the duration, extension and cessation of the moratorium?

We do not agree that introduction of a moratorium is necessary.

If it were to be introduced then as outlined above three months is far too long for SMEs to manage and too long for creditors to have to wait.

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

The Supervisor must have restructuring experience, should be a qualified Insolvency Practitioner and his or her suitability must form part of the court’s approval process. Alternatively, secured creditors, who after all have the right to choose an Administrator in an Administration, should be able to approve or otherwise the choice of Supervisor.

The Supervisor of the moratorium should not be prevented from taking an appointment in a formal insolvency. Indeed we consider that there will be cost and familiarity benefits in a smooth transition handled by the same insolvency practitioner who is familiar with the case. Creditors will, after all, have the ability to determine whether they wish the appointee to act in any formal insolvency proceedings as they have now.

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

An expectation of costs should be contained in the application and the Supervisor’s fees limited in the same way as they are in Administration proceedings.

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

The same information that is provided to the court prior to approval – details of the plan for restructuring the business as approved by the Supervisor – should be provided to Creditors on commencement or at least within seven days thereof. Creditors have a period of 28 days in which to apply to the court to have the moratorium set aside and need to have sufficient information on what the advantages and disadvantages of the moratorium would be and to judge for themselves the viability of that plan succeeding.

If creditors are able to request information as and when, this could cause significant workload for the Supervisor. A requirement that the Supervisor provides an update after the first 28 days (within 14 days thereof) should ensure
that creditors are kept informed of progress. Creditors should then be updated every calendar month.

The Supervisor should also be required to immediately advise creditors of failure of the Moratorium.

**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?

The potential removal of ransom payments must be applauded. However it is vital that only truly essential contracts are so designated.

We support the considerations in clause 8.15 which must be taken into account in determining whether a contract is essential.

The status of the supplier and the terms of trade should be considered too. Larger suppliers may find it easier to continue to supply over a longer period than smaller which may have had their prices squeezed by the insolvent business and should prefer to no longer supply, particularly if they have suffered significant loss as a consequence of the business’ insolvency.

The position of finance providers as essential suppliers must be considered. Overdraft provision, Asset Finance, Invoice finance and asset based lending might be considered essential supplies. Continuing to provide finance during a moratorium could severely disadvantage these suppliers of finance and so if they are nominated as essential suppliers there should be provision that the finance provider should not be obligated to increase its exposure during the moratorium. Continuation of supply of finance might also require that the providers obtain super priority in respect of finance during restructuring and insolvency processes under 10.16.

Factoring providers also provide collection expertise which would be vital for ensuring that customers of distressed businesses continue to pay on time.

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?

Again, we have a concern that designation is in the hands of the company in the event of a moratorium and that the burden of the costs of objecting are placed on the creditor. We suggest that the supervisor should approve a company’s recommendation.
Payments must be made pro forma.

Suppliers who rely upon credit insurance are likely to find themselves without cover or regarded as failing to act as a “Prudent Uninsured” which would be a breach of the terms of their policy. What provisions will there be to support these businesses?

**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?

We question whether in fact there are existing processes which might allow for the aims of this proposal to be met already, but if implemented it seems sensible to use the existing CVA procedure and add it in as an extension.

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

Protection of the exposures of secured creditors are paramount if the increased risk is not to have an effect on the cost and availability of finance.

Creditors must decide whether the restructuring plan is viable and whether they agree with its proposals.

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

It needs to be the High Court with decisions made by judges who understand the implications of their decisions.

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?

Liquidation value might be considered to be too low as this might put too many classes out of the money.

Distinction needs to be made too between the position of classes in voting and their position in the event of realisations being higher than anticipated. They should not be disadvantaged.
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?

We believe that there are sufficient options available to businesses within the current framework to facilitate a rescue finance package without the need for creation of super priority.

The current insolvency regime allows secured lenders the comfort of knowing that in the event of insolvency they will have first charge over the asset against which they have advanced. To change this situation would lead to traditional funders becoming more reluctant to provide finance to newer and less financially stable businesses and would increase the costs of finance.

So we must start from the principle that secured creditors should not be placed in a worse position than they would have been had rescue finance not been utilised.

Existing providers of finance – particularly those such as providers of invoice finance and asset based lending – will usually continue to provide finance during periods of insolvency and restructuring. They will be discouraged from funding during these periods if they were concerned that another funder could outrank them in a recovery. So if the proposal is to create a super priority class then it should be extended to those funders pre insolvency which continue to support post insolvency or moratorium.

Where a negative pledge is in existence on a charge and it can be shown that further finance can be provided without prejudicing the position of the charge holder then the court should be able to adjudicate on a proposition put before it to avoid that negative pledge. But the charge-holder’s position should not be subordinated to that of the new funder.

To obtain a first charge over the asset or super priority the new funder should pay out the old to clear out its exposure.

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

Although a court should be able to void a negative pledge the new funder should not outrank the former or should buy the in situ funder out. So the question of valuation can be left to the market. The new funder would need to value the asset as part of its decision to lend and or clear out the previous charge-holder in competition with other funders.
17) Which categories of payments should qualify for super-priority as ‘rescue finance’?

We do not support the principle of super-priority.

Impact on SMEs

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

The ABFA does not believe that the moratorium proposals should apply to SMEs because of the cost implications and the potential for abuse. CVAs provide sufficient opportunity for potentially viable companies to continue to trade whilst Prepacks ensure that companies which fail but which have a viable business can continue in another form.

The ABFA would like to see termination clauses on larger customer contracts prohibited if trading continues in administration or in a CVA where that customer could be considered an “essential” customer for an SME. This would have the dual impact of ensuring that the SME has sufficient sales volume to continue to trade in a CVA and also that customers cannot raise excuses for non-payment by reason of non-completion of contract if the Administrator continues to complete the work.

Removal of liquidated damages clauses would also ensure that large customers cannot hide behind this clause and refuse to pay a customer in insolvency. We would be pleased to discuss the negative impact of liquidated damages clauses in greater detail.
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
Bar Council response to the BIS ‘Review of the Corporate Insolvency Framework’ consultation paper

1. This is the response of the General Council of the Bar of England and Wales (the Bar Council) to the Department for Business, Innovation and Skills consultation paper entitled A Review of the Corporate Insolvency Framework.¹

2. The Bar Council (respondent type: professional body) represents over 15,000 barristers in England and Wales. It promotes the Bar’s high quality specialist advocacy and advisory services; fair access to justice for all; the highest standards of ethics, equality and diversity across the profession; and the development of business opportunities for barristers at home and abroad.

3. A strong and independent Bar exists to serve the public and is crucial to the administration of justice. As specialist, independent advocates, barristers enable people to uphold their legal rights and duties, often acting on behalf of the most vulnerable members of society. The Bar makes a vital contribution to the efficient operation of criminal and civil courts. It provides a pool of talented men and women from increasingly diverse backgrounds from which a significant proportion of the judiciary is drawn, on whose independence the Rule of Law and our democratic way of life depend. The Bar Council is the Approved Regulator for the Bar of England and Wales. It discharges its regulatory functions through the independent Bar Standards Board.

Overview

4. The Government is here proposing and seeking comment upon a new way of establishing a “breathing space” for distressed companies. The proposed procedure will establish a moratorium for trading companies of all sizes with the exception of companies, generally those trading in the financial markets. The intention is to introduce a 3-month (but extendable) moratorium to enable refinancing steps to be promulgated and established. During the moratorium, the company will be under the control of the board but with an independent supervisor. The moratorium procedure would be initiated by the issue of proceedings in Court and the Court will be in overall control of the moratorium.

¹ the Department for Business, Innovation and Skills 2016, A Review of the Corporate Insolvency Framework consultation paper
The Introduction of a Moratorium

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

4. The Bar Council considers that this will be a very useful addition to the general armoury available to companies in financial difficulties. The standalone gateway will provide a very useful method of enabling companies in difficulties to achieve a breathing space.

Question 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?

5. The Bar Council considers that a filing in Court will permit a company to act swiftly and in the interests of its creditors and shareholders where the need arises. However, care must be taken to ensure that, where necessary, the Court(s) involved must be in a position to respond quickly and appropriately to the initial application. In relation to this, the High Court can move very swiftly when necessary; other Courts are less able to do so.

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

6. The Bar Council considers that, save for one point, the proposed eligibility tests and qualifying criteria do provide appropriate protection for suppliers and creditors. The exception to which we refer above affects the suggestion in paragraph 7.20 that the procedure should not be available to any company which is subject to a winding up petition. On the basis that no winding up order has been made, we can see no reason why the fact of the existence of a winding up petition should preclude a company proposing a moratorium. Indeed, there could be circumstances where the existence of a winding up petition will “hold the ring” pending an application to propose a moratorium.

7. Further, the Bar Council considers that it would be appropriate to provide within the legislation for a review of how the proposals are working after 2 years so that if there are matters which require change or fine-tuning, those steps may be taken.

Question 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?

8. Yes.

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

9. The Bar Council is concerned that the proposed duration and extension of the moratorium may not, in some cases, provide sufficient time for plans to be put in place and
would prefer to see more flexibility in that regard, particularly as the proposals are intended to be available to companies of all shapes and sizes.

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

10. Yes.

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

11. Yes.

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

12. The Bar Council considers that as the current proposal is intended to be available for all businesses, save in broad terms financial institutions, creditors should be entitled to seek and obtain information subject to the points raised in paragraph 7.48 of the Consultation. The Bar Council considers that, ideally, there should, particularly in the case of larger companies, be a creditors’ committee through which all creditors should be able to seek information from the supervisor if the creditors’ committee considers it appropriate.

**Helping Businesses Keep Trading through the Restructuring Process**

**Question 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?**

13. The Bar Council is concerned about the fact that “essential contracts” will cover a wide variety of circumstances, each going to be different in individual cases. However, provided that the criteria listed in paragraph 8.15 of the Consultation are followed, the proposal to extend “designated contracts” is sensible.

**Question 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?**

14. Yes

**Developing a Flexible Restructuring Plan**

**Question 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?**

15. The Bar Council considers that it is sensible to provide the restructuring plan as a standalone procedure rather than an extension of some other procedure. At least initially the Court is likely to be kept, we consider, quite busy working through the detail of the proposed restructuring and the procedure should be kept separate. It may be that in due course, once...
Question 12: Do you agree with the proposed requirements for making a restructuring plan universally binding in the face of dissent from some creditors?

16. Yes. The purpose of the restructuring exercise is to assist in the rescue of the whole or part of a business. Without binding in all affected creditors it must be unlikely that a rescue would be achieved.

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

17. Yes.

Question 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?

18. The Bar Council considers that this is the hardest question to answer in the Consultation. The question of how to value liabilities will depend very much upon the circumstances of the particular company under consideration and the circumstances of the market of which that company forms part. Whilst it may be possible to provide for a “minimum liquidation valuation”, the law should also provide what is to happen, as regards voting on and/or being bound by the moratorium where the valuation is “zero”. These creditors will need still to be bound into the moratorium.

Rescue Finance

Question 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?

19. The Bar Council consider that, as part of a culture intended to assist in the rescue of a company in difficulties, the providers of necessary finance should be given the opportunity to gain a “super priority” where secured creditors of the ailing company are not prepared to provide further assistance. The Bar Council recognises that this proposal represents a distinct change in culture for rescue attempts, but can see no other option if further finance is to be provided, particularly in circumstances where the timescale is relatively short.

20. The Bar Council also recognises and would not wish to underestimate the difficulties attached to the question of valuation which is the subject of question 16, below.

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

21. The Bar Council considers that the value to be attributed to property should either be agreed between the relevant charge holders and the supervisor or, if that is not possible within
a relatively short space of time, the matter should be aired before a Court which should have power to fix the maximum value to be attributed to the property the subject of the charge.

22. Alternatively, those proposing to provide the rescue finance should be given the opportunity to buy out or otherwise deal with the charge holders in order to enable rescue finance to be provided.

**Question 17:** Which categories of payments should qualify for super-priority as ‘rescue finance’?

23. The definition of “rescue finance” should be left flexible. As the discussion paper makes clear, it could take various forms. The Bar Council suggests that the supervisor should explain in a report to the Court what will constitute “rescue finance”. This report should define the “rescue finance” very tightly but leave the supervisor with the opportunity to return to the Court to broaden the definition as necessary.

**Impact on SMEs**

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

24. The Bar Council has no particular proposals to put forward to promote the recovery of SMEs.

**Question 19:** 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.

25. The Bar Council has no other comments to add.

**Bar Council**

06.07.16

_For further information please contact_

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2 Prepared for the Bar Council by the Law Reform Committee
Consultation on a Review of the Corporate Insolvency Framework

1. This is the response of the judges of the Chancery Division of the High Court. The working paper was prepared by two judicial members of the International Insolvency Institute who between them regularly participate in international judicial colloquia, work with the World Bank and with UNCITRAL, and have recent practitioner experience in the relevant areas: but it has been considered and endorsed by the Chancery Judges.

2. It is not our role to comment on the policy aspects of the Review but drawing on our experience we would make five preliminary comments:-

   a. The English and Welsh jurisdiction has a very high international standing for striking a notably fair balance between “creditor friendly” and “debtor friendly” approaches to restructuring and insolvency. At a recent global conference in Tokyo some delegates from other jurisdictions were surprised that disturbing this balance was under consideration. The introduction of “debtor friendly” measures will need to be balanced by effective supervision and ready access for creditors to the courts if our present international standing is to be maintained.

   b. For every business that is protected from claims by creditors there are significant numbers of creditors whose own businesses are put in jeopardy by inability to recover debts. It is all too easy to think of “the creditors” as being well-capitalised banks or utility or other suppliers. But sight must not be lost of the small trade creditor or labour-only contractor for whom a further three month delay in recovering an already overdue bill may have very serious cash flow implications that might precipitate insolvency.

   c. Whilst a desire to raise the United Kingdom in World Bank rankings is understandable it must be appreciated that these rankings turn on the perception of a single institution (albeit a respected one) about the desirability of certain technical features. The taking of “the best from
everywhere” (as some of the newer “off shore jurisdictions” have done) does not necessarily lead to a coherent and balanced system. Moreover some countries that rank highly in relation to the return to creditors through insolvency processes do so precisely because they do not offer a range of flexible restructuring options, but simply recycle assets through liquidations by officeholders who are paid a commission on realisations.

d. The approach of the English courts to questions arising in insolvency and restructuring has hitherto been to leave commercial judgments as to how best to rescue companies or their businesses to those insolvency practitioners who are qualified and experienced enough to make them, and to resist turning commercial questions into legal issues. In many overseas “debtor-in-possession” regimes, the courts (whether specialist bankruptcy courts or otherwise) become involved in overseeing and resolving the most minute commercial questions. Based upon the experience of lawyers and judges in other jurisdictions we have substantial concerns that such changes will simply lead to greater expense and delay, and may not be consistent with the accepted role of the English judge in resolving legal disputes.

e. If there is to be any increased availability of “debtor-in-possession” procedures, these must of necessity be balanced by a ready access for creditors to the courts. In order to be workable and to avoid a waste of time and costs, it is vital that the issues to be decided by the courts must be clear legal and/or factual issues. It is therefore imperative that the implementing legislation must use concepts that are much more clearly defined than those employed in the Review and within mechanisms that are much more tightly drawn.

**The Moratorium**

1. **Do you agree with the proposal to introduce preliminary moratorium as a stand alone 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?

3. We consider these questions together because they are so closely interrelated. The introduction of a “stand alone” moratorium is a policy matter on which we do not comment. The fairness and workability of its implementation depend upon the definitions of the conditions for entry, the scope of the moratorium, its duration, its supervision, and the redress available to those affected by it.

4. As to the conditions for entry, the proposed moratorium is a unilateral act of a company which “is experiencing or anticipates imminent financial difficulty”. To use it otherwise e.g. to frustrate court proceedings or to secure commercial advantage in the renegotiation of a contract, would be an abuse of process. It is therefore essential that the circumstances in which the relief can be invoked are clearly defined, that the conditions for entry are such that it can be clearly demonstrated that they are satisfied, and that creditors can have confidence in the person or persons making the judgment.

5. We do not consider that the anticipation of imminent financial difficulty provides a sufficiently stringent test. A test that the company “is or is likely to become insolvent” employs a defined, effective and well-known statutory test of insolvency and the need publicly to acknowledge this state of affairs will deter abuse.

6. It is proposed that a company may only enter a moratorium if (a) it has a reasonable prospect of remaining viable as a going concern and (b) is likely to have sufficient funds to carry on its business during the moratorium, meeting its obligations as and when they fall due. These are both questions upon which directors are notoriously over-optimistic (as our experience of wrongful trading cases and failed CVAs demonstrates). To retain the confidence of creditors, before a company enters into a moratorium it ought to obtain from the supervisor a certificate (such as an administrator gives when consenting to act)
that there is a reasonable prospect that the object of the moratorium can be achieved: and the statute should provide that the supervisor owes a duty of care to the creditors as a whole in providing the certificate. (We explain below why restricting entry to a moratorium is more satisfactory than facilitating exit from one).

7. As to the scope of the moratorium, we understand that it is intended to prevent the commencement of any insolvency proceedings, the taking of possession of any assets, the enforcement of any security, the commencement of any proceedings, the holding of any company meetings or the commencement or continuation of any legal process. But we consider that it ought not to prevent an application being made for an administration order. Creditors may well take the view that the desire to preserve the company as a going concern (and so to preserve the interests of directors / shareholders) in fact stands in the way of the achievement of a proper return for them (as providers of voluntary or involuntary credit), and that they would be better served by an administration (in which the viable parts of the undertaking are sold). It is, after all, the business itself (and not its corporate structure) that ought to be preserved.

8. As to duration, we are of the view that a unilateral three month moratorium is too long and does not strike a fair balance between debtor and creditors and is open to serious abuse. We believe that a 28 or 42 day moratorium strikes a fairer balance. It will put some, but not undue pressure on creditors: and if real headway is being made in that initial period then an extension can be sought either with the consent of (a specified majority of) the creditors or upon an application to the court (with the moratorium continuing until that application is determined).

9. As to the need for independent judgment, we do not consider that the role of "supervisor" as envisaged is sufficient. His or her accountability is not nailed down. The shorter the period of the moratorium, the less significant this issue is. In a 28 day moratorium a supervisor who has general oversight, a right of access to information, an obligation to answer creditors’ questions and an ability to seek termination of the moratorium is probably sufficient. But to retain creditor confidence in a three month moratorium a supervisor must have greater powers...
to participate in or oversee the management of the company’s affairs and in particular to have a role in the restructuring negotiations. A useful model is that of “the monitor” under the Canadian Companies’ Creditors’ Arrangements Act.

10. As to the redress available to creditors, we do not consider that giving creditors a general right to apply to the court during the first 28 days of a moratorium provides any protection. This is the time at which material with which to test the key assumptions made about the ultimate viability of the company (in essence a commercial judgment about the outcome of negotiations for the financing or restructuring) is likely to be at its scarcest. The reality is that, given the current level of court fees, the limits on the availability of court resources, and the need for procedural fairness, any challenge to a moratorium is (a) in itself unlikely and (b) unlikely to be resolved within the life of the moratorium. This is why it is vital, in order to retain the confidence of creditors as a whole, that the conditions for entry are clearly stated and that there is in place an independent person with real power to oversee the moratorium.

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?

11. It is proposed to alter the law on wrongful trading during a moratorium. There is a requirement that before invoking the moratorium directors should hold the view that during the moratorium debts will be paid as and when they fall due. If that judgment is sound (and if the judgment that there is a reasonable prospect that the company will emerge from the moratorium as a viable business is also sound) then there should be no wrongful trading in any event. The real problem arises if those with whom a company trades whilst the moratorium is in operation (class B) is not the same as those with whom the company was trading at the time when it entered the moratorium (class A). In that case the debts due to class A are frozen and they are prevented from commencing recovery proceedings, whereas the debts of class B are paid as and when they fall due and
(under the present proposals) any shortfall will be paid in priority to class A in any subsequent insolvency. Then class A would have a real interest and incentive to challenge the judgment of the directors as to the satisfaction of the conditions of eligibility.

12. It is important that creditors generally should not have their rights curtailed. Rather than relieve directors from liability for wrongful trading during a moratorium, a fairer balance would be to leave the liability in place but to provide the directors with a specific statutory defence. This (allied with the accountability of the supervisor) should ensure that the moratorium is only invoked for proper purposes and in proper circumstances, and would maintain the integrity of the United Kingdom as a jurisdiction striking a fair balance between debtors’ and creditors’ interests.

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

13. We have answered this in the context of the first three questions raised. But we deal with one additional matter relating to the consent of creditors.

14. It is proposed that an extension of the moratorium can be effected with the consent of all of the secured creditors and (as we understand it) more than 50% by value of the unsecured creditors. However the unsecured creditors cannot be treated as a single class for this purpose. There will be creditors who were creditors of the company at the date when the moratorium commenced (class A above). There will be other creditors (such as new suppliers (class B above) or “essential suppliers) with whom the company deals during the moratorium but whose debts remain in part unpaid at the end of the moratorium) who have different rights because they can claim in priority in any subsequent insolvency. Creditors in each category must be treated fairly, but, we think, cannot be treated as a single class.

6. Do you agree with the proposals for the powers of and qualification requirements for a supervisor?
15. We agree that any “supervisor” must have relevant expertise in restructuring and be a member of a regulated profession. The integrity of a moratorium (even one of 28 or 42 days) is heavily dependent on the integrity of the supervisor since (as we have explained) in reality creditors will not have access to the courts to bring a moratorium to an end. A fair balance between the debtor in possession and his creditors requires effective oversight by someone whom the creditors can be confident is bringing an objective view to the matter: and since that person will have been selected by the directors, experience and the discipline of a regulated profession are the bare minimum. A supervisor should have the power to give notice of intention to terminate the moratorium five days after the notice in the event of any breach of the company’s obligations to him or to the creditors, or in the event that the company ceases to satisfy any of the eligibility criteria (including the payment of moratorium debts as and when due), leaving it to the company to seek injunctive relief to restrain the issue of the certificate.

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

16. The proposal that the supervisors’ costs “will be repaid first by the company as an expense of the process” is somewhat opaque since there is no “process” but merely a stay on all enforcement and legal proceedings pending negotiations with the creditors. It is plainly right that the supervisor should be treated as a supplier to the company during the moratorium and his fees paid as and when due (even if those fees have been incurred at the behest of the creditors seeking information or engaging in argument). In so far as such fees (and the debts of moratorium creditors) remain unpaid it would seem fairest if these ranked equally with the administration or liquidation expenses in any subsequent insolvency. It is difficult to see why, when the “moratorium has failed to achieve its purpose, they should have priority over the fees of an incoming office holder.
8. Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?

17. Where creditors are not to receive the equivalent of the proposals of an officeholder, replies to requests for information are essential. In regimes where there are initial proposals and periodic reports we consider the case for a general right to request information to be less compelling.

**Essential contracts**

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

18. We do not address the third of these questions (which is outside our experience).

19. We agree that it is not desirable to provide too stringent a definition of “essential contract”, but the malleability of the concept means that it should never be left to the debtor alone to classify a contract as such: the decision should either be that of the officeholder (in appropriate cases) or the debtor with the certificate of the supervisor (in other cases). We agree that the supplier should be able to challenge such a designation and regard it as essential that there should be an abbreviated procedure enabling the supplier to do so, perhaps requiring the court only to determine “who has the better of the argument” on the issue, rather than to make a definitive determination. But the only question for the court should be whether the contract is or is not “essential”. The court should not be drawn into any debate over the terms of supply. In the US and Canada litigation over the terms of “essential contracts” is substantial.

20. If the definition of “an essential contract” is not to be too stringent we consider it highly desirable that the implementing legislation (whilst saying that whether
a contract is “essential” depends on all the circumstances of the case) directs attention to particular factors to be taken into account, such as

- Whether the product or service is necessary (as opposed to simply advantageous or convenient) for the survival of the business
- The availability of substitute sources of supply
- The time likely to be needed to source the product or service elsewhere
- The degree to which the source of supply is integrated into the company’s operations (e.g. through shared tooling or “just in time” scheduling
- Regulatory requirements
- Shared IP.

This list (not exhaustive, but drawing upon experience of insolvencies in the motor industry) is indicative of what might emerge from judicial consideration of an “essential contract”. But it would be hugely desirable for the implementing legislation itself to address the matter rather than to leave office-holders without guidance and the development of the concept to judicial consideration of what might be atypical cases.

21. It is proposed that a distressed business will be able to file an application to prevent the use of “ipso facto” clauses. We do not comment upon the policy of introducing this transatlantic feature. However, we consider that close attention must be paid to the definition of such clauses and the circumstances in which their use can be curtailed. It is one thing to say that a supplier shall not be entitled to terminate a contract solely because of the occurrence of an event of insolvency. It is another to say that the contract cannot be determined if other clauses are breached that put the supplier at increased risk of further default or that the terms of supply cannot be altered in the event of insolvency. Where there are substantial arrears many businesses put customers “on stop” or “cash with order”. We do not consider that freedom of contract should be interfered with to an extent greater than is necessary to secure the desired objective. The
desired objective is the continuation of supply and the avoidance of demands for ransom payments in relation to debts existing at the onset of insolvency. Being deprived of the right to withdraw trade credit from a marginally solvent business goes beyond what is necessary and may jeopardise the stability of the supplier.

10. Do you consider that the court’s role in the process and a supplier’s ability to challenge the decision, provides suppliers with sufficient safeguards to ensure they are paid when they are required to continue essential supplies?

22. Subject to the preceding comments (a) as to access to the courts (b) the test to be applied to determine any application and (c) that interference with the terms of supply should be strictly limited, we agree with the proposals.

A “Cram-Down” Plan

23. The proposal for a new multi-class cram-down restructuring procedure (“a Plan”) is a radical proposal that - especially if coupled with a moratorium - would introduce a potentially very powerful compulsion upon dissentient classes of creditors and gives rise to a complex series of issues. We express apprehension whether the courts have either the resources or the procedures to resolve these issues.

24. As a preliminary observation, we note that such a proposal appears to derive from US law and practice under Chapter 11 of the US Bankruptcy Code. US bankruptcy law is different in many respects from English insolvency law and (as mentioned in the introduction) we caution against a belief that the process can easily be transplanted into English law. From discussions with other judges in the US it is understood that the process of negotiation of a Chapter 11 plan in is a notoriously complex and expensive exercise which requires judicial supervision and oversight by the US Trustee and can result in lengthy valuation disputes. The introduction of a similar cram-down Plan procedure in England
and Wales requires the most detailed and careful thought. In particular, the relationship between a “moratorium” and a “plan” (on which the Review is obscure) needs more careful examination.

25. We take the questions posed in the Review out of numerical sequence, as we consider that logically the first issue is whether a Plan containing a cram-down mechanism should be introduced at all.

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

26. The ability to bind dissentient creditors in a class by a majority vote subject to sanction by the Court already exists in the form of a scheme of arrangement. Schemes of arrangement can be, and frequently are, proposed to classes of secured creditors. The ability to bind dissentient classes as a whole already exists where a scheme of arrangement is combined with a pre-pack administration.

27. Although the Review refers to perceived difficulties with secured creditors and CVAs as a justification for introducing a cram-down, it is unclear whether, or in what circumstances, it is suggested that a majority vote in a junior ranking class should be able to impose a restructuring proposal upon a senior secured class. Prima facie, the proposed power to “cram down” junior classes of creditors ought not to obviate the necessity for a company to engage in discussions with the senior classes (c.f. paragraphs 9.2-9.3 of the Review). Nor would it be “unfair” for a class of secured creditors to dissent from a proposal that does not respect the security, and hence senior position in an insolvency, for which they bargained (c.f. paragraph 9.4 of the Review).

28. By way of illustration of this point, in the US under Chapter 11, there is a requirement (the “absolute priority rule”) that (i) a plan of reorganisation must pay any non-consenting class in full before a junior class receives anything under the plan, and (ii) that a senior class may not receive more than 100% of its claim where a dissenting junior class will receive less than 100%. This needs to be addressed carefully in any legislation.
29. The most cogent justification offered for a cram-down procedure is to avoid the need to use a combined pre-pack administration sale of the assets of the company to a newco owned and financed by the creditors who are “in the money” and leaving behind those junior classes of creditors who are “out of the money” (see para 9.9 of the Review). Such transactions are indeed complex and costly and could more efficiently be carried out under a new, combined procedure. There have, however, not been a large number of such cases under the existing regime, and we are not aware of the empirical evidence that there is a real demand for a new process to serve such cases.

30. Furthermore, the existing arrangements have the great benefit that in general the most contentious question (valuation of the business, from which proceeds the constitution of the classes who are “in the money” and those who are “out of the money”) depends crucially upon the commercial judgment of the administrator supporting the pre-pack administration (against whom disgruntled creditors have a right of recourse) and not upon the judge.

31. Moreover, as discussed below, there must be a need for the protections offered to junior creditors under a new Plan process to be no less than currently offered by the safeguards that now attend a pre-pack administration (in which, as we have noted, the price at which the business is sold to the newco is verified by an insolvency practitioner who is potentially liable if it is sold at an undervalue) and a scheme of arrangement (which provides court supervision and an opportunity for creditors to object to the class composition and to object to the terms upon which certain creditors participate in, or are excluded from, the newco).

11. Would a restructuring plan including [the proposed] provisions work better as a standalone procedure or as an extension of an existing procedure, such as a CVA?

32. It is worth recalling that there are fundamental differences between the existing CVA and a scheme of arrangement.
33. Among such differences are (i) that a CVA is a collective insolvency proceeding within the EU Insolvency Regulation, and (generally speaking) is available only to a company with its COMI in the UK, but will automatically be recognised throughout the EU under the EIR, and (ii) a CVA requires no court approval and the court is only engaged if the CVA is challenged.

34. In contrast, (i) a scheme is not a collective insolvency proceeding and may be available to any foreign company having a “sufficient connection” with the UK irrespective of its COMI, but a scheme does not fall within the EIR and relies for international effect in the EU upon recognition under Part III of the recast EU Judgments Regulation; and (ii) the court is involved with a scheme throughout the process of convening the class meetings and seeking sanction.

35. We would be opposed to any amendment to the scheme jurisdiction to accommodate the new Plan procedure. Schemes of arrangement are not collective proceedings and are not limited to insolvency situations. Moreover, the scheme jurisdiction has existed in essentially unchanged legislative form for well over a century, has a flexible jurisdictional test, works efficiently and is widely admired in other jurisdictions. We should leave well alone.

36. There are also difficulties accommodating the new “Plan” into the existing CVA regime. Although such a Plan would be a collective proceeding embodying a compromise of all debts and thus fit within the EIR, it will require a fundamental variation from the existing CVA process if there is to be a requirement for identification and court approval of classes and for the applicant to satisfy the court of the fairness of the proposals to the dissentient classes.

37. In principle, therefore, the new proposed Plan ought to have a standalone procedure, the gateway to it being the court.

38. We can, however, see the pragmatic attraction of introducing the new Plan as a modification (albeit an extensive modification) to an existing process: not least because there is already a complex proliferation of insolvency procedures under English law, and if anything the aim ought to be to simplify insolvency rather than add to its complexity.
39. As the Plan is essentially a collective insolvency procedure, on balance we consider that it could be introduced as a modification or extension of the existing CVA procedure, being limited to the same companies to which the CVA applies and benefitting from recognition under the EIR, but requiring applications to be made to the court for approval of classes and to the cramdown itself.

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

40. If a new cram-down Plan process is to be introduced, it is essential for the protection of dissentient creditors and to avoid abuse (i) that the selection of voting classes should be approved by the court before the meetings, (ii) that creditors have an appropriate opportunity to challenge the class constitution prior to the meetings being held; (iii) that sufficient information on the proposal is provided in an explanatory statement circulated in a timely fashion to creditors before the meetings; (iv) that the voting requirements were met and that the majority in each consenting class was representative of the class; and (v) that the proposal must be demonstrated to operate “fairly and equitably” on the creditors who are to be crammed down.

41. To a large extent these requirements reflect those outlined in paragraph 9.29 of the Review, and track similar requirements in relation to schemes of arrangement. We consider each requirement below.

Class composition

42. We agree that the constitution of creditor classes should be determined by reference to their existing rights and the treatment of those rights under the proposed Plan (and any associated restructuring) in the same manner as in relation to a scheme of arrangement: see paragraphs 9.15 and 9.26 of the Review.

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1 Though we do not understand the reference therein to the Plan containing “information” about such matters.
43. We also agree that the constitution of the classes should be approved in advance of the creditor meetings by the court: see paragraphs 9.16, 9.17 and 9.26 of the Review. This mirrors the procedure in relation to schemes of arrangement and should avoid a situation in which time and money are wasted if it were subsequently to be held that the wrong classes had been constituted by the company.

44. Consistently with the practice in relation to schemes of arrangement, the onus must be on the company to persuade the court that the classes are correctly constituted, and creditors must receive notification of the terms of the Plan proposal and of the proposed classes in sufficient time to take advice and make an informed decision as to whether to seek to contest the constitution of the classes. What is a sufficient time will depend upon the nature, location and means of communication with the creditors, and the complexity of the proposals.2

45. We also agree that creditors should have the ability, at the confirmation hearing, to challenge the representative nature of the majority voting in each consenting class.

The Explanatory Statement

46. The court cannot practically and should not be required to approve the form and content of the explanatory statement in advance, but it must be open to a creditor to challenge a Plan at confirmation on the basis that the information provided was inadequate.

“Fair and equitable”

47. By far the greatest cause for concern and for complexity are the generalised suggestion that a Plan could not be approved unless it was “fair and equitable”, and the elaboration that this requires (inter alia) impaired creditors to be left “no worse off than would be the case in a liquidation”.

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2 See e.g. Re Indah Kiat [2016] EWHC 246 (Ch).
48. A safeguard along the “just and equitable” line is the barest minimum if a cram-down is to be imposed. But to say, in general terms, that a Plan should not be approved unless it is “fair and equitable” is to state the obvious. No court should approve a Plan that it thought was unfair or inequitable. As such, we agree that what is “fair and equitable” in the context of a cram-down needs to have some detailed frame of reference such as suggested in paragraph 9.32 of the Review.

49. But we think it would be wrong to prescribe, as seems to be suggested in paragraph 9.32, that if the three specified criteria are met, a scheme “will be” fair and equitable. We would suggest, as appears to be the implication in paragraph 9.35 of the Review (where it is suggested that a liquidation valuation should be the minimum that impaired creditors should receive), that the criteria identified should be a non-exhaustive list of the minimum safeguards, leaving open the possibility that the court might decline to confirm a Plan for other reasons.

50. We do not think that this will give rise to unnecessary uncertainty. Rather it would retain necessary flexibility to avoid injustice. In scheme cases the courts have been careful to emphasise that at sanction, if the other requirements have been satisfied such that the scheme has been approved by all the necessary classes, the majorities were representative of the class, and that the information provided was adequate, the court will generally recognise that the creditors are the best judges of what is in their own commercial interest. The court has emphasised that its role is not to pass its own judgment on whether the scheme is generally “fair” or (in its view) the “best” scheme that can be devised.

51. As to the tests suggested in paragraph 9.32 of the Review, we have already commented upon the requirements in US law of the “absolute priority rule” which seems to be the source of the second and third tests.

52. It is, however, the requirement that creditors (and in particular impaired creditors) should be “no worse off than would be the case in a liquidation” that is the most controversial and is likely to give rise to the greatest difficulties.
53. In English law, “liquidation” means a winding-up either by the court or in a voluntary liquidation. That process almost invariably produces the lowest return to creditors. There are many other possible alternatives to the Plan - such as administration - which may be available to a company which would produce a better return to creditors than a liquidation.

54. In order to avoid abuse by majorities in senior classes, we do not think that the essential safeguard for dissentient creditors who are to be crammed down should merely be that the Plan offers them no less than they would obtain in a liquidation. The requirement should be that such creditors should be no worse off under the Plan than would be the case if the Plan were not approved.

55. Without this safeguard we consider that the proposed cram-down Plan process would be capable of causing significant injustice by, for example, junior creditors being offered the barest minimum on the basis of a liquidation valuation, in circumstances in which the true alternative to the Plan is an administration in which they would receive a higher return.

56. This leads on to the vexed question of valuation, to which we return below.

**Moratorium and time-limits**

57. The Review appears to propose that a Plan might be formulated during a moratorium and might itself be subject to a twelve month time limit.

58. We have already commented upon the moratorium proposal above. We consider that in order to avoid abuse, prejudice to creditors from the continuation of the moratorium and unnecessary complexity, the same basic provisions should apply where a Plan is being formulated. If longer time periods are needed to facilitate the formulation of a Plan, extensions can be sought.

59. We also understand that it is proposed that a Plan should be “time-limited to 12 months” (paragraph 9.10) and “last no more than twelve months” (paragraph 9.29) – if necessary covered by an extended moratorium. We are unsure precisely what this is intended to mean. An obvious Plan proposal may be to
extend the maturity of term loans. If the relevant creditors agree, we do not see why the term of any extension should be limited to one year.

60. Lastly, we emphasise the need to consider the relationship between the “moratorium” and the “Plan”. The Review appears to contemplate that the two exist at the same time: but we cannot see why this should be so. Once a Plan is in place, that should determine the relationships between the company and the Plan creditors (so that a “moratorium” is unnecessary): and since the object of the Plan is the survival of the company (and for that reason Plan creditors have adjusted their rights to achieve that objective) a “moratorium” which benefitted new creditors would seem unjust.

14. Do you agree that there should be a minimum liquidation valuation basis included in the test for determining fairness of a plan which is being crammed down onto dissenting classes?

61. We have commented above on the inadequacy of the proposal in the Review as it stands. We have suggested that if expressed as part of a test going to fairness, the correct approach should be to identify the appropriate counterfactual scenario to the approval of the Plan, whether that be liquidation, an administration or a different scheme. The valuation evidence must then be addressed to that scenario.

62. We can see that there would be less objection if the “no less than in a liquidation” test were only expressed to be the bare minimum jurisdictional requirement for a cram-down to be approved, leaving it entirely open to the court to decide on a different basis for valuation as part of applying a “fair and equitable” test. But we think that would serve only to state the blindingly obvious in the statute, and would be potentially confusing given that the English court would inevitably end up applying the counter-factual valuation test when exercising a discretion.
63. The approach we suggest based upon the counter-factual if the Plan is not approved would, we believe, also mark a principled difference to the approach under Chapter 11 in the US, where the courts frequently entertain contentious and often speculative evidence as to the value that the company will have if the Chapter 11 plan succeeds. This approach has been rightly criticised as enabling creditors and even shareholders who are “out of the money” to claim what (at least on the basis of the prevailing English cases) is an unwarranted benefit in the restructuring negotiations.

64. The identification of the appropriate counterfactual ought in any event to have been done at the stage at which the court approves the classes by reference to existing rights (i.e. the rights that are capable of being exercised against the company in the absence of the Plan). And the valuation material ought to be summarised in the information provided to creditors in the explanatory statement.

65. We would, however, strongly emphasise the point implicitly acknowledged in paragraph 9.35 of the Review that substantial disputes over valuation will inevitably arise whatever valuation methodology is adopted. These will have to be resolved in already hard-pressed courts if a cram-down proposal is to be introduced to English law. The experience of the US shows this to be an unwelcome by-product of the cram-down process. We are deeply concerned that this extra cost in terms of additional expense for distressed companies, and the additional burden it will impose on scarce court time and judicial resources, is simply not justified by the benefits likely to be offered by the proposed new Plan process.

**Rescue Finance Questions 15-17**

66. We note the proposals for rescue finance. As is evident from the experience of other jurisdictions if a moratorium of the length proposed and the “Chapter 11” restructuring plan proposals are carried into effect, then rescue finance is an integral part of that scheme.

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67. As judges we do not, however, consider that we can contribute to achieving the objective of encouraging rescue finance. Nor can we express a view as to whether negative pledges should be overridden to promote the provision of rescue finance, or as to whether the providers of rescue finance ought to be given “super priority” over other creditors. That objective and these questions raise issues of policy and will be of central concern to banks and other funders.

68. We would only say, however, that it is essential that any interference with negative pledge clauses, or the subjection of security or other accrued rights to some super priority arrangement must involve the approval by and oversight of the court on criteria that are carefully thought out and clearly defined in legislation if the confidence of other creditors and providers of routine finance is to be maintained.

18. SMEs

69. As judges we do not consider we have any policy proposals to advance.
RESPONSE OF CITY OF LONDON LAW SOCIETY – INSOLVENCY LAW COMMITTEE

INTRODUCTION

1. We refer to the Insolvency Service Consultation entitled “A Review of the Corporate Insolvency Framework – A consultation on options for reform” published in May 2016 (the Consultation). This response has been prepared by the City of London Law Society (CLLS) Insolvency Law Committee. The Policy Unit The Insolvency Service 4 Abbey Orchard Street London SW1P 2HT

2. The CLLS represents approximately 17,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

3. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. The CLLS Insolvency Law Committee, made up of solicitors who are expert in their field, has prepared the comments below in response to the Consultation. Individuals and firms represented on this Committee are set out in appendix 2.
4. Members of the CLLS Insolvency Law Committee would be happy to discuss or expand on any of the comments made in this response, if requested.

STRUCTURE OF OUR RESPONSE

5. The Consultation contains four proposals which, if implemented, could have a significant impact on the existing UK insolvency regime. These proposals raise a number of important issues, not all of which fall within the scope of the specific Consultation questions. We have therefore highlighted a number of key points arising from our detailed review of these proposals in the main body of our response. We have then set out in the Appendix our responses to the specific Consultation questions, but emphasise that these should be read in the light of this response as a whole.

SUMMARY

6. We very much welcome initiatives which are intended to ensure that the United Kingdom insolvency regime retains its competitive advantage in terms of efficiency and effectiveness and can see merit in further exploring and developing a number of the proposals contained in the Consultation.

7. In particular, we believe that the existing corporate rescue regime could potentially be improved by the introduction of a new statutory procedure which permitted the cramming-down of out of the money creditors without their consent. Such a measure could both increase the chances of a debtor company surviving as a going concern and reduce the need for senior secured creditors to implement a restructuring solution by way of a “pre-pack” sale. The proposals set out in the Consultation relating to the new cram-down procedure are, however, relatively high level, and will require further detailed consideration if they are to proceed and result in a procedure that is both robust and easy to apply.

8. While we agree that interference with the right of freedom to contract is “only justified where absolutely necessary”, we can see that the proposed extension of existing statutory restrictions preventing the use of ipso facto clauses to terminate “essential” contracts may prove a useful tool in dealing with “ransom” creditors. Further measures would, however, need to be put in place to ensure that the position of the relevant supplier was properly protected.

9. There is, however, a sense that this proposal, when combined with the impact of the recent extension of Section 233 of the Insolvency Act 1986, marks a further step towards a general prohibition on ipso facto clauses. While this may offer a comparatively simple solution, it should only be adopted following a deliberate policy decision, rather than becoming the default position following a series of unrelated incremental statutory changes which result in different levels of protection applying, depending on the nature of the supply.

10. In addition, it may be necessary to specify that certain types of contract (for example interest rate and currency hedging agreements and undrawn overdraft facilities) cannot be designated as “essential” contracts, given the practical issues involved in ensuring that the position of the relevant counterparty would not be prejudiced.

11. The case for establishing a new pre-insolvency moratorium is, however, much less convincing. We have, in practice, experienced very few (if any) cases in which a viable and
well managed business has failed as a result of the absence of a moratorium of the type proposed in the Consultation.

12. We would therefore not support the wider moratorium proposals contained in the Consultation. The limited benefits of having such a moratorium available as part of the insolvency “tool kit” are outweighed by both the potential costs involved (which may make it too expensive for use by some SMEs) and concerns that the legitimate interests of creditors are not sufficiently protected by the proposals for a three month moratorium contained in the Consultation.

13. The suggested options for rescue financing raise a number of difficult and complex issues, particularly as there are often few, if any, assets of a distressed debtor which are not already encumbered by security. We would suggest that the key matter to address is to determine what is actually holding back potential participants in this market. Possible structures for giving such funding priority already exist, but the market remains relatively inactive. It is those potential participants, rather than we, who are best placed to explain exactly what they require, in order to support a more extensive and bespoke DIP finance market than that currently operating in the United Kingdom.

14. Once those requirements have been established, it will be possible to judge whether it would be worth giving effect to them, or whether the possible benefits of establishing a DIP financing market would be outweighed by the probable negative impact that taking such steps would have on existing lending products and practices.

15. We would, however, emphasise the significant legal, practical and economic problems that would arise if any proposal were to emerge that gave rescue financing priority over existing fixed charge security. Any such proposal would give rise to significant disputes. It is unclear whether the UK courts would have the experience or capacity to deal with such disputes. In addition, any such measure would create market uncertainty if the benefit of taking fixed charge security were perceived as being devalued, such uncertainty resulting, at best, in increased costs for borrowers.

16. Overall, the proposed changes are fundamental in nature, being arguably the most significant proposals to reform UK insolvency legislation since the Enterprise Act. Those proposals which proceed will require further detailed consideration, both in their development and subsequent implementation.

17. We would strongly recommend, as part of this process, that any proposed legislative changes are made available in draft form to interested stakeholders and that, given the importance of what is being proposed, those stakeholders are given sufficient time to review and comment on that draft legislation before it is enacted.

SPECIFIC COMMENTS - A NEW CRAM DOWN REGIME?

18. We have previously recommended that the Insolvency Service may wish to consider whether those no longer have any economic interest in a business (for example

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3 Para 1.53 of the Impact Assessment notes that “collectively the costs of producing a report, monitoring compliance for the period of the breathing space and getting legal agreement for the breathing space will cost between £0.24 and £2.245m per case.”

4 The gradual emergence of a litigation funding market shows that the development of new types of funding is currently possible where there is a market led demand for such products.

5 In our response to the Insolvency Service consultation paper entitled “Proposals for a Restructuring Moratorium” published in July 2010
shareholders or “out of the money” junior creditors) should effectively still be able to veto a viable restructuring proposal which has the overwhelming support of those creditors who retain an economic interest in the business.

19. We therefore welcome the proposal that a statutory mechanism could be put in place, permitting the cram down/elimination of out of the money debt claims, whether secured or unsecured. This would:-

(i) limit the need for a company’s business to be transferred, often by means of a “pre-pack sale”, in order to deal with the claims of “out of the money” creditors, a route which in certain situations can be complex, value destructive and expensive; and

(ii) prevent the UK insolvency regime from being perceived, as a result of retaining a veto for out of the money creditors, as being friendly to “ransom” creditors whose actions may place a company’s survival, and the jobs of its employees, in jeopardy.\(^6\)

20. We would, however, make the following specific points in relation to the proposed new procedure (which is referred to in this response as the “Corporate Recovery Plan”).

21. **Relationship with other procedures:** We would support the suggestion\(^7\) that the Corporate Recovery Plan should be a stand-alone restructuring procedure which would sit alongside the existing rescue options and which could be used by the directors of any company which was, or was likely to become, insolvent or by an administrator or liquidator of that company. All companies, whether large, SME or otherwise, should be able to use this procedure, as long as they are not one of those listed in Para 9.23 of the Consultation.

22. We note the alternative suggestion that the new procedure could be incorporated into the existing CVA voting procedure. The major weakness of this procedure is that the rights of secured creditors cannot be affected without their consent. However, adopting this approach would introduce the concept of voting by class into a CVA, thereby limiting its main attraction, namely the flexibility afforded by having a “single class” creditor compromise and composition procedure.

23. We do not consider that the Corporate Recovery Plan should replace the existing, and successful, Scheme of Arrangement procedure as:-

(i) Schemes can be used in a wide variety of circumstances, for example to impose a claims bar date or to settle a class action, by any company, whether solvent or insolvent;

(ii) the use of Schemes is not limited, as would be the case with the new Corporate Recovery Plan (subject to the outcome of Brexit discussions), to companies with a Centre of Main Interests (“CoMI”) in the United Kingdom; and

(iii) one of the major attractions of a Scheme is that a company can decide which claims it wants to compromise. It is, for example, possible to cram down a class of junior secured creditors under a Scheme while keeping unsecured claims whole, provided that there is a valid commercial reason for doing so. A company can also ignore those classes of creditor that would not be affected by the proposed

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\(^6\) This perception may place the UK insolvency regime at a competitive disadvantage, given that proposed legislative reforms in a number of other Member States, including The Netherlands, are seeking to limit the rights of such creditors.

\(^7\) In Paragraph 9.14 of the Consultation.
restructuring. The proposed Corporate Recovery Plan does not appear, under the current proposals, to offer as much flexibility, although this point could be addressed by the inclusion of the measures discussed below.

24. **Terms of the Corporate Recovery Plan.** Paragraph 9.32 of the Consultation states that a Corporate Recovery Plan would be considered fair and equitable if, inter alia, junior creditors do not receive “more on repayment than creditors more senior than them.” It would follow that if a company had both junior secured creditors and unsecured operational creditors (whether suppliers, employees or customers), amounts owed to the latter would have to be written off before the claims of junior secured creditors could be cramdowned down using a Corporate Recovery Plan.

25. In practice, there may, in certain cases, be good commercial reasons why it would not be realistic to expect an unsecured creditor to write-off their debt, particularly where their ongoing support was of critical importance to the business going forward. One obvious example of this would be the supplier under an “essential” contract, whose claims would be likely to be unsecured.

26. Deviating from the absolute priority rule is not a step to be taken lightly, but we believe that there may be a case for giving the court the discretion, in exceptional cases, to sanction a Corporate Recovery Plan under which a junior creditor receives a greater recovery than a more senior creditor where (i) the ongoing support of that more junior creditor is critical to the viability of the debtor’s business, (ii) the payment, and the rationale for making it, were fully disclosed and (iii) the relevant senior creditors were still better off than would otherwise have been the case.\(^8\)

27. The absence of such flexibility could have the unintended consequence of making the Corporate Recovery Plan more attractive to finance vehicles (which are less likely to be dependent on the on-going support of more junior creditors) than to operating companies.

28. **Duration:** Paragraph 9.29 of the Consultation suggests that the Corporate Recovery Plan should “last no more than twelve months”. It is not clear whether this would, for example, prevent the plan from being used to extend existing debt maturities for two or three years where payments fell due after more than 12 months (as often happens under an “Amend and Extend” Scheme of Arrangement). Would the debtor company have to go through the effort and expense of proposing a new plan each year, providing for a further extension? It would be a strange outcome if, as a matter of policy, a plan could write off a debt but it could not extend the maturity of that debt for 18 months.

29. **Shareholders:** While not expressly addressed in the Consultation, it would clearly be inequitable if any Corporate Recovery Plan could leave shareholders in the company with their existing equity, at a time when some or all creditor claims had to be compromised or written off. We therefore assume that the Corporate Recovery Process would follow the Australian model adopted in relation to voluntary administrations and Deeds of Company Arrangement, under which shareholder equity can be extinguished as part of a court approved restructuring process.\(^9\)

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\(^8\) This would be consistent with the approach adopted in relation to Schemes of Arrangement, where the treatment of creditors in Schemes including *Re PT Garuda Indonesia* and in *In the matter of (i) Stemcor (S.E.A.) Pte Ltd and (2) Stemcor Trade Finance Ltd*, has not always followed the absolute priority rule

\(^9\) See Section 444GA of the Australian Corporations Act 2001 and the Mirabella and Nexus cases
30. **Voting**: It is proposed that, as with a Scheme of Arrangement, voting would be by classes, and the approval threshold would be the same as for a Scheme (the approval of 75% by value and more than 50% in number of each class being required). We agree that voting should be by class, and that the class test should be the same as that used in relation to Schemes.

31. We would, however, question whether the numerosity test applicable to Schemes should be incorporated into the Corporate Recovery Plan, as our experience is that this test offers no significant creditor protection. It does, however, give dissenting creditors the ability to sabotage (and potentially destroy) a widely accepted and viable restructuring proposal though the simple expedient of splitting out their votes.

32. **Existing case law relating to Schemes**: Existing case law and practice established in relation to Schemes of Arrangement (for example cases covering class composition) should also apply to the new Corporate Recovery Plan, in order to avoid the risk of long established and accepted practices being challenged. While existing case law may not necessarily be treated as binding if the Scheme in question was not contested, developing an entirely new body of case law relating to the composition of classes or the holding of meetings would create unnecessary uncertainty while also being time consuming, expensive and potentially detrimental to creditors.

33. **Court approval**: Similarly, we believe that the role of the court in considering whether to approve a Corporate Recovery Plan should be the same as the role of the court when sanctioning Schemes of Arrangement. The test currently applied by the court when deciding whether or not to sanction a Scheme works well and is widely understood. The same test should therefore apply to a Corporate Recovery Plan, thereby avoiding uncertainty and possible attempts to “play the system” as stakeholders gain familiarity with its operation in practice.

34. **Valuation**: As noted in the Consultation, valuations will play an important role in any Corporate Recovery Plan, as much will depend on whether a class of creditors would be “in the money” or “out of the money”. We do not, however, believe that legislating for the use of a “minimum liquidation valuation” would necessarily be a helpful measure, even if it was possible to come to a generally accepted definition of exactly what this meant. There are clearly cases where liquidation would be the correct comparator (one obvious example being MyTravel, whose business was dependent on the continuing availability of a CAA licence which would be lost if the proposed restructuring was not approved), but there is a risk that the liquidation comparator would rapidly become the default valuation option. The fairness of any plan should be judged by reference to the most likely alternative outcome, which may not necessarily be the immediate liquidation of the debtor company.

35. We would therefore suggest that, as each case turns to some extent on its own facts, the court should continue its current practice of considering valuation issues on a case by case basis, having regard to independent valuation evidence.

**THE INTRODUCTION OF A NEW PRE-INSOLVENCY MORATORIUM**

36. Members of our committee were, when this issue was raised in 2010, divided in relation to whether a strong case could be made out for a temporary restructuring stay of this nature.

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10 Paragraphs 9.12 and 9.19 of the Consultation
11 As set out in Paragraph 9.29 of the Consultation
12 This being the test suggested in Paragraph 9.10 of the Consultation
Some members gave examples of restructurings where it was necessary to use the stay inherent in a formal insolvency process in order to bind dissenting creditors or where a restructuring almost failed as a result of last-minute creditor action. Others questioned whether the moratorium was the right focus for any legislative change, suggesting that the greater risk was not so much that individual creditors might threaten to destabilise a restructuring at the negotiating stage but that such creditors could derail a restructuring altogether by refusing to consent to it.

37. When the issue was raised again in 2015, it was felt that there was a stronger argument for having a short pre-insolvency moratorium available as part of the restructuring tool kit, given the increasing diversification of the creditor base in many restructurings, and the resulting increased challenges faced by the company or representative creditor groups in communicating directly with the wider creditor constituency.

38. We believe that the fundamental point, when considering any such proposal, is to be clear exactly what any such moratorium is expected to achieve. We note, in this respect, the proposals for a short, pre-insolvency, moratorium made by R3 in April 2016\(^{13}\) which highlighted the problems caused by anxious creditors disrupting business rescue plans by petitioning to have a struggling company wound up. We agree that such behaviour can prove an unhelpful distraction and that it would be useful to have the threat of a statutory moratorium available, in order to deter hostile creditor action of this nature.

39. A measure such as this should be relatively uncontroversial as it would simply formalise the approach already adopted in cases such as BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group,\(^{14}\) with courts using their case management powers to impose a short de facto standstill on hostile creditor action while a restructuring plan is finalised.

40. Having a short moratorium in place could also have the benefit of creating “deal tension”, imposing a timetable within which interested parties should agree the terms of a restructuring. This might make discussions more focussed, to the benefit of all stakeholders.

41. What is proposed in the Consultation would, however, go considerably beyond this identified issue. It would limit significantly the rights of secured creditors (and in particular the rights of the holder of a Qualifying Floating Charge) while allowing a potentially incompetent management team to carry on running a business for an initial period of three months under the (limited) supervision of an individual who would have “relevant expertise in restructuring” but who might not be an insolvency practitioner.\(^{15}\)

42. The risk is that an extensive three month moratorium of this nature may, rather than creating an environment in which plans could be put in place for the rescue of a potentially viable business, simply encourage directors to put off dealing with a company’s financial difficulties. This could, in turn, lead to creditor anger and frustration, should the company’s financial position deteriorate during the moratorium period.

Concerns with the current moratorium proposals

43. We have two fundamental concerns with the proposals made in the Consultation. The first is that there appears to be a suggestion that a company would have to enter into the

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\(^{13}\) In “A Moratorium for Business: Improving Business & Job Rescue in the UK”

\(^{14}\) [2013] EWHC 1146 (Ch)

\(^{15}\) Paragraph 7.41 of the Consultation
The moratorium process before it could utilise any statutory cram-down procedure. The second is that what is currently proposed does not strike a fair balance between the interests of the debtor company and the legitimate expectations of that company’s creditors (and, in particular, its secured creditors).

The first concern - The moratorium should be optional

44. Paragraph 7.7 of the Consultation states that the moratorium would “precede and act 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”. This suggests that it might be mandatory for a company to propose a statutory moratorium before it could utilise any of these procedures.

45. It is assumed from statements made elsewhere in the Consultation that this is not the intention, but if this is what is being proposed, we believe that this approach would be a significant mistake. In many cases, a company facing financial difficulties which is renegotiating the terms of its financial indebtedness would not want to publicise this fact to its operational creditors, given the reputational damage which would arise from such disclosure.

46. In particular, experience suggests that a notification that a company is seeking protection from its creditors would be likely to concern trade creditors, suppliers, employees, credit insurers and other stakeholders (whose claims might be totally unaffected by any proposed restructuring). It might cause them to change the terms on which they do business with the debtor company, to the detriment of both that company and its creditors. Competitors could also take advantage of concerns surrounding the debtor company’s financial standing. Why risk these consequences, unless the debtor company actually needs the protection of a statutory moratorium?

47. As an optional tool, a limited moratorium could have some value. As an obligatory step in the restructuring process, any such value would be very clearly outweighed by the negative impact that seeking an (otherwise unnecessary) moratorium could have on the business being restructured.

The second concern – Striking the correct balance between the interests of the debtor and creditor protection

48. The proposals set out in the Consultation seem to assume an administration style moratorium which would extend to both secured and unsecured creditors. The position here is, however, very different to that which arises in an administration, as (i) the existing management team would continue to run the business, even where they were responsible for the problems which it had encountered, (ii) there is a very limited element of court supervision and (iii) the holder of a Qualifying Floating Charge (“QFC”) would have no control over the process.

49. Creditor protection: It is important that the legitimate expectations of creditors are addressed in relation to any proposed moratorium, particularly if it is to last for three months. Appropriate checks and balances should be put in place to ensure that, as far as realistically possible, the creditors’ position does not deteriorate during the moratorium period. We would, in particular, expect to see firmer restrictions on (i) creating new

16 For example in Paragraph 7.33 which limits the availability of the moratorium – it would be surprising if, as a matter of policy, a company could not be put into administration because it had been subject to an unsuccessful moratorium
security, (ii) disposing of material assets outside the ordinary course of business, (iii)
repaying pre-moratorium liabilities and (iv) making payments to connected parties during
the moratorium period (together the “Relevant Transactions”).

50. The Consultation states that the supervisor would need to sanction any disposals made by
the company outside of the ordinary course of its business. Given that the supervisor is a
company appointee whose appointment is not ratified or approved by the court, and that
(unlike under the Schedule A1 moratorium regime) there is no concept of a representative
creditor body, there would appear to be a strong argument that, in order to maintain
creditor confidence, the company should not be able to enter into any Relevant
Transaction without the prior consent of the court.

51. We do not believe that introducing such a requirement would result in a substantial level of
court involvement during the moratorium process, as companies should not, other than in
exceptional circumstances, be creating security or making significant disposals outside the
ordinary course of business during the moratorium period.

52. The supervisor: We understand that there may be policy and cost issues underpinning
the suggestion that the supervisor should not have to be a licenced insolvency practitioner,
as long as they are a solicitor or accountant “with relevant expertise in restructuring”
Measures should, however, be put in place to ensure that the supervisor’s expertise
extends to (for example) being able to analyse properly any cash flow/liquidity forecast
prepared by the company’s directors and to decide whether there are any CoMI issues.
The success of any moratorium procedure will depend on creditors having confidence in
both the procedure itself and in the supervisor who is effectively protecting their interests.

53. Given (i) the practical difficulties involved in establishing whether a solicitor or accountant
has the necessary skill set and experience to take on the role as supervisor and (ii) the
possibility that this limitation could be challenged by restructuring specialists who may well
have the necessary experience, but who would not necessarily be solicitors or
accountants, the simplest option might be, as with other insolvency procedures, to limit the
role of the supervisor to licenced insolvency practitioners, given that the latter should, by
reason of their qualification, have the necessary skill set to take on this role.

54. Challenges. It is proposed that “creditors would…have a general right to apply to court
during the first 28 days of the moratorium”. It is unclear why the right to challenge the
moratorium should be limited to this period. Circumstances change, including in relation to
the prospects of agreeing a successful restructuring, with the result that creditors may well
have valid grounds to argue after (say) two months that the company’s financial position
and prospects no longer merit the continuation of the moratorium.

55. Should the moratorium extend to secured claims? The proposal that the moratorium
should extend to the enforcement of security gives rise to two key issues, namely (i) would
imposing a three month moratorium on the holder of a QFC be likely to serve any useful
purpose, if the latter was determined to enforce their security directly they were permitted
to do so? and (ii) even if such a moratorium were to be imposed, would any necessary
carve-outs limit its effectiveness?

17 Paragraph 7.43
18 Paragraph 7.41 of the Consultation
19 Paragraph 7.25
56. Looking first at the position of a QFC holder, it is acknowledged in the Consultation that “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.”

57. We agree that a moratorium should not be allowed to proceed where the management of the debtor company lacks the support of the company’s key secured creditors, particularly where it is clear that (for example) the holder of a QFC intends to enforce its security at the end of any moratorium period. There may therefore be a case for making the moratorium conditional on first obtaining the consent of any QFC holder (in which case, it should not be necessary for them to be bound by any moratorium).

58. Turning to the question of carve-outs, the Consultation states that the moratorium would cease if a secured creditor could demonstrate to the satisfaction of the court that their “collateral or interests are not sufficiently protected”

(ii) it is assumed that the moratorium would not extend to arrangements falling within the scope of the Financial Collateral Arrangements (No. 2) Regulations 2003 or to security falling within the scope of Article 5(1) of the EC Regulation on Insolvency Proceedings 2000; and

(iii) it is also assumed that those creditors who retain the power to appoint an administrative receiver (such as those granted security as part of a “capital market arrangement”) and who are currently excluded from the small company CVA moratorium, would also be excluded from this moratorium.

59. We would question, looking at the cumulative effect of these provisions, how valuable a moratorium on enforcing security would be if (i) any QFC holder was effectively excluded, (ii) the various carve-outs set out in the previous paragraph were to apply and (iii) any other secured creditor would, unless the company went into administration, be able to enforce their security after three months.

60. Eligibility: There are five specific points in relation to a company’s eligibility for the moratorium process which may require further consideration. These are as follows:-

(i) The test for establishing whether the company’s financial position makes it eligible for the moratorium needs to be clarified. The Consultation states that “the company must demonstrate that it is already or imminently will be in financial difficulty, or is insolvent” whereas the impact assessment states that in order to be eligible the company must “satisfy the court that it is already or imminently will be in financial difficulty, but is not yet insolvent”.

(ii) Experience derived from advising directors of companies facing financial difficulties highlights the amount of work that needs to be carried out, in all but the simplest of
businesses, in order to establish and maintain a proper cash flow forecast which can give comfort that the company should have sufficient funds to meet its obligations as and when they fall due.

It follows that the requirement that “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” could, assuming that it is taken seriously, limit the availability of the moratorium to companies which have the expertise and/or resources necessary to create a proper liquidity forecast.

(iii) Linked to this point are the questions of (i) whether a lender would be able to accelerate a facility during the moratorium and to demand repayment following such acceleration and (ii) if so, whether the amount demanded would, having fallen due, have to be repaid if the moratorium were to continue. If the intention is that amounts can be accelerated but that they do not have to be repaid as a quid pro quo for the continuation of the moratorium, this should be made clear.

(iv) Conversely, what would the position be if an amount fell due during the moratorium period, but the relevant creditor was prepared to defer payment? Would the continuation of the moratorium be dependent on the company having sufficient funds to pay that amount, notwithstanding the deferral?

(v) Finally, although not strictly an eligibility point, it is stated at Paragraph 7.22 of the Consultation that the requirement that the company must be able to show that it is likely to have sufficient funds to carry on its business during the moratorium “is to ensure that existing creditors are no worse off.” It is unclear why the availability of such funding would necessarily mean that existing creditors were no worse off.

If such funding is provided by a third party it would, even if not secured, have priority as an expense of the process, and would be repaid out of the company’s available assets before the claims of existing unsecured and floating charge creditors. Even if new liabilities were satisfied using the company’s assets, such payments could still reduce the amount available for repayment of the company’s existing creditors. In either case, particularly where the funding was used to cover ongoing operational losses, existing creditors could be significantly worse off.

We think that it is important that the possibility that the creditors’ position could deteriorate during the moratorium process should not be forgotten when considering the length of the moratorium and the balance to be struck between the interests of the company and those of its creditors.

61. The option of going to court to obtain a moratorium: It is suggested in paragraph 7.20 of the Consultation that “if a company ...is subject to a winding-up order or petition, it will not be able to qualify for a moratorium.” This may have the unintended, and unwelcome, consequence that a hostile creditor could circumvent the moratorium by presenting a winding-up petition directly they suspected that the company might seek a moratorium. In order to address this, it may be worth considering giving the court discretion in such circumstances to allow an otherwise ineligible debtor company to use the moratorium.

25 Paragraph 7.22
26 Paragraph 7.46
62. **Accruing interest:** Paragraph 7.11 of the Consultation suggests that “*When a company enters the moratorium, the arrears owed to creditors will be frozen*”. This would seem to suggest that creditors would be unable to charge either normal or default interest on outstanding amounts during that period. If correct, it is unclear why this significant interference with contractual rights is required as part of a moratorium. The fact that interest is technically accruing on outstanding debts would not interfere with the company’s ability to put a restructuring proposal in place. Indeed, allowing interest to keep running would be more consistent with the concept of the moratorium being a temporary process linked to the company’s rehabilitation. The proper place to deal with any such accrued interest is in any restructuring plan.

63. **The position of directors:** The proposed treatment of directors’ liabilities may require clarification, as it is proposed that the directors would remain in control of the company during the moratorium period, but with “*no exposure, subject to safeguards, for personal liability*”\(^{27}\) Normal wrongful trading provisions would not apply during the moratorium,\(^{28}\) but directors could face personal liability if the moratorium were to continue at a time when there was no longer a reasonable prospect of agreeing a restructuring solution.

64. In practice, the two personal liability tests seem very similar. A simpler, and more straightforward, solution (which would also avoid confusion) would be to leave the existing wrongful trading regime in place. If a company’s directors are satisfied that there is a reasonable prospect of achieving a restructuring, they should also be able to get comfortable that there is a reasonable prospect of avoiding insolvent liquidation/administration.

65. Any other option could be interpreted as a suggestion that there might be a lower bar during the moratorium period than that imposed by the wrongful trading test, a conclusion which could lead to inappropriate risk taking, particularly if directors believed that they could entirely rely on the views of the supervisor, rather than making their own assessment of the company’s prospects.

66. **Extending the moratorium:** In larger or more complex restructurings, a three month period may be too short to be useful, unless extended. Under the current proposals, obtaining such an extension may prove problematic as it would require the consent of every secured creditor.\(^{29}\)

67. Given that the process of seeking an extension would normally be time consuming and potentially disruptive, it may be worth considering building some flexibility into any moratorium legislation, in order to avoid the company’s management being distracted during the moratorium period by efforts to obtain the consent of every secured creditor to an extension.

68. One option might be to allow a short further extension in the circumstances envisaged in Paragraph 7.35 of the Consultation with the consent of (say) 75% of each class of secured creditor, conditional on the supervisor confirming that he or she is satisfied that significant progress is being made towards implementing a restructuring solution.

69. **Effect of the termination of the moratorium:** It is unclear from the Consultation whether defaults that occur as a result of the moratorium process are immediately actionable once

\(^{27}\) Key Points box in Section 7 of the Consultation
\(^{28}\) Paragraph 7.34
\(^{29}\) Paragraph 7.36
the moratorium falls away. This may not, in most cases, be a significant issue, assuming that the company either executes a successful restructuring plan which addresses those defaults or goes into a formal insolvency process (in which case the point becomes academic), but there will be cases where neither scenario applies.

EXTENDING EXISTING RESTRICTIONS ON CONTRACTUAL TERMINATION

70. We have previously highlighted the fact that one of the greatest challenges to the successful operation of the existing administration moratorium is that counterparties are able to terminate key contracts simply because a company has gone into administration.

71. This point was reflected in the Insolvency Service’s summary of responses to its 2014 consultation on the continuity of supply of essential services to insolvent businesses, which noted that

“When a company or individual running a business enters an insolvency procedure, some suppliers may have contractual rights entitling them to terminate the supply contract on account of the insolvency. Where those supplies are essential to the continuation of the business, termination may have an adverse impact on the prospects of a successful rescue of the business and thereby on the amount of money available for creditors.”

72. The proposal contained in the Consultation that existing statutory restrictions on the exercise of contractual termination rights should be extended to “essential” contracts therefore addresses an issue raised by various stakeholders. We would, however, suggest that a number of additional checks and balances would need to be considered, should this proposal be progressed, in order to protect the position of the relevant supplier.

73. **Payment terms:** The Consultation focusses on the need for the debtor company to continue making payments under the relevant contract “on time and in full”, but the supplier is required to continue providing the relevant goods or services “to the business during the moratorium in accordance with the original terms of supply”. [our emphasis].

74. Where the goods in question were supplied on 90 or 120 day payment terms, a supplier denied the right to terminate the contract could be exposed to a significant credit risk as the debtor company might, contrary to its expectations, be unable to make payment in 3 or 4 months’ time. The company could even be in insolvent liquidation at that stage, should its attempts to secure a restructuring have failed before the contractual payment date.

75. The supplier’s concerns might be exacerbated by the fact that credit insurers may withdraw cover if a supplier is not able to terminate a contract on the occurrence of a payment default or other insolvency event.

76. While it may be argued that the supplier’s claim would have priority as an expense of the process, the benefit of such priority would depend on there being sufficient floating charge or unsecured assets to satisfy that claim. There would also be timing issues, as a supplier (which might be facing pressures on its own liquidity) might have to wait for a considerable time before its claim was paid by the debtor company’s administrator or liquidator.

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30 Paragraph 7.29 of the Consultation
31 Paragraph 7.30
We therefore believe that any supplier should be able to insist, whatever the original contractual payment terms, on being paid in full, in cash, on delivery of the relevant goods or services, should the contract in question be designated an essential contract.

If this were not the case, we believe that there would be a strong argument that the debtor company should have to apply to court to have a contract designated as being "essential", thereby giving a judge the opportunity to balance the benefit to the debtor company against the risks faced by the relevant supplier.

Termination of status as an “essential” contract. Any such designation, whether effected with or without a court order, should lapse if the company fails to pay any amount due to the supplier during the period of the moratorium.

Limitations on the nature of “essential” contracts: The question of whether a counterparty should be prevented from terminating a contract would depend on both (i) whether the continued provision of a supply was “essential” to the successful rescue of the business and its ongoing viability and (ii) whether “alternative arrangements can be made at a reasonable cost within a reasonable time”. As the term “essential” is not defined, it might be read as extending to financial products, such as hedging arrangements, overdrafts and/or the provision of ancillary banking facilities (such as BACs payment arrangements).

If it is intended that banks could be prevented from terminating such arrangements if (as is likely) no other bank was willing to provide such facilities on the same terms now that the company was facing financial difficulties, further detailed consideration would need to be given to the question of how best to protect the position of such counterparties. It should be noted in this respect that exposures under such contracts could increase significantly (and, in the case of currency and interest rate hedges, relatively unpredictably) during the moratorium period, and that the possibility of a continuing or increased exposure could have a significant impact on a bank’s capital adequacy requirements.

In practice, as indicated in the Summary of our response, it may prove impractical to put satisfactory protections in place for certain financial contracts, and it may therefore be necessary to specify that some types of contract (for example interest rate and currency hedging agreements and undrawn overdraft facilities) cannot be designated as “essential” contracts.

Treatment of the essential contract in any restructuring plan: If a supply of particular goods or services is deemed “essential”, it would logically follow, as noted in Para 8.17 the Consultation, that any proposed restructuring plan would require the support of the relevant supplier. We would therefore suggest, as a further check to ensure that this power was not used inappropriately, that the Court approval of any restructuring plan should specifically take into account the position of any supplier that the company had designated as being “essential”, focussing on whether that supplier was likely to terminate its relationship with the company and, if so, how the company was planning to deal with the absence of an “essential” supply.

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32 Paragraph 8.12 of the Consultation

33 "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"
84. **Preservation of rights of set-off**: It is not expressly stated in the Consultation whether any contract could still be designated as being “essential” and therefore not terminable, if the counterparty was relying on a right of set-off which required such termination and, if so, how the relevant counterparty’s position would be protected, if its position deteriorated as a result of not being able to exercise such set-off right. In order to avoid an inequitable outcome, one option might be to allow a supplier to terminate the relevant contract, and to exercise any resulting rights of set-off, provided that they confirmed that they were willing to continue making supplies on the same terms under a new contract.

**EXPLORING OPTIONS FOR RESCUE FINANCING**

85. We think that it is right that this area should be kept under review, as new money has historically been provided by banks who were already creditors of the company in question. Today, those banks are increasingly selling their debt at an early stage in the restructuring process, with the result that a company’s creditors, once a restructuring is under way, increasingly comprise CLOs, hedge funds and bondholders who may be unwilling or unable to provide additional liquidity.

86. We do not believe that the reason why competitive DIP finance and exit finance markets have failed to develop to date in the United Kingdom is the absence of mechanisms for giving such claims priority, as:-

(i) any such funding can already be given statutory priority as an administration expense;

(ii) new funding can, as part of a consensual restructuring plan or under a Scheme of Arrangement, be given priority over all other secured claims;\(^\text{34}\) and

(iii) it appears that any such funding made available as part of the moratorium process would also be given statutory priority.\(^\text{35}\)

In short, procedures are already in place to give priority to new funding, albeit subject, in some cases, to the claims of existing fixed charges.

87. When looking at this issue, the Commission Recommendation of 12\(^\text{th}\) March 2014 focussed on two specific risks which might be deterring new lenders, namely that:-

(i) new financing agreed upon in the restructuring plan and confirmed by a court might be declared void, voidable or unenforceable as an act detrimental to the general body of creditors; and

(ii) providers of new financing as part of a restructuring plan which is confirmed by a court could potentially face civil and criminal liability relating to the restructuring process.

Neither of these risks is considered to be particularly relevant in a UK context.

88. As noted in our March 2015 response, it is possible that one of the main bars to third party funding in a restructuring or insolvency context may be a lack of transparency, which

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\(^{34}\) Should interim liquidity be required, a DIP facility could even be proposed as part of a "Moratorium Scheme of Arrangement"

\(^{35}\) Paragraph 7.46 of the Consultation
makes it difficult for a prospective lender to identify or price potential opportunities. By way of example, in the US, it is possible to search the court docket for all the documents filed with the court in the context of US Chapter 11 proceedings, including any debtor-in-possession financing agreement, whereas, in the UK, it can often be difficult to get hold of a copy of the order placing the company into administration, let alone any of the agreements entered into by the administrator.

89. This is, however, a topic best explored directly with potential providers of third party funding, as they will be best placed to explain whether lack of transparency is indeed an issue (and, if so, whether any practical steps could be taken to address it), or whether there are other potential bars to third party lenders providing additional liquidity during the restructuring process.

90. Once there is a clearer understanding of what is preventing the growth of a competitive third party funding market, and of what steps would need to be taken to remove any identified obstacles, careful consideration would have to be given to the question of whether such obstacles could be removed without causing significant uncertainty and possible disruption to existing financial markets and products and without making new lending more expensive.

91. The concerns voiced in 2009 in response to an earlier consultation would, however, strongly suggest that this “complicated issue” is not one which can be satisfactorily explored in the context of a six week consultation.

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36 We note in this context that Para 22(d) of the Commission Recommendation anticipates that any restructuring plan should set out “the conditions for new financing”, which, if the plan is a public document, may result in a greater degree of transparency than may currently be found in the United Kingdom.
APPENDIX 1 – SPECIFIC QUESTIONS

The Introduction of a Moratorium

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

We would support the introduction of a short, pre-insolvency, moratorium which put onto a statutory basis the approach already adopted by the courts in cases such as *BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group*, where case management powers have been used to impose a short de facto standstill on hostile creditor action while a restructuring plan is finalised. Dealing with such actions can prove an unhelpful distraction during the restructuring process and it would be useful to have the threat of a statutory moratorium available, in order to prevent anxious or disruptive creditors from attempting to derail business rescue plans by petitioning to have a struggling company wound up.

What is proposed in the Consultation, namely a wide administration-type moratorium, would, however, go considerably beyond this identified issue, and would make fundamental changes to the existing restructuring landscape. The existing rights of secured creditors (in particular the rights of the holder of a Qualifying Floating Charge) unsecured creditors and suppliers would be significantly restricted, while the directors of a business would potentially be allowed to carry on incurring losses during the moratorium period or to continue trading such that free assets were progressively converted into charged assets during that period.

There is a clear risk that what is proposed may, rather than creating an environment in which plans could be put in place for the rescue of a potentially viable business, simply encourage directors to put off dealing with a company's financial difficulties. This could, in turn, lead to creditor anger and frustration, should the company's financial position deteriorate during the moratorium period.

The question is therefore one of whether the significant restrictions on creditor rights, and the risk of the moratorium being abused, could be justified by reference to the number of viable and well managed businesses which would, under the current legislative framework, fail, but which would be likely to survive, should a moratorium of the type proposed in the Consultation be available.

We have, in practice, experienced very few cases in which a viable and well managed business has failed as a result of the absence of a moratorium of the type proposed in the Consultation. We would therefore not support the wider moratorium proposals contained in the Consultation, as any potential practical benefit is outweighed by the potential prejudice to creditors.

While we do not believe this to be the intention, we would also emphasise our view that the preliminary moratorium should be an optional process and that a company should not have to enter into the moratorium before it can go into administration or utilise any statutory cram-down procedure.

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?

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37 [2013] EWHC 1146 (Ch)
The process of filing at court, combined with filing with the Registrar of Companies and sending a copy of the application to all known creditors, would make the moratorium a matter of public record and should ensure that creditors are made aware that a moratorium is in place.

There may be merit in requiring the company to notify any other parties with which it does business during the moratorium period that it is subject to a moratorium. As with other insolvency procedures, notice to this effect could appear in correspondence from the company and on any website, thereby ensuring that those dealing with the company were aware of its financial position (particularly if they were a potential new supplier who was at risk of having their contract designated as an “essential” contract).

We would also suggest that the court could potentially play a greater role, in certain limited circumstances, in order to avoid the risk of hostile creditors presenting a tactical winding-up petition directly they suspected that the debtor company might seek a moratorium. In order to address this, it might be worth considering giving the court discretion in such circumstances to allow a company to use the moratorium where it would, but for such winding-up petition, be eligible to do so.

Turning to the dissolution of the moratorium, it appears, given the subjective nature of the proposed qualifying conditions, that only the court would be in a position to decide whether or not the moratorium should be ended in the face of creditor objections.

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

Overall, there is a concern that the proposed tests are very subjective and that, as drafted, they lack detail.

The requirement that “the company must also 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” raises the following questions:

(i) How will compliance with this test be demonstrated? Experience derived from advising directors of companies facing financial difficulties highlights the amount of work that needs to be carried out, in all but the simplest of businesses, in order to establish and maintain a proper cash flow forecast which can give comfort that the company should have sufficient funds to meet its obligations as and when they fall due. This requirement could limit the availability of the moratorium to companies which have the expertise and/or resources necessary to create a proper liquidity forecast.

(ii) How would compliance with this test be policed on an on-going business? It appears that only the supervisor will be in a position to provide independent oversight of the company’s liquidity position, but taking on this role would seem to be inconsistent with the “light touch” approach generally contemplated by the Consultation.

(iii) Could this requirement be satisfied by having new third party funding made available? If so, the objective of ensuring that “existing creditors are no worse off.” may not be satisfied, as even if such funding was not secured, it would still have priority as an expense of the process, and would be repaid out of the company’s available assets before the claims of existing unsecured and floating charge creditors, whose position could be prejudiced, particularly if the new funding had been used to cover on-going operational losses.
If a lender was be able to accelerate a facility during the moratorium and to demand repayment following such acceleration, would the amount demanded, having fallen due, have to be repaid if the moratorium were to continue?

Turning to the requirement that the “company must be able to demonstrate that there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors”, the following questions arise:

(i) What does the “reasonable prospect” test actually involve? Would the supervisor be looking for evidence of a certain level of creditor support (and if so, what percentage?) or would it be sufficient for the debtor to assert that any plan which improved the position of creditors should, as a general proposition, have a reasonable prospect of obtaining creditor support?

(ii) Would the consent of any qualifying floating charge holder or any essential supplier be required? We would, as noted in the main body of our response, question whether the moratorium should extend to secured claims, but if it did, the moratorium should not be allowed to proceed where the management of the debtor company lacked the support of the company’s key secured creditors, particularly where it was clear that (for example) the holder of a QFC intended to enforce its security at the end of any moratorium period.

Finally, we would point out, as stated in the main body of our response, that there should be exclusions from the moratorium for arrangements falling within the scope of the Financial Collateral Arrangements (No. 2) Regulations 2003, security falling within the scope of Article 5(1) of the EC Regulation on Insolvency Proceedings 2000 and security in respect of which creditors retain the power to appoint an administrative receiver (such security being currently excluded from the small company CVA moratorium).

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?

No. As noted in the main body of our response, it is important that the legitimate expectations of creditors are addressed in relation to any proposed moratorium, particularly if it is to last for three months. Appropriate checks and balances should be put in place to ensure that, as far as realistically possible, the creditors’ position does not deteriorate during the moratorium period. We would, in particular, expect to see firmer restrictions on (i) creating new security, (ii) disposing of material assets outside the ordinary course of business, (iii) repaying pre-moratorium liabilities and (iv) making payments to connected parties during the moratorium period (together the “Relevant Transactions”).

There would appear to be a strong argument that, in order to maintain creditor confidence, the company should not be able to enter into any Relevant Transaction without the prior consent of the court. We do not believe that introducing such a requirement would result in a substantial level of court involvement during the moratorium process, as companies should not, other than in exceptional circumstances, be creating security or making significant disposals outside the ordinary course of business during this period.

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

Duration and Extension: In larger or more complex restructurings, a three month period may be too short to be useful, unless extended. Under the current proposals, obtaining such an extension
may prove problematic and time consuming, particularly as it would require the consent of every secured creditor. It may therefore, as noted in the main body of our response, be worth considering building some flexibility into any moratorium legislation, in order to avoid the company’s management being distracted during the moratorium period by efforts to obtain the consent of every secured creditor to an extension.

**Cessation:** It is proposed that “creditors would...have a general right to apply to court during the first 28 days of the moratorium”. It is unclear why the right to challenge the moratorium should be limited to this period. Circumstances change, including in relation to the prospects of agreeing a successful restructuring, with the result that creditors may well have valid grounds to argue after (say) two months that the company’s financial position and prospects no longer merit the continuation of the moratorium. The creditors’ right to challenge should therefore last as long as the moratorium lasts.

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

As discussed in the main body of our response, measures should be put in place to ensure that the supervisor has sufficient expertise to (for example) analyse properly any cash flow/liquidity forecast prepared by the company's directors or to decide whether there are any CoMI issues. The success of any moratorium procedure will depend on creditors having confidence in both the procedure itself and in the supervisor who is effectively protecting their interests.

Given the practical difficulties involved in establishing whether a solicitor or accountant has the necessary skill set and experience to take on the role as supervisor, the simplest option might be, as with other insolvency procedures, to limit the role of the supervisor to licenced insolvency practitioners, given that the latter should, by reason of their qualification, have the necessary skill set to take on this role.

Additionally, the idea that the supervisor could be a solicitor sits uncomfortably with the SRA's refusal to regulate insolvency practice.

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

While it is reasonable that debts properly incurred running the business and the reasonable costs of the supervisor during the moratorium should be treated in the same way as costs in administration, being repaid first by the company as an expense of the process, there need to be checks and balances on incurring such debts and costs, given that they may reduce the recoveries of the company's floating charge and unsecured creditors. In particular, it is unclear from the Consultation:

(i) Who would approve such costs? Under the current proposals, there does not seem to be any mechanism for such costs to be approved by either the company’s creditors or the court.

(ii) Who would resolve any dispute as to whether such costs were reasonable?

(iii) Should there be a cap on such costs (or at least on the supervisors’ remuneration)? and

(iv) Would such costs include liabilities incurred during the moratorium under continuing contracts or would priority only extend to those contracts which were designated as essential?

8. **Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?**
Creditors should be provided with sufficient information to allow them both to (i) assess whether the eligibility criteria are satisfied and (ii) consider the viability of any proposed restructuring plan. They should also be entitled to request such information, if it is not provided. This should increase both transparency and creditor confidence in the process.

There must, however, be limitations on what can be requested, as a flow of requests for information could become so onerous that it began to interfere with the restructuring process. There is a clear risk that those who should be focussing on developing the restructuring plan and negotiating with key stakeholders could be distracted (particularly in a company with limited resources) by requests for additional information.

There should, for example, be a clear carve-out, allowing the company and/or the supervisor to ignore unreasonable requests or requests (such as those for the provision of confidential trading information), the disclosure of which might damage the company’s business.

Finally, we believe that it is important that there should, as between creditors, be a level playing field in relation to the provision of information, particularly in the case of larger companies whose debt is being traded. There may therefore be merit is requiring the debtor company to place any material information supplied at the request of one creditor onto its website, so that such information can be accessed by its other creditors.

**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?

The proposed extension of existing statutory restrictions, in order to prevent the use of ipso facto clauses to terminate “essential” contracts, may prove a useful tool in dealing with “ransom” creditors, as long as the interests of the relevant supplier are properly protected. There would, however, appear to be some inconsistency between the Consultation and the Impact Assessment as the Consultation suggests that the number of essential contracts would be very low, while Paragraph 1.74 of the Impact Assessment suggests that “the average company may ask for 5 – 10 suppliers to be assigned as essential”.

If the figures contained in the Impact Assessment are correct, it might be argued that we are edging towards a general prohibition on ipso facto clauses, given that such prohibition already extends to supplies of gas, water, electricity and IT. While this may, in some respects, be a simpler solution than that proposed in the Consultation, careful consideration would need to be given to the question of whether it was also a desirable solution.

Further measures would, however, need to be put in place to ensure that the position of the relevant supplier was properly protected. There should, in particular, as noted in the main body of our response, be limitations on the nature of “essential” contracts. It is likely, for example, to prove impractical to put satisfactory protections in place for certain financial contracts, with the result that it may be necessary to specify that some types of contract (for example interest rate and currency hedging agreements and undrawn overdraft facilities) cannot be designated as “essential” contracts.

**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?
No. The supplier is, for the reasons set out in the main body of our response, potentially incurring a significant credit risk if the goods or services in question were supplied on 90 or 120 day payment terms. The supplier's concerns might be exacerbated by the fact that credit insurers may withdraw cover if a supplier was not able to terminate a contract on the occurrence of a payment default or other insolvency event.

The ability to go to court in order to challenge the decision to designate a key contract as being “essential” does not provide a supplier facing this risk with sufficient safeguards. Even assuming that the supplier could afford to go to court (which may not be the case for smaller suppliers) and that it had access to the sophisticated legal advice needed to mount a credible court challenge, it would, as noted in the Impact Assessment, still not make commercial sense for a supplier to do so unless the amount which they expected to lose as a result of continuing supply was greater than the expected litigation costs.

Even if the supplier did go to court, it is unclear from the Consultation whether they could only challenge the decision to categorise a contract as “essential” or whether they could also challenge the assessment that the business would be able to meet its payments as they fall due.

Given that the supplier's main concern, in most cases, would be that might not be paid, they should have the right not to supply where they have reasonable grounds for doubting that they would be paid in full. The alternative approach, as noted in our response, would be to allow any supplier to insist, whatever the original contractual payment terms, on being paid in full, in cash, on delivery of the relevant goods or services, should the contract in question be designated an essential contract.

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?

We would support the suggestion that the Corporate Recovery Plan should be a stand-alone restructuring procedure which would sit alongside the existing rescue options and which could be used by the directors of a company which was, or was likely to become, insolvent or by an administrator or liquidator of that company.

We would not, for the reasons set out in the main body of our response, support the alternative suggestions that the new procedure could be incorporated into the existing CVA voting procedure, or that it should replace the existing, and successful, Scheme of Arrangement procedure.

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

Yes. We agree, in principle, that the existing corporate rescue regime could potentially be improved by the introduction of a new statutory procedure which permitted the cramming-down of out of the money creditors, whether secured or unsecured, without their consent. The new procedure should not, however, allow interference with the rights of in the money fixed charge security holders without their individual consents.

The proposals set out in the Consultation relating to the new cram-down procedure are, however, relatively high level, and will require further detailed consideration if they are to proceed. In particular, the position of shareholders needs to be clarified, as it would clearly be inequitable if a Corporate Recovery Plan could leave shareholders with their existing equity, at a time when some or all creditor claims had to be compromised or written off.
Turning to the specific proposals, we agree that that (i) voting should be by class, (ii) the class test should be the same as that used in relation to Schemes and (iii) the approval threshold should be 75% by value of each class. We would, however, question whether the numerosity test applicable to Schemes should be incorporated into the Corporate Recovery Plan. Our experience is that this test offers no significant creditor protection. It does, however, give dissenting creditors the ability to sabotage (and potentially kill off) a widely accepted and viable restructuring proposal though the simple expedient of splitting out their votes.

As noted in the main body of our response, there may also be a case for giving the court the discretion, in exceptional cases, to sanction a Corporate Recovery Plan where a creditor whose ongoing support is vital to the debtor’s business would receive a larger repayment than more senior creditors, as long as the payment, and the rationale for making it, were fully disclosed and the relevant senior creditors were still better off than would otherwise have been the case.

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

The existing safeguards relating to Schemes of Arrangement work effectively, both protecting creditors’ interests and giving them confidence in the process. We therefore believe that existing case law and best practice established in relation to Schemes of Arrangement should also apply to the new Corporate Recovery Plan.

Similarly, we believe that the role of the court in considering whether to approve a Corporate Recovery Plan should be the same as the role of the court when sanctioning Schemes of Arrangement. The test currently applied by the court when deciding whether or not to sanction a Scheme works well and is widely understood. The same test should therefore apply to a Corporate Recovery Plan, thereby avoiding uncertainty and possible attempts to “play the system”.

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?

We do not, as noted in the main body of our response, believe that legislating for the use of a “minimum liquidation valuation” would necessarily be a helpful measure, even if it was possible to come to a generally accepted definition of exactly what this meant, as there is a danger that this would rapidly become the default valuation option. The fairness of any plan should be judged by reference to the most likely alternative outcome, which may not necessarily be the immediate liquidation of the debtor company.

As each case turns to some extent on its own facts, the court should continue its current practice of considering valuation issues on a case by case basis, having regard to independent valuation evidence.

On this basis, we would not agree that “potential future earnings” should be excluded for valuation purposes in every case, as a business may depend on a key contract (such as a patent) which would reasonably be expected to provide a future income stream. This could have a significant impact on the company’s value. While it could be argued that this income stream was “expected” rather than “potential”, attempting to draw a firm line between expected and potential earnings is likely to prove both problematic and a likely cause for dispute.

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?

Rescue finance can already be given statutory priority as an administration expense. New funding can also, as part of a consensual restructuring plan or under a Scheme of Arrangement, be given priority over all other secured claims. Mechanisms therefore already exist for rescue finance providers to be given priority over existing floating charge holders, including those with the benefit of negative pledge clauses.

Extending such priority arrangements to the holders of fixed charge security would, however, be a major step. As explained in the main body of our response, doing so would create significant problems that would in turn have a significant impact on new money lending.

Turning first to potential problems, giving new lenders priority over existing fixed security is likely to generate significant disputes as to, for example, (i) whether new fixed charge security is actually required, (ii) the value of the assets over which security has been created and (iii) whether the existing charge holder would be adequately protected. It is not clear that the UK courts have the experience or capacity to deal with such disputes.

These issues are likely to create uncertainty. Even if some safeguards are put in place, who would take the risk of the valuation being incorrect or the value of the secured asset deteriorating after new prior ranking security has been created? Lenders facing the possibility that the benefit of taking fixed charge security might be eroded would inevitably try to pass that risk onto new borrowers, resulting in increased costs for those borrowers.

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

Please see above. As with the question of how to value assets for the purposes of the proposed Corporate Recovery Plan, we believe that the court should consider valuation issues on a case by case basis, having regard to independent valuation evidence. We do not consider that it would be realistic, or helpful, to set out rigid guidelines for valuing assets as diverse as ships, commercial property, intellectual property rights and book debts, particularly where those fixed charge assets may be located in different jurisdictions and subject to local factors which impact on their value.

17. Which categories of payments should qualify for super-priority as ‘rescue finance’?

If by “super priority” this question refers to giving rescue financing priority over existing fixed charge security, we refer to our previous answers. If it refers to giving rescue financing priority over floating charge security that would suggest that the existing administration/liquidation expense regime should apply.

5 July, 2016

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Its contents should not be taken as legal advice in relation to a particular situation or transaction.
APPENDIX 2

THE CITY OF LONDON LAW SOCIETY INSOLVENCY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Jennifer Marshall (Allen & Overy LLP) (Chair)
Ms C. Balmond (Freshfields Bruckhaus Deringer LLP) (Deputy Chair)
H. Anderson (Norton Rose Fulbright LLP)
J. Bannister (Hogan Lovells International LLP)
G. Boothman (Ashurst LLP)
A. Cohen (Clifford Chance LLP)
L. Elliott (Herbert Smith Freehills LLP)
S. Frith (Stephenson Harwood LLP)
I. Johnson (Slaughter and May)
B. Klinger (Sidley Austin LLP)
B. Larkin (Jones Day LLP)
D. McCahill (Skadden Arps Slate Meagher & Flom (UK) LLP)
B. Nurse (Dentons UKMEA LLP)
J.H.D. Roome (Akin Gump Strauss Hauer & Feld LLP)
P. Wiltshire (CMS Cameron McKenna LLP)
J. Windsor (Linklaters LLP)
M. Woollard (King & Wood Mallesons SJ Berwin LLP)
A Review of the Corporate Insolvency Framework response form


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

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: The Law Society

Organisation (if applicable): /

Address: 113 Chancery Lane, London WC2A 1PL

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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?
References in square brackets are to the numbered paragraphs of the consultation paper. "IA 1986" and "IR 1986" refer to the Insolvency Act 1986 and Insolvency Rules 1986 respectively.

**The Introduction of a Moratorium**

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

The Law Society supports the proposed moratorium, but has some concerns about the detail of the proposals set out in the consultation paper (as set out in response to the further questions below).

As a general observation, it is unclear how the current proposals would interact with the various special administration regimes. We presume that any legislation will include provisions to avoid clashes between the regimes (e.g. permitting the FCA to apply for the appointment of a special administrator to an investment bank without first obtaining the permission of the court, or excluding investment banks from the moratorium altogether).

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?**

Yes: We agree that an “out of court” filing process, as proposed in the consultation paper, is appropriate. However, whilst out of court filing is undoubtedly efficient and cheap by comparison to an “in court” process, experience of out of court administration appointments suggests that it can also lead to companies and practitioners paying insufficient attention to the statutory tests applicable to the filing. To address that risk, we suggest that the relevant forms should clearly direct the mind of the supervisor to those tests. To that end, it might be appropriate to require the supervisor to include a narrative statement rather than simply “ticking a box”.

In addition to the “out of court” process, we suggest that there should be an alternative “in court” process which might be used in appropriate cases (e.g. where there was uncertainty as to the location of the centre of the debtor’s main interests or where there was a pending winding-up petition, subject to our comment below).

We also agree that creditors aggrieved by the moratorium should be entitled to apply to the court to dis-apply it. Upon such an application, as well as dis-applying the moratorium, the court should have the power (if appropriate) to appoint administrators or to wind the company up (c.f. paragraph 13(1) of Schedule B1 IA 1986).
3) **Do the proposed eligibility tests and qualifying criteria provide the right level of protection for suppliers and creditors?**

(a) **Eligibility tests:**

The proposed eligibility test as stated at [7.18] (“in financial difficulty”) is uncertain. We propose that the test should replicate the test for administration at paragraph 11(a) of Schedule B1 IA 1986, namely that the company “is or is likely to become unable to pay its debts”. That test is sufficiently wide to cover probable future insolvency and has the advantage of certainty, given the accrued authority as to its meaning.

We do not agree with the proposal ([7.20]) that a company should not be able to file for a moratorium if there is a pending winding-up petition. Such a rule would merely create a race to court, by creating an incentive for creditors to present petitions in order to gain an advantage over other creditors, and would also render the moratorium useless in circumstances where it might be most useful in achieving the survival of viable businesses. The Law Society’s view is that: (i) it should be possible for a company to file for a moratorium despite a pending winding-up petition; or (ii) in such circumstances it should, at least, be possible to obtain a moratorium by application to court (i.e. the position should mirror that applicable to the appointment of administrators by the company or its directors).

(b) **Qualifying criteria:**

We consider that the primary qualifying condition described at [7.22] requires further consideration and clarification.

It is currently stated that 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.” It is stated that this test is intended to “ensure that existing creditors are no worse off.”

We do not understand the policy reason for obliging companies to pay “current obligations as and when they fall due”. That appears arbitrarily to favour the creditors whose debts fall due for payment during the moratorium over those whose debts will fall due later (and which may therefore be compromised or, in the worst case, not paid at all).

Furthermore, the condition as formulated takes no account whether trading during the moratorium will deliver a net benefit to the company.
Although this is clearly not what was intended, a company would meet the criteria if it had sufficient funds to pay its current and moratorium liabilities, but only those liabilities. If such a company were to enter a moratorium and not achieve a restructuring it might well leave creditors whose debts did not fall due during the moratorium worse off. We suggest that the test be reformulated so that the company must show that the moratorium is likely either to improve its balance sheet position or to be neutral as regards that position.

As regards the criteria at [7.22] and [7.23], it is the supervisor who must be persuaded that the criteria are met. The supervisor “will be expected to base their assessment on evidence requested from and prepared by the directors” ([7.42]). Provided that the supervisor is under a clear duty to use reasonable care and skill in assessing that evidence, we consider that the criteria should provide adequate protection to creditors and suppliers. We reach that conclusion taking into account their right to apply to court to challenge the moratorium and subject to our observation that the proposed initial period of three months is too long.

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?

(a) Creditor rights:

We do not understand why the creditors’ right to apply to court to challenge a moratorium should be limited to only the first 28 days of the moratorium ([7.25]).

This limit appears to have been proposed by analogy with the limit applicable to challenges to CVAs (under section 6(3) IA 1986 and paragraph 38(3) of Schedule A1 IA 1986). In that context a limit is eminently sensible, in that it allows the company and creditors to proceed on the basis that, once the period has expired, the CVA will not be challenged. The same rationale does not apply to the moratorium itself, and it is easy to think of circumstances in which a creditor might first become aware of strong grounds for a challenge more than 28 days after the commencement of a moratorium. We do not see any good reason for barring such a challenge simply because it arises after 28 days, and we consider that creditors should have that right throughout the moratorium.

(b) Essential goods and services:

We respond to these proposals below.
(c) Directors’ powers and responsibilities:

[7.34] states that “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.”

As regards the risk of liability for wrongful trading (under section 214 IA 1986) during a moratorium, directors will only be at risk once the company has reached the point at which they “knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation”. Plainly, directors should also terminate a moratorium at, or before, that point, so that it is unnecessary to relieve the directors of liability whilst the conditions for a moratorium are maintained. Indeed, to do so would simply introduce unnecessary complexity into the law.

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

There needs to be a careful balance in the duration of the moratorium. This means that adequate time needs to be provided to enable essential processes to be undertaken such as obtaining valuations, and discussing/negotiating restructuring plans. A period of one month will not allow time for these sorts of considerations, and we are concerned that an initial moratorium consisting of a three month period is too long, and would increase the risk of the procedure being misused and stakeholder confidence in it being undermined. We consider that an initial period of two months would be appropriate, subject of course to the possibility of extension.

In addition to the extension by consent proposed at [7.36], we suggest that it should be possible for the company to apply to court for an extension. An example of when such an extension might be appropriate would be where the company intended to seek to cram down junior secured creditors as part of a restructuring plan, and had therefore been unable to obtain the support of all secured creditors to an extension.

As an additional observation, those provisions of the insolvency legislation that define the commencement of the insolvency of company should be amended so as to include the date of commencement of a moratorium. Those provisions would include, for example, section 240(3) IA 1986 (the “onset of insolvency” for the purpose of transactions at an undervalue and preferences) and rules 4.90(2) and 2.85(2) IR 1986 (exclusion from insolvency set-off of sums acquired by assignment).

6) Do you agree with the proposals for the powers of and qualification requirements for a supervisor?
The Law Society supports the Government’s stated aim of enlarging the pool of expertise upon which distressed companies can draw, so as to increase competition and reduce cost [11.4]. However, we also believe it to be essential that supervisors should have sufficient, demonstrable expertise to undertake the role competently. It is proposed that any insolvency practitioner, solicitor or accountant could act as supervisor of a moratorium, subject only to the condition that they have “relevant expertise in restructuring” [7.41]. It is not stated how such expertise would be assessed.

We consider it to be essential that there should be some objective measure of a proposed supervisor’s relevant expertise; it should not simply be a matter of self-certification. Unless expertise is measured objectively, there would be a clear risk of distressed companies (particularly SMEs) receiving inadequate advice and appointing incompetent supervisors, to the detriment of creditors and the credibility of the moratorium process as a whole.

The obvious objective measure of expertise in this area is qualification as an insolvency practitioner. Other than that it is not clear to us what measure could be adopted. In principle, the Government could create a separate licensing system for supervisors (for which the criteria would be focused on restructuring and thus less onerous than those for an insolvency practitioner’s licence). We doubt that that is what the Government has in mind but, unless that or some equivalent system were implemented, our view is that it should only be licensed insolvency practitioners who should be able to act as supervisors.

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

The Law Society agrees that debts incurred during the moratorium should be paid in full, as an expense.

We have some concern that, by comparison with administration or liquidation, there would be a greater risk that moratoria would end in circumstances where the assets of the company available for the payment of expenses were insufficient to pay those expenses in full. That is because we consider that risk to be greater in a process controlled by directors than is the case in a process controlled by an officeholder (and that that is the case notwithstanding the supervision of a moratorium by a supervisor). However, as it is not immediately clear how that risk could be reduced without rendering the process impractical, we do not propose any alternative treatment of expenses.

8) **Is there a benefit in allowing creditors to request information and should the provision of that information be subject to any exemptions?**
Although we agree with the principle that creditors (as a body) should be provided with more information than is typically contained in progress reports, we are concerned that if individual creditors were given a right to request information at any time it could create a very considerable burden for officeholders, driving up the costs of insolvencies and thus reducing their chances of success and their accessibility to smaller companies. Furthermore, it is likely that the majority of such enquiries would be made shortly after the start of an insolvency process, which is generally the busiest period of any appointment as well as the time when officeholders have least access to information.

We are not persuaded that those burdens would be balanced by an equivalent benefit to creditors.

**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?**

The criteria identified at [8.12] are that continued supply would "contribute to the success of the rescue plan" and whether "alternative arrangements can be made at a reasonable cost within a reasonable time". We are concerned that these set the bar too low. Continued supply from existing suppliers is always likely to be desirable, and thus to contribute to a rescue plan, when set against the effort and disruption involved in sourcing alternative supplies.

[8.15] formulates the test differently, and refers to continued supply being "essential to the successful rescue of the business and its continuity". That seems to us to be a more appropriate standard, but it leaves open the meaning of "essential". Different officeholders and directors could construe such a provision very differently, and it is therefore desirable that the standard should be more clearly defined.

We suggest that the test should be whether cessation of the supply by the supplier would be likely to impede the purpose of the moratorium or other process (replicating, to the extent feasible, the test applicable to lifting the administration moratorium in *re Atlantic Computer Systems*) (which test would automatically require the officeholder / company to consider the availability and cost of alternatives).

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?**
Subject to our comments above regarding how the standard for "essential" supplies is set, we agree that the proposal provides appropriate protection to suppliers. We are, however, concerned that the proposal would generate significant work for the courts, particularly in early years whilst suppliers are getting used to it and when the scope of the law remains untested. It is not clear that the courts could easily accommodate this extra work, or deal with it as quickly as would be necessary for the system to function. As the points at issue will be commercial, rather than legal in nature, it may be that they could better be resolved by some alternative dispute resolution procedure (such as arbitration), with an application to court as only a last resort.

**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?

The Law Society’s view is that it would be preferable to create a standalone procedure than to amend the law relating to CVAs. That is because, for all their flaws, we consider that some aspects of CVAs (e.g. relatively low costs, the absence of classes) may make them more appropriate than the proposed restructuring plan for some debtor companies (especially smaller companies).

There are clearly arguments against creating too many, essentially similar, procedures. On balance, however, we consider that those arguments are outweighed by the advantages of ensuring that a broad range of procedures remain available to distressed companies to enable them to choose the procedure that best responds to their particular circumstances.

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

Yes – that seems an essential feature of the plan procedure.

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

Yes.

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?
Yes, as long as the legislation provides for flexibility. In some circumstances, the rigid application of a liquidation valuation could cause injustice to junior creditors (e.g. deeming them “out of the money” when, if a plan were not adopted and there were an administration and a sale of the business as a going concern, they would not be). It is important that the flexibility referred to at [9.35] should allow the court to apply a more realistic valuation methodology in such cases.

The risk of flexibility is that it will lead to litigation regarding which valuation methodology should be used (as is recognised at [9.35], and is certainly the case in the USA), which could be very expensive and significantly delay the implementation of the restructuring. Nonetheless, even taking this into account, we consider a flexible approach to valuation to be preferable to an inflexible approach which might hand too much power to senior creditors by undervaluing the outcomes for those lower down the waterfall.

**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?**

Although it certainly true that the UK’s rescue finance market is less developed than those in other jurisdictions, we do not consider that this creates a material impediment to business rescue. As the consultation notes at [10.6], English law does provide ways of conferring priority on rescue finance. If these are not often used, it is because other solutions are generally found in those cases where funding is required.

If the Government does decide to legislate on this point, we would not support the introduction of measures whereby rescue financing could be secured ahead of existing fixed charge security without the consent of the holder of the existing charge. We do, however, see some value in the proposals to create subordinate security over assets already subject to charges, despite the existence of a negative pledge, where there is free equity in the assets.

Our chief concern, in this regard, is that there should be safeguards to prevent the directors of a debtor company, subject to a moratorium, obtaining rescue finance over free assets in support of a restructuring that is unlikely to succeed, thus prejudicing the position of creditors generally.

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

No comment.
17) **Which categories of payments should qualify for super-priority as ‘rescue finance’?**

No comment.

**Impact on SMEs**

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

Although the Law Society is broadly supportive of the proposals made in the consultation paper, we have some doubts as to how effective those proposals will be in facilitating the restructuring of SMEs.

The nature of the proposals makes it essential that the court should oversee some aspects of the procedures in order to protect the rights of stakeholders and prevent abuse, but such oversight will necessarily lead to costs that may put the procedures beyond the reach of smaller companies. We do not see that can be avoided, however, and we think the proposals go as far as they reasonably could to reduce those costs whilst still maintaining appropriate safeguards.
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
Comments on A Review of the Corporate Insolvency Framework
23 June 2016

Introduction:

This feedback is given by the Credit Division of Tokio Marine HCC. We provide Whole Turnover and Single Risk Credit Insurance to a range of businesses with turnovers from below £1m to in excess of £100m. Approximately 75% of our customers would be regarded as SME or Micro SME. Our comments on the report are taking into account their position as small businesses who are often disproportionately impacted by the insolvency of their customer. They are not reflective of our position as a multi billion dollar top 10 global insurance company.

General Comments:

- The aims and intentions overall appear to be positive.
- We have some concerns over how a small creditor would enforce their rights e.g. to challenge being designated an essential supplier.
- If these proposals come into effect, it is likely that the credit insurance market could adapt the cover it offers to customers.
- The process needs to be cost effective and transparent.

Moratorium:

- This generally seems a good idea and we anticipate would prevent viable businesses going into administration so overall better for our customers and the credit insurance market.
- Questions over retention of title – it would appear that suppliers would not be able to enforce their rights to retention of title for goods supplied and not paid for prior to the moratorium. We would propose that with the exception of essential services, suppliers should be allowed to identify their goods and the supplier given the choice whether to pay for the goods and use them or return them to the supplier.
- Filing at court – court processes can be slow and expensive. As much of the process as possible should be handled outside the courts by licensed insolvency practitioners who understand business.
- Who would decide whether a business is viable? We have seen abuses of the administration process in the past (pre-pack administrations). For moratoriums to be an acceptable solution the creditors must have the confidence that the viability assessment is robust, independent and transparent or we will end up with an abuse of the moratorium as a tool.
• One of the eligibility criteria is to show that there is sufficient funds to trade during the moratorium. In all likelihood, credit insurers will withdraw cover (unless they are afforded essential supplier status?) which will mean that suppliers seek to trade on cash terms and this will squeeze the cash flow of an already distressed business. How likely is it that a business can show it has sufficient funds to trade during the moratorium?

• Important that the business engages with credit insurers prior to the moratorium to establish the level of support and therefore the availability of credit terms

• It’s presently unclear how it would be assessed that the business is viable and can trade during the moratorium.

• 28 days period for creditors to challenge – this would need to be a robust and cheap process so that it is available to creditors. Historically there has been a right to challenge a number of things eg fees or require a creditors meeting but all require creditors to stump up large sums of money when they have already lost money. How is it proposed that such challenges are funded? Unless this is solved, challenges will be rare and the ability to challenge is nothing more than a token gesture

• The impact of the moratorium on small creditors could be to push them into insolvency. They cannot afford to wait for their money. Domino effect though not clear if that will be any worse than current insolvency processes.

• We consider it unlikely that creditors will be consulted based on the track record of pre-pack administrations. The usual approach is to keep creditors in the dark as much as possible and the moratorium seems to support that. Insolvency processes must be transparent and allow unsecured creditors proper representation at each stage

• Extensions should be an exception - creditors need to be able to move forward with certainty and insurers need to crystallise the debt. Our experience of Irish moratoriums is that they are allowed to be extended over and over which is unhelpful to creditors

Essential Suppliers:

• The proposal focuses on the needs of the insolvent company to continue to trade during the moratorium. Consideration should be given to the creditors who are often small suppliers – if they have suffered a bad debt they may not be in a position to continue to supply. What protection is available to them?

• What is the process and cost to creditors in challenging the designation of Essential Supplier? If the process is not quick and cheap then it is purely a token gesture

• It is unlikely that the credit insurance market will continue to provide cover during the moratorium for essential (or any other) supplies. That position could change if the insurers are given essential supplier status but may be something each insurer wishes to consider commercially. It is possible the insurance produce could develop to offer this as add on cover to suppliers who know their product is unique.

• Could some consideration be made to giving essential suppliers a higher priority for pre-moratorium debts to compensate for having to continue supplies?

• Essential suppliers should be arms length suppliers and not connected to the distressed business
Class Structure:

- Our view is that separating creditors into different classes creates inequality and goes against the pari passu rule. It also over-complicates the insolvency process
- We do not agree that rescue finance providers should be granted security in priority. Rescue finance providers tend to operate a different business model to mainstream lenders. Costs are high but there is expectation that some deals will fly and some will fail. That position should not change (as it will give priority and unlikely they will adjust charges in line)
- The interest of existing chargeholders should not be diluted. They provided finance in good faith based on the security provided at the time and that cannot be amended after the event
- Trade Credit - this sits separately to other forms of rescue finance and should be regarded separately as the recipient pays no charge or interest for the credit. It is also generally unsecured. Anything that improves the position of trade credit suppliers is a positive step. Unsecured lenders take more risk for less return. They are also most likely to fall victim themselves of a default by a customer and therefore should be afforded greater protection than secured lenders
Dear sir/madam,

A Review of the Corporate Insolvency Framework Consultation Response Form

We write in response to the above consultation and welcome the opportunity to share our opinions in respect of the proposals tendered for the reform of the current UK Insolvency Framework to allow preventative measures enabling viable businesses to be rescued.

Introduction and Background of the Turnaround Management Association

The Turnaround Management Association (TMA) was established in the USA in 1987 and now has close to 10,000 members worldwide. It is based on a chapter structure with 53 chapters worldwide and approx. 20% of the membership is now outside the USA. The UK Chapter was established in 2001 and currently has 326 members.

TMA’s mission is to serve as a forum for corporate renewal professionals from all disciplines to promote high standards of practice, foster professional development, and enhance the image of TMA members. TMA’s vision is to be recognized by the global business community as the pre-eminent organization for representing the interests of turnaround and corporate renewal professionals from all disciplines.
Response to the Consultation Paper

The Introduction of a Moratorium

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

Yes.

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?*

Yes. However, we take the view that court intervention should be kept to the minimum and therefore we believe the filing of the application to moratorium should be simple and done via an online platform if possible.

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

Yes.

However, we are concerned with one of the proposed eligibility tests, being that “the company must demonstrate that it is already or imminently will be in financial distress or is insolvent”, may lead to companies leaving it too late before seeking to implement the preliminary moratorium. Companies need to be persuaded to seek help sooner rather than later if the prospective benefits of a turnaround are to be given the best chance of being realized.

Further, continuing liquidity is critical to any turnaround, as envisaged by paragraph 7.22. We consider a more appropriate criteria may simply be “for the company to be concerned about its viability” or “for the company to be facing short-term cash flow problems”.

As regards the proposed qualifying condition set out at 7.23 we believe
it is critical for the company to be able to demonstrate, as part of its application for a moratorium, that there is a realistic prospect that a compromise or arrangement can be agreed with its creditors. Presumably there will be an obligation on the Supervisor to express such a view independent of the company’s Directors?

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?**

Yes, but we would comment as follows:

The preliminary moratorium will provide an immediate stay on creditor legal and enforcement actions. A wide spread promotion to all creditors of the moratorium should be avoided and should be limited only to those wishing to pursue legal actions and exercise enforcement actions. Such creditors can make an application to court to challenge the moratorium, if they are able to demonstrate that the moratorium is wholly prejudicial to them.

Directors prospective liability for wrongful trading should not continue during the preliminary moratorium. However, they should be reminded of their duties and be obliged to take every reasonable step to ensure that the position of creditors is not adversely prejudiced during the period for which the moratorium is in force, and making adequate provision to achieve this should form part of their and the Supervisors assessment both of the company’s viability whilst the moratorium is in force and of the efficacy of the restructuring that is anticipated to be implemented during that time.

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

Yes, but we would comment as follows:
In the event of the company entering administration after the moratorium, we do not see why the period of the administration should be adversely prejudiced (reduced by the preliminary moratorium timeframe) by the failed moratorium actions of the incumbent directors.

As regards an extension. Consent from all secured creditors could be problematic in complex capital structures and does create opportunities for parties to buy debt with the intention of taking a ransom position. As drafted it appears a charge holder could frustrate an extension even if they have no monetary interest and/or might eventually be crammed down.

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

Yes, but we would comment as follows:

We believe the choice of supervisor should be the choice of the company’s directors or shareholders and be independent of creditors, and specifically of secured creditors. It is critically important for the supervisors to be independent, objective and for them to act in the best interests of the company.

We welcome the proposal that supervisors do not have to be licensed Insolvency Practitioners, but recognize the importance of them meeting certain minimum standards and qualifying criteria; having relevant expertise in restructuring and be a member of a regulated professional body.

There are a number of highly experienced turnaround practitioners working in the UK with a history of dealing with consensual restructurings and they are an important resource to ensure the objectives of this proposal are met.

We believe the minimum standards and qualifying criteria for a supervisor should be extended to include the Certified Turnaround Professional (CTP) qualification of the European Association of Certified
Turnaround Professionals. This is a UK/European version of the American CTP qualification which has long been recognized in the USA for working on Chapter 11 type restructuring processes. Four CTPs were appointed to run Lehman Brothers USA in Chapter 11 when it collapsed and at the same time four IPs were appointed to run Lehman Brothers in Administration in UK.

We believe TMA members, many of whom operate on their own account, provided they are appropriately insured, could offer at least the same level of expertise and assurance at a cost which is considerably less than some of the larger business advisory practices operating in this arena.

In the event of a subsequent formal insolvency appointment, supervisors ought to be held to account for concluding as part of their application for a moratorium, that there was a realistic prospect that a compromise or arrangement could be agreed with creditors, and that the business could be restructured to achieve viability.

Further, it should be recognized that a supervisor is a professional advisor, advising the directors and not managing the business. However, the concept of “shadow director” exists and turnaround professionals are well versed in acting in full knowledge of directors’ responsibilities and liabilities.

We are strongly supportive of the proposal in 7.45 that an Insolvency Practitioner acting as a supervisor be prevented from taking a subsequent formal insolvency appointment were the company to enter formal process. That would be a clear conflict of interest. We would also add that any firm taking the appointment as supervisor should be prohibited from taking any subsequent insolvency appointment with the company.

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

Yes, but we would comment as follows:
We agree that the costs of paying the supervisor be treated the same way as costs in an administration, and that any unpaid supervisor’s costs be treated as a first charge if the company proceeds to enter a formal insolvency process after the moratorium has ended.

The supervisor’s reasonable remuneration should be agreed by the Directors, however it is recognized that in the event of a subsequent insolvency the level of remuneration is likely to be reviewed.

We do not consider it is appropriate for any unpaid preliminary moratorium debts to be treated as a first charge if the company proceeds to enter a formal insolvency process, albeit such claims may give rise to a wrongful trading claim against the company’s Directors by a subsequently appointed Administrator or Liquidator.

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

Yes, although best practice in consensual restructurings tends to initiate regular communication with all creditors in any event.

Exemptions will be required for commercially sensitive or confidential information, disclosure of which would be prejudicial to the debtors’ interests and may be subject to confidentiality agreements, e.g. negotiations to sell some or all of the business. And also there should be an exemption for information that is not readily available and be too time consuming and costly to prepare compared to any benefit.

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?**
Yes, but would comment as follows:

Would it not be easier in practice to simply outlaw the refusal by any former supplier to a company the subject of a preliminary moratorium or administration or Liquidation on anything but the same terms as the company enjoyed previously, except in so far as the timing of any payments to be made in respect of those new supplies.

This would avoid having to consider what is essential and provided the suppliers have a right to challenge the supply request in Court, should provide adequate protection for suppliers if such a continuity is considered to be so adversely prejudicial to their interest in doing so?

We believe such continuity of supply regulations would result in a greater number of business rescues.

Furthermore, termination clauses in contracts should be limited to maintaining the status quo (i.e. reimbursement of consequential losses) had the contract continued, not to enabling suppliers to profiteer from a company’s failure.

This is particularly prevalent within the provision of Asset Based Lending (“ABL”), where the company’s demise can provide more profits for the supplier than its survival. In such situations many ABL’s are motivated for the company to fail.

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?

Yes, but subject to our comments in response to question 9.

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?

In our opinion a restructuring plan would work better as a standalone procedure, albeit such a preliminary moratorium could be utilized to allow time for the preparation of a CVA proposal and convening of a meeting with Creditors.

A CVA is an insolvency procedure and as such has a certain stigma to creditors, employees and customers. We believe that any moratorium should be a separate procedure that does not use the “insolvency” word at all. All stakeholders need to be comfortable with the procedure and not regard it as an “Insolvency” process, better a “Commercial” process that seeks to avoid insolvency and any destruction of enterprise value.

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

Yes.

This is a problem that currently impacts larger companies with multi-layer capital structures. Experience in the UK, Europe and even more so in the US is that hold-outs by out of the money creditors or opportunist hedge funds and buy-out specialists can be a real problem which delay restructurings and significantly add to costs. Schemes of Arrangement are a useful tool but are expensive.

The moratorium should provide for restraining secured creditors from enforcement and offer scope for binding the unsecured portion of their claim so as to prevent enforcement by ransom creditors.

In reality the threat of such mechanisms should mean that all but the most contentious are agreed consensually and never have a need to go anywhere near a court.

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

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?**

Yes, but we would comment as follows:

Where a plan is being crammed down onto dissenting classes, then the evaluation of the minimum liquidation valuation should be provided by a suitably qualified professional valuer who is independent of the company’s Directors and its Supervisor.

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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?**

No. We would comment as follows:

In our experience most DIP funding comes from existing senior lenders and only where there is some collateral still available. Alternatively, alternative lenders do have the option of replacing the existing lender(s) and providing new and increased facilities where sufficient collateral exists but where the existing lender was unwilling to do so.

We are concerned that the availability of super priority funding could be contrary to the stated objective of encouraging debtors to seek early advice while some liquidity is still available.

16) **How should charged property be valued to ensure protection for existing charge holders?**
At its open market value i.e. assuming a disposal within a 3-6 months’ time frame.

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

We have nothing to add.

**Impact on SMEs**

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

Promoting the critical importance of seeking professional support early when financial distress is anticipated.

Promoting a mechanism that provides access to professional advice that is affordable.

Promoting information regarding tools and resources available to businesses in distress by direct publicity from the government and by channeling awareness through business organisations such as the IoD, CBI, Chambers of Commerce, FSB, etc. We also believe that banks and credit providers should be compelled to make their corporate customers aware of the different types of help that are available.

Unfortunately, there will always be some businesses that are too small to avail themselves of such help.

We would reiterate our comments in response to question 6 that professionally accredited experienced turnaround professionals be encouraged to help small businesses avail themselves of this new framework.