A Review of the Corporate Insolvency Framework response form

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

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

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

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

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

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

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:

http://bmandt.eu/wp-content/uploads/2014/06/BMT-ICAEW-Turnaround-Guideline-Final.pdf

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

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.

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

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 opportunist 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