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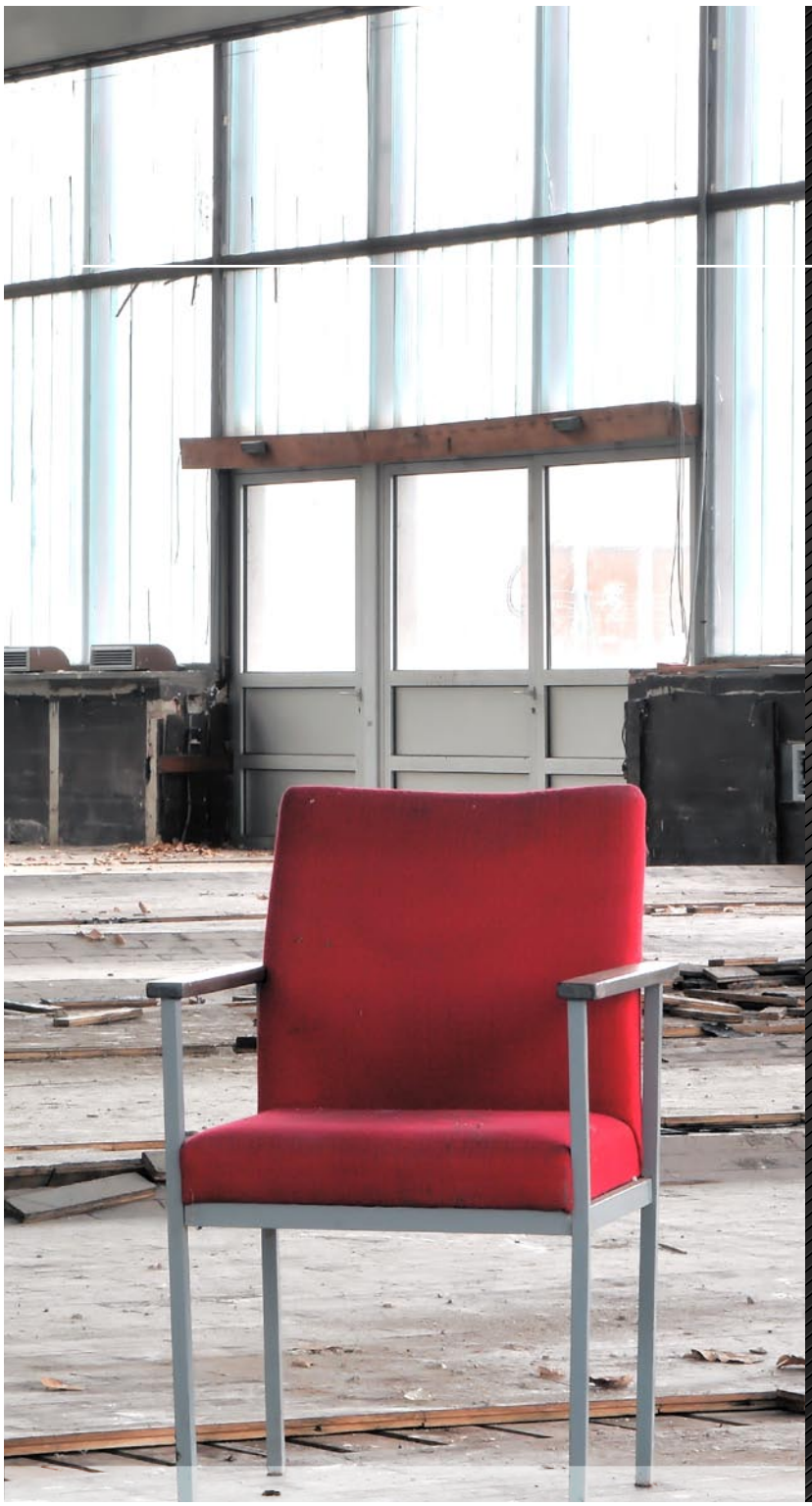

10QUESTIONS

PROPOSED UK INSOLVENCY LAW REFORM

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FW speaks to David Bryan, a managing partner at BM&T LLP, about proposed UK insolvency law reform.

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David Bryan is a founding principal of BM&T LLP and a hands-on certified turnaround professional with extensive experience working with international and UK companies in restructuring and improvement. He has operated at CFO level in large and SME companies in the UK, US and Europe and has many years experience with public and private equity owned businesses. His industry experience includes automotive supply, manufacturing, industrial systems and numerous B2B services. He can be contacted on +44 (0)20 3178 4902 or by email: dbryan@bmandt.eu.

FW: In your opinion, how efficient and effective is the UK's existing insolvency regime? Do you believe substantive changes are required?

Bryan: The UK has prided itself on having an efficient insolvency regime which avoids the drawn-out court driven regimes of many other countries. Recent attention has focused on the World Bank rankings where the UK has slipped from seventh to 13th. However, this misses a more fundamental issue. Once a company becomes insolvent, our system is very efficient. Returns to secured creditors are better than most countries, but returns to unsecured creditors are close to zero. This is fine for the banks, but not for everybody else. Far too many businesses find themselves going through insolvency processes and the UK has no regime for trying to save viable businesses. This has a domino effect, with as many as a third of insolvencies being caused by the insolvency of a customer.

FW: Which areas of UK insolvency law do you believe need to be updated to ensure the regime keeps pace with today's complex business world?

Bryan: The UK needs a process which allows viable businesses breathing room to address their problems and restructure. This procedure should be outside the scope of any insolvency process as the very mention of insolvency can be value destructive.

FW: Following the UK corporate insolvency framework consultation, what do you hope the scope of potential legislative change will be?

Bryan: The UK framework consultation was around an initial government proposal covering four new initiatives. Firstly, there should be a moratorium of up to three months, whereby creditors are not allowed to take any action against the company while it addresses its problems. Secondly, companies should be able to designate certain suppliers as essential, so they cannot refuse to supply during the moratorium period. Third, company rescue plans should be able to 'cram-down' hostile creditor classes, subject to suitable protection, so that a subset of creditors cannot hold a restructuring to ransom. Finally, there should be proposals to facilitate rescue lending to companies in distress.

FW: With many of the basic insolvency procedures in the UK having remained largely unchanged for over a decade or so, even in the years following the financial crisis, is it simply the case that the UK insolvency regime is no longer fit for purpose?

Bryan: UK insolvency law has changed little in 20 years. In practice, however, the process has changed for the worse. Insolvency practitioners enjoy a unique regime in the UK and have great freedom to act. In turn, they are heavily regulated. Over the years, issues around personal liability have meant that few practitioners are willing to trade a business in administration for any time. Most insolvent businesses are moved on quickly through an asset sale with limited due diligence and no warranties. The goodwill of the business is eroded and enterprise value drastically reduced. Unsecured creditors normally get next to nothing.

FW: What, in essence, is the UK government proposing to do to improve the existing regime?

Bryan: The new proposals aim to expand the options available, by creating a system where businesses are encouraged to act early, where management remains in place and where new tools are available to help reach a consensual solution.

FW: To what extent are the international insolvency law changes responsible for a shift in perceptions as to what constitutes 'best practice' for the UK's insolvency regime?

Bryan: In March 2014, the EU recommended all countries adopt laws that move "towards encouraging viable businesses to restructure at an early stage so as to prevent insolvency". In November 2016, this was published as a final proposal which should lead to a mandatory Directive for all EU countries, probably becoming effective by 2018. The UK issued its consultation proposals in May 2016 so is ahead of the EU. However, the EU proposal is more far reaching in its scope for pre-insolvency consensual restructuring. This will add weight to the UK government's position against vested interest opposition. It is ironic that by the time the Directive becomes binding, the UK will likely have commenced its exit from the EU and thus will not be bound by the Directive. However, there remains sense in having similar procedures based on the same underlying principles. The UK must strive to become a more attractive place for business over the coming years. Having a robust pre-insolvency regime that avoids insolvency being the default option must be in the country's best interests.

FW: To what extent do you believe the UK insolvency regime should be influenced or guided by the principles and processes of US Chapter 11?

Bryan: Previous amendments to UK law started from the basis that Chapter 11 was something of a gold standard. However, lobbying by the banks and the insolvency profession largely negated any such changes. Chapter 11 has had problems in the US. It is an expensive process that few businesses use in its original intended form. The ability of every class of creditor to appoint advisers at the debtor company's expense has turned it into a fee feast for lawyers and others. Current practice is to avoid a drawn-out process by a quick asset sale or pre-negotiated solution. The current UK and EU proposals share many of the better characteristics of Chapter 11, but avoid the cost and delays. Many of those who commented in the UK consultation think the proposals will only benefit large companies. I do not agree. If the government keeps this a lightly regulated process, which encourages directors to seek help early, then I believe this can work cost effectively for even modest sized businesses.

FW: In your opinion, what effect might reforms to the current UK insolvency regime have on the protections currently afforded to creditors and employees?

Bryan: I do not think there should be any effect on the protections afforded to creditors and employees. Some have suggested that a moratorium could be a mechanism for unscrupulous directors to avoid insolvency, to the detriment of creditors. The proposals do set out criteria that must be met to enter a moratorium and the appointment of a supervisor who should ensure that those conditions continue to be met. I do not think this would be a rogue's charter. Data shows such practice as the exception rather than the rule. What will change is the way that creditors and employees engage with the company at an earlier stage. The intention is that a consensual resolution be reached and that may involve much more discussion and negotiation with all creditors and employees, rather than them just finding out after the event that the company has entered formal insolvency.

FW: What advice would you give to those with a vested interest in corporate insolvency – insolvency practitioners, restructuring lawyers, employees, creditors, etc. – in terms of preparing for what may well be a major overhaul of insolvency laws in the UK?

Bryan: In conversations with various interested parties I am surprised that many seem unaware of the proposals. Others seem to be hoping that it will all go away and never be enacted. I think the government recognises that the detail needs to be worked on but will push these proposals through. The EU is pushing ahead with parallel proposals as a Directive, so it will eventually be law in the EU. The UK may have voted to leave the EU but will not want to be

left behind. It will not want companies forum shopping to the EU for a more value preserving process. Professionals, employees and creditors need to embrace this. They may feel comfortable with the status quo, but I do not think that is going to be acceptable. High profile bad behaviour by banks, poor returns to unsecured creditors and international pressures have created the momentum for change.

FW: What are your predictions for the UK insolvency regime in the months and years ahead? How would you like to see the process evolve?

Bryan: The responses to the government consultation show a lack of understanding from some respondents of how consensual restructurings work to all stakeholder advantage. Parties must understand that consensual restructuring does provide a better outcome for creditors and other stakeholders. Some parts of the proposals need refinement, and rushed legislation is never a good idea. Parliamentary time will also be at a premium to get a bill passed, but I do believe it will happen. Businesses will need to adapt. We need to educate managers that these new processes exist and overcome the fear and stigma of failure. They will need to understand that getting help is not an admission of failure and that seeking help earlier than many do now creates more options and gives a much better chance of saving a viable business. ■