House of Commons

Business, Innovation and Skills Committee

The Insolvency Service

This is a volume of submissions relevant to the inquiry into The Insolvency Service, which have been reported to the House.

Only those submissions written specifically for the Committee have been included.

Version 1 **17 January 2012**

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IS 03

Written evidence submitted by the Association of British Insurers

1 Introduction

1.1 The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

2 Overview

2.1 We support developments in UK law that enhance the market power of unsecured creditors to play a role in the insolvency process and improves the way our existing regulatory system handles complaints. This must include measures to reduce the complexity of the current system to make it more accessible for unsecured creditors, rationalise the number of Recognised Professional Bodies and improve consistency in decision making across the regulatory framework.

3 Pre-pack administrations

3.1 The ABI has long expressed concern about the increased use of pre-packaged ("pre-pack") administrations. The ABI is not opposed to pre-packs in principle, but they are not always a fair solution, and are open to abuse. While a pre-pack deal means that a company is bought out and can continue with business as usual, in most cases its unsecured creditors are left exposed. These are often SMEs who, in most cases, will never be repaid the money owed to them and are themselves therefore at serious risk of collapse. Only around 20% of SMEs have trade credit insurance, so those who do not are left to cover the losses on their own. In many cases, these unsecured creditors will have been trading with the company, unaware that it is about to enter a pre-pack, right up to the time the deal is done. The current system risks preserving large companies at the expense of their smaller suppliers, potentially leading to more jobs lost than saved.

3.2 The lack of transparency and notification of unsecured creditors in pre-pack situations is a serious problem both for SMEs and for insurers. We are disappointed that there has been no progress on this matter considering there was a consultation on proposals for a restructuring moratorium last year – which we responded to.

3.3 Statement of Insolvency Practice (SIP) 16 was intended to reduce the incidence of abuse of pre-pack sales, by compelling Insolvency Practitioners to disclose - albeit after the event - certain information concerning each transaction. It has failed to achieve its aim. It is being ignored by many Insolvency Practitioners, apparently with little consequence. Tighter regulation is required.

3.4 Pre-packs are being actively marketed by restructuring advisers as a convenient way in which to "dump debt" and start afresh free of troublesome creditors. The potential abuse of pre-packs is in danger of becoming institutionalised. We think that the heart of the problem lies in the serious conflict of interest inherent in an Insolvency Practitioner devising a pre-pack sale in secret in conjunction with the directors and secured lenders of a failing company, and then immediately implementing that transaction as administrator with a duty to act in the best interests of all creditors. Despite the professional and legal rules designed to prevent abuse, it is inevitable that a large proportion of pre-pack transactions will be structured so as to favour the owners of the business and their secured finance providers, who initially engage the Insolvency Practitioner and are privy to the design of the scheme, at the expense of unsecured creditors who have no opportunity to comment or intervene. We therefore favour greater transparency for unsecured creditors and support the Insolvency Service's proposal for legislation requiring a 3-day notice period.

4. Regulation and sanction of licensed insolvency practitioners

4.1 We support any development in the UK regulatory system that restores trust among unsecured creditors. The current structure does not protect their interests sufficiently and a lack of transparency and accessibility has undermined confidence in the process. This has contributed to a perception that RPBs are not consistent when handling after-the-event complaints and the oversight regulator has insufficient powers to correct market failure.

4.2 We support the creation of an independent complaints body alongside measures to rationalise the number of regulators, introduce a single and coherent regulatory framework and a single complaints portal to reduce complexity for creditors. Such a body must incorporate lay membership as a feature to improve confidence in the handling of complaints. If such a body is given the powers to review fees and remuneration charged by IPs these responsibilities should reflect their duty to act for the body of creditors as a whole.

5. Creation of an Insolvency Ombudsman

5.1 We believe that creation of an Insolvency Ombudsmen should be a matter of last resort if self-regulation through RPBs fails to correct market failure consistently.

6 Strengthening control of IP's remuneration

6.1 We would welcome greater transparency in the remuneration of IP's. We would support a strengthening of the control of IP's remuneration, such an agreed hourly rate or maximum amount, as it would improve transparency. It should include an obligation to inform creditors from the outset that any changes or meetings to renegotiate fees would still result in a cost to the estate.

21 December 2011

Written evidence submitted by the British and Irish Ombudsman Association (BIOA)

This submission is made on behalf of the Chair and Executive Committee of the Association which was established in 1991 and includes as members all major ombudsman schemes and complaint handling bodies in the United Kingdom and Republic of Ireland. The Association's objectives include:

- encouraging, developing and safeguarding the role and title of Ombudsmen in both the public and private sectors
- setting criteria for the recognition of Ombudsman offices by the Association
- formally recognising those persons or offices who satisfy the criteria
- facilitating mutual learning and providing services to members designed to develop best practice working to raise the profile of Ombudsmen and the understanding of their work

The Association welcomes this opportunity to comment and give evidence to the Committee, primarily about the possible creation of an 'Insolvency Ombudsman' which is contained in the Terms of Reference of the Inquiry.

BIOA would ask the committee to bear in mind that the most effective ombudsman schemes are "BIOA compliant", which means that they must meet the following five key criteria:

- Independence
- Fairness
- Effectiveness
- Openness and transparency
- Accountability

Indeed, these criteria are recognised by the Cabinet Office in its guidance to departments on setting up ombudsman schemes (copy attached).

The development of the current ombudsman landscape has been, to an extent, fragmented and piecemeal and can sometimes cause confusion and result in unintended underlaps and overlaps. Before proposing the creation of a new ombudsman scheme, BIOA urges the committee to consider whether insolvency practitioners could be incorporated within an existing scheme - but it if it is felt that a new ombudsman scheme is required, such a scheme should be fully integrated within the wider ombudsman landscape.

Please let us know if there is any further information the Association can supply at this, or any other stage of the Inquiry.

30 December 2011

IS 06

Written evidence submitted by David N Clough

It has been my privilege to work within The Service or BIS (in its various incarnations) for 28 years and for CIB for the last 17 of those , an experience which I found thoroughly rewarding and through which I have met many fantastic people.

there are a few matters concerning recent changes within the live company side of Investigation & Enforcement Services (IES) that you would wish to be brought to your attention. I would just add that I have considerable respect for Robert Burns (the head of IES) , who has always had CIB's interests at heart.

The Service as a whole is currently going through a turbulent time but certain developments within IES give me grave cause for concern, firstly as a professional but now as a tax-payer.

IES branding

In the private sector, a well-known and respected brand is seen as an asset. The CIB brand was well known within the enforcement community and covered all aspects of live company investigation – complaint vetting, investigation and follow-up action leading to winding up and disqualification. The 'troops' within (what was) CIB, still cannot understand why this respected brand was discarded. Not only is there now no snappy alternative (Company Investigations, Manchester, Company Investigations, London, Corporate Intelligence and Authorisations Team being among the alternatives), a strong silo management ethos has built up to separate, what used to be, a homogenous business area, where all stages of the process worked closely together.

"Fly-tipping" of complaints

You may be aware that the disqualification side of IES does very little high profile work and, indeed, has gained a reputation externally for tackling "low hanging fruit". This seems incongruous given the high profile failures which have been in the press over the last couple of years. I have been told by colleagues dealing with that area of work that part of the disqualification vetting function is engaged in trying to 'head off' cases where targeted directors might put up a fight, the preference being for 'easy' wins which look good statistically. I will follow with interest whether anything comes of the rumour of a referral by the FSA to The Service, covering the conduct of top officers within Royal Bank of Scotland .

The low hanging fruit tag was never applied to CIB. In fact, the landmark court case on land banking was achieved by CIB, not the FSA, despite the latter being the lead regulator in this area.

Until the end of 2010, the CIB vetting function was carried out by staff with relevant specialist qualification or experience, including decisions on whether to take a complaint forward for detailed consideration. Now the initial sifting of complaints is performed by staff at A2 (junior administration) grade on a formulaic basis and with no understanding of deeper issues that might lie with the complaint correspondence.

Let me elucidate just one example of the impact this has had. During the pre-winding-up of a company, which targeted vulnerable people, the Manchester Live Investigations team became aware that the directors were already trading in the same way via a phoenix. The new company details were sent for vetting and the matter refused by an A2 grade *in less than 60 seconds*. When the investigators protested, the A2's decision was reviewed by higher, specialist grade staff and a new investigation sanctioned *with a Medium risk priority*! My point is that decision-making on live company complaints is being made at too junior a grade by staff following a process but without understanding the issues. If a complaint falls at this hurdle, it is lost to CIB. Could the decisions made by A2 grade staff provide an explanation for the number of live company vetting files being opened having slumped from when the work was transferred to them?

The Live Companies statistics for incoming complaints from sources external to The Service and the number of cases accepted for investigation, year-on-year, should be called for from The Service. Since the changes to procedures in 2010 referred to above, volumes have fallen most markedly. Has this happened because:

- The public is disinclined to complain;
- There is a policy of choking off complaints at vetting stage (due to internal politics) to a volume roughly equal to what Vetting judge the investigators can handle, with no consideration for case quality (the low hanging fruit issue again).

Finally, I would just say my concerns are for the reputation, effectiveness and efficiency of live company investigations as carried out within IES. I have worked hard to play a part in the long-term success of 'CIB' and do not want to see a respected brand devalued and the object of critical public comment, as appertains to the IES insolvent disqualification work. Do not be fooled by smooth management speak; it's the results that count. Change is continual – I have left The Service – but change needs to be positive and too much of the change I have seen lately is neither positive nor offers any benefit in terms of efficiency or economy.

29 December 2011

IS 12

Written evidence submitted by the Insolvency Practitioners Association

The IPA is a Recognised Professional Body under the Insolvency Act 1986 and is the only one of the RPBs specialising in insolvency. The IPA currently regulates 515 Insolvency Practitioners. It also runs insolvency examinations and is committed to the development and maintenance of high standards in the insolvency profession.

On the matters that we understand to be the subject of the inquiry, we comment as follows.

The role and functions of the Insolvency Service

Generally with respect to the role of the Service, the main points we wish to make concern a) the Service as a direct regulator of Insolvency Practitioners; b) the Service as Official Receiver in bankruptcy cases; and c) the Service and the reform agenda.

By way of opening remarks, we would like to place on record our appreciation of the positive and constructive way in which the Service and its senior personnel undertake their roles and engage with the profession. For the most part the points we wish to raise are those which we have had an opportunity to raise with the Service direct during the course of the last year or so.

a) Regulator of IPs

The Service has a number of different roles, one of which is as direct authorising agent (as a competent authority) of IPs on behalf of the Secretary of State. The Office of Fair Trading raised this matter in its report on its study into the insolvency market and concluded that the Service should ideally cease to authorise IPs directly, and we understand that the Service intends to accept this recommendation. We encourage that move for two main reasons:-

i) it removes a conflict between the Service's role as regulator of IPs and its more pivotal role as regulator of regulators, and
ii) it ensures that there will be a more level playing field in the arena of regulatory and disciplinary sanctions, as the Service does not have the powers under current legislation to take effective measures against its directly authorised IPs in the same way that it requires RPBs to do.

b) Official Receiver

The OR's role as trustee in bankruptcy cases causes some concern because of the current fee structure. Whilst it is understood that in the current economic climate it is undesirable for the Service to be making call on the Treasury for funding, nevertheless there is something fundamentally inequitable about a system which penalises some creditors (in cases where there are estate funds – assets or income) by overcharging in those cases to cover the costs of administering others in which there are no assets/income. Appendix I illustrates how creditors in an income-based case would invariably be better off if the same income payments were made through an Individual Voluntary Arrangement rather than a bankruptcy. We understand the Service is looking at the fee structure and we urge that work to continue with a view to implementing change as soon as possible.

We have made separate representations to the Service on the OR's current approach to dealing with family property. The Service is a party to joint regulatory initiatives through the Joint Insolvency Committee, and as part of that arrangement has approved an Insolvency Guidance Paper issued to IPs setting out how such property should be realised – essentially guiding IPs to deal with any equity early in the bankruptcy process, avoiding speculation on property prices and providing clarity, a degree of certainty and fairness to the bankrupt and any spouse/other person residing in the property. Unilaterally, the Service has now instructed ORs to ignore this guidance and delay dealing with property until around 2½ years after the commencement of the bankruptcy (by which time the bankrupt will ordinarily have been discharged). That presents IPs with a problem, if they are then appointed to realise the property equity, given the three-year use it or lose it rule, but it is also illustrative of a lack of joined up thinking in policy terms, because it contradicts the previous guidance and creates inconsistency in the way these matters are dealt with across the profession.

c) Reform agenda

The Service is engaged in dialogue and policy making in a number of different areas – perhaps too many at the same time. There is an open consultation on reform of the petition process, where we have some concerns about the role of the proposed adjudicator and more generally about the narrowness of the issues being consulted upon. There is a real danger of missing an opportunity here to take creditors' rights into account. We do not think it is appropriate for a bankruptcy order to be obtained by a debtor (rather too easily, one might argue) under the proposed new streamlined electronic procedures without due consideration being given to alternative insolvency mechanisms that could produce better outcomes for creditors.

On regulation, the Service does not appear to have defended the system it has overseen for the last 25 years as robustly as it might have done in the face of criticism by the OFT, particularly given that some of the OFT's evidence was anecdotal. Notwithstanding that, the Service is now engaged in dialogue with the profession to explore non-legislative solutions to achieve the greater consistency desired in the way in which complaints against IPs are dealt with by the RPBs. We very much welcome this and trust that sufficient time will be given to consider fully the changes that we believe can be made to improve the present system.

Those changes have to be cost effective and workable, and they should represent a proportionate response to the issues identified by the OFT. We believe the proposals we and others have put forward to the Service will achieve those aims, and deliver results more quickly than could be brought about through legislation.

Pre-pack administrations (issues of transparency, their link to 'phoenix' companies)

This is one of the areas in which reform is under discussion. The Service has indicated how it plans to address the phoenix issue, and creditors' concerns around this process are well understood. We are worried that the detailed reforms (the draft new Rules) will not be published in sufficient time ahead of implementation for the Service to be able to consider any potential problems in drafting. We are also concerned that in the drive to eradicate scope for abuse there is a real danger that a valuable rescue mechanism may be lost, and that creditors will gain little in participation and information but will almost certainly lose out if businesses are closed instead of saved. There is also likely to be an adverse impact on jobs.

Possible regulation and sanction of licensed insolvency practitioners

Of course, IPs are already regulated and have been for the last 25 years. Other than in respect of those authorised by the Service, all the RPBs have (as they are required to do under the Memorandum of Understanding with the Service) procedures for disciplining their licensed IPs when the need arises. The current discussion around sanctions is really about consistency, and on this subject we have submitted proposals to the JIC with a view to implementing and publishing a common sanctions guide. This will drive consistency in decision-making and publicity. Other related proposals involve increasing accessibility and accountability, use of common review and appeal mechanism where possible, all with the aim of increasing levels of trust in the system. Again, though, proportionality is a factor. There were only around 100 complaints against IPs last year where some sanction was required – a remarkably small number given that there were approximately 100,000 insolvency cases and numerous creditors, employees and directors in each one. Insolvency by its very nature will involve people who have lost money or jobs, and so the existence of complaints should not be a surprise. Not always are those complaints about the conduct of the IP; they are often about little-understood procedures and about dissatisfaction with outcomes for unsecured creditors. They may also be about the conduct of directors and frustration with the IP's perceived inability to bring them to account (see comment below regarding effects of reductions in staff and budget).

Creation of an Insolvency Ombudsman

The Financial Ombudsman Service deals with redress for consumers. We do not believe that an insolvency ombudsman with a wider or more general role would be appropriate. Insolvency is a collective process. Remedies are available through the courts, as specified in the Insolvency Act and Rules, and redress should be for creditors or certain classes of creditor as a whole, not to individual complainants.

Strengthening of the control of IP's remuneration

We are in discussion with the Service about ways in which the complaints system can deal with complaints about fees, but again the statutory remedies in this area already provide protection for creditors. Indeed, the Rules were amended as recently as April 2010 to give creditors enhanced rights and remedies. Fees can more easily be challenged. It is too early to know how effective those measures have been, and the Service has not carried out a review of the impact of that new legislation. It is therefore premature to contemplate further change in this area.

The effects of the reductions in the Service's staff and budget.

The main area of concern here is the resourcing of the director disqualification unit. In a recessionary period, this is the one department that should be receiving additional funding. Our IPs often tell us that the returns they make to the disqualification unit are not acted upon, and they attribute this in part to resource constraints.

We are grateful for the opportunity to submit comments for consideration by the committee, and stand ready to offer any further assistance the committee may require.

David A Kerr MIPA
Chief Executive

6 January 2012

IS 12A

Bankruptcy (debtor petition) three yrs' Income Payments	£	IVA based on comparable three yrs' Contributions	£
Surplus Income 36 x £250 a month	**9,000**	**Surplus Income** 36 x £250 a month	**9,000**
Fees		**Fees**	
Case Administration Fee - (net of debtor's deposit)	**1,190**	Nominee Fee: typically limited to 5 x contributions	**1,250**
Collection Agents Fee @ 5% VAT	**450** **90**		**-**
		Bond, Registration Fee and other allowable expenses (estimated)	**125**
Secretary of State Fee @ 0% on first £2,000 100% on next £1,700 75% on next £1,500 15% on remainder of £3,800	 **-** **1,700** **1,125** **570**	Supervisor Fee 15% of Surplus Income (36-5) x 250 @ 15%	 **1,162**
Distribution Fee (average based on time/rate) VAT	**160** **32**	Distribution Fee - included in Supervisor Fee	**-**
Total Fees + VAT	**5,317**	**Total Fees**	**2,537**
Available for Creditors	**3,683**	**Available for Creditors**	**6,403**

IS 05

Written evidence submitted by The Insolvency Service

INTRODUCTION

1. This memorandum briefly describes the work of The Insolvency Service (“The Service”) as well as highlighting some current issues and future challenges that The Service faces.

2. The Service’s role is to provide an effective and efficient insolvency regime for citizens and businesses. It operates under a statutory framework mainly comprising:

   - the Insolvency Acts 1986 and 2000
   - the Company Directors Disqualification Act 1986
   - the Employment Rights Act 1996 and
   - the Companies Act 1985.

3. BIS Ministers determine the policy framework within which The Service operates, drawing on the knowledge of its specialist staff. The Chief Executive is responsible for the day to day running of The Service, and reports to Ministers on the execution of policy, progress towards targets, and proposals for future developments.

4. The Service is committed to delivering excellent service to all of its customers, many of whom are in considerable financial distress. The Service’s customer service approach, across all its business areas, has been independently recognised by the award of Charter Mark accreditation, now rebranded as Customer Service Excellence, which The Service has held continuously since 1998.

5. Insolvency work is complex and The Service’s ability to deliver high quality customer service depends critically on the professional abilities of its staff. In line with its organisational values of People, Pride and Professionalism, The Service makes significant investments in training and developing its staff to the necessary professional levels. This, and its work more generally in learning and development, has been recognised by the award of the Investors in People standard, which The Service has now been held for 12 years.

OVERVIEW

6. The Service became an executive agency of the Department of Trade and Industry in 1990 and is now an agency of the Department for Business, Innovation and Skills (BIS).

7. The Service employs some 2135 staff (of whom around 2020 are permanent and 115 are agency staff) and operates out of 35 locations across Great Britain, most of which are official receiver's (ORs) offices working with local county courts. The head office is in London, but a substantial proportion of The Service's corporate services are delivered from its offices in Birmingham.

8. The Service has 6 main areas of work:

   Policy. The Service combines its operational responsibilities with the role of advising Ministers on insolvency matters. The Service provides advice on the complex framework of legislation as well as developing policy to ensure that the insolvency framework remains world-class and fit for purpose, contributing to BIS's wider growth agenda. This work is funded by a budget from BIS, which was £1.7 million in 2010-11.

   Regulation of Insolvency Practitioners. On behalf of the Secretary of State, The Service is responsible for the oversight of the system of regulation of insolvency practitioners (IPs). Most IPs are authorised by one of seven professional bodies. The remaining 66 IPs are authorised directly by the Secretary of State. This activity is funded by fee income, which in 2010-11 was £1.5 million.

   Insolvency Case Administration. The Service's ORs administer the compulsory winding up of incorporated businesses and the bankruptcies of individuals upon appointment by the courts as liquidators or trustees. This work is carried out by 29 ORs (supported by some 1200 staff) located throughout England and Wales. The ORs are answerable to the courts for the conduct of individual case administrations. Insolvency case administration is funded by administration fees that are set at levels intended to recover costs from a combination of petition deposits and asset realisations. The petition deposit charged recovers only part of the relevant case administration fee and in many cases there are insufficient assets to recover the remaining element of the fee. The Service also delivers, in partnership with approved intermediaries, Debt Relief Orders (DROs) which provide relief for those overwhelmed by relatively low levels of debt and without surplus income or assets.

   Estate Accounting. The Insolvency Services Account (ISA) provides banking facilities to ORs and IPs in relation to the estates of bankrupts and compulsory liquidations. This activity, together with the associated estate accounting, is funded by fees and the total cost in 2010-11 was £4.3 million, of which £2.15 million is charged to OR administration and covered by the administration fee. £2.15 million is charged to IP cases and recovered through fees charged to the estates administered by them.

Investigation and Enforcement. The Service's investigation and enforcement activities aim to promote confidence in markets by ensuring that dishonest, reckless or irresponsible bankrupts and company directors are identified and dealt with in a professional and proportionate manner, in the public interest. There are three main strands to this work:

- ORs investigate the causes of failure in the cases they administer. Where they find misconduct, they prepare reports with a view to obtaining either bankruptcy restrictions or director disqualifications and, where appropriate, they refer cases to prosecutors for criminal investigation. Bankruptcy restrictions, introduced in 2004, have the effect of extending the time during which individuals are subject to the restrictions of bankruptcy. Official receivers can also apply to have the bankrupt's period of discharge suspended in cases where the bankrupt fails to co-operate. It is also possible to obtain a Debt Relief Restrictions Order against individuals who abuse the Debt Relief Order process.

- In addition, The Service is responsible for investigating and then taking forward proceedings against directors of companies that are subject to administration, administrative receivership and voluntary liquidation, where the IP office holder has formed the view that there is unfit conduct;

- Using Companies Act powers, The Service's Companies Investigations Directorates carry out fact-finding investigations into live companies and may petition the court for the winding up of companies in the public interest.

With the exception of the bulk of investigation work carried out by the ORs, The Service's investigation and enforcement work is funded by means of a BIS budget. In the current financial year 2011-12, the budget provided by BIS is £33.5 million.

Redundancy payments. The Service is responsible for the payment of claims from the National Insurance Fund made to people whose employers have either become insolvent or who have refused to honour an employment tribunal award. Some 150 staff are engaged in this activity and in 2010-11 they handled 116,972 claims. This work is funded by an administration budget from HM Revenue and Customs, created by a transfer out of the National Insurance Fund and agreed with The Service via a service level agreement. In 2011-12, the cost of this activity is expected to be £8.6 million.

9. During the last two years, The Service has experienced a substantial reduction in income associated with an unexpected and steep fall in bankruptcy. This, combined with a fall in asset values in insolvency cases, which has adversely affected The Service's ability to recover its fee from insolvent estates, has put The Service under severe financial strain. The effects of this have been felt across The Service and are referred to later in this memorandum. The Service has already taken substantial steps to address this issue. For example, since 1 April 2010 it has reduced its headcount by 28%, including running a major voluntary exit scheme for some 470 permanent staff in 2011. As a result of this and other measures, The Service has reduced its total annual costs by around 30% from £203 million in 2009-10 to a projected £143 million in the current year.

10. Continuing falls in case numbers and the absence of any recovery in asset values means that The Service needs to do more if it is to avoid rising deficits in the years ahead. The Service is therefore working closely with BIS and in consultation with its trade unions, on the development of a soundly based investment plan to restore it to a sustainable financial position over the medium term.

POLICY

11. The Service works to maintain and develop the insolvency regime to make sure that it remains world-class and fit for purpose. It does so in close consultation with interested parties.

The Personal Insolvency Framework

12. The personal insolvency framework recognises the importance of getting the balance right between the needs of the indebted and those of their creditors. A portfolio of different procedures ensures that, whatever an individual's circumstances, a suitable remedy is available. These are:

    - **Bankruptcy** provides debt relief and rehabilitation for those who cannot pay their debts and ensures that any assets are shared out fairly amongst creditors;

    - **Debt Relief Orders (DROs)** provide access to debt relief for those on low incomes, with no assets of value, who are overwhelmed by relatively low levels of debt; and

    - **Individual Voluntary Arrangements (IVAs)** allow people with unmanageable debt but steady incomes and/or assets to reach a formal compromise with their creditors, thus avoiding bankruptcy.

13. In addition to these statutory procedures, it is possible to reach informal agreement with creditors. The principal means by which this is done is through a Debt Management Plan.

The Corporate Insolvency Framework

14. The corporate insolvency framework facilitates the orderly and effective handling of the affairs of companies that become insolvent or that need to restructure to avoid liquidation. It is designed to promote economic stability and growth by enabling viable businesses to be restructured and to close non-viable businesses efficiently. The regime provides for an efficient resolution of the insolvency and seeks to protect, as far as possible, the interests of creditors by safeguarding their security, ensuring the equitable treatment of similarly ranked creditors, and providing protection to all creditors through claw back of preference and under-value transactions.

15. The UK system is well regarded internationally for its corporate rescue procedures: **administration** and **Company Voluntary Arrangements (CVAs)**. The World Bank's annual "Doing Business" report published in October 2011, includes a section on 'resolving insolvency' (formerly 'closing down a business'). In this latest report, the UK is ranked 6th out of 183 countries based on the time, cost and rates of return to creditors from corporate rescue procedures. This compares favourably with The Service's main competitors: the USA is ranked at 15, Germany is at 36 and France at 46.

16. In **administration**, the management of an insolvent company is handed over to an IP, whose primary duty is to effect a rescue subject to acting in the wider interests of the creditors. Substantial reforms introduced in the Enterprise Act 2002 made the process faster, fairer and focused on rescue. It achieves this by making the process easier to enter and by giving companies a one year period to produce a plan for the business to be rescued, during which time creditors cannot take action (a moratorium). Administration is now the main procedure used for dealing with troubled businesses where there is some prospect of rescue or part trading on of the business.

17. The term "**pre-pack administration**" refers to an arrangement under which the sale of all or part of the company's business or assets is negotiated with a purchaser prior to the appointment of an IP as administrator. The sale is then effected shortly after the IP is appointed (often on the same day). A pre-pack will normally be used where commercial pressures require urgent action. In 2010, pre-packs accounted for approximately 27% of all administrations.

18. It is the Government's view that the existence of pre-pack administrations can make a valuable contribution to preserving jobs and economic value of ailing businesses. It is however important that the process is not abused. In 2009, a new Statement of Insolvency

Practice (**SIP16**) was introduced to provide greater transparency. Under SIP16, IPs are required within 14 days to provide creditors with certain information regarding the pre-pack sale. This includes the reasons for the use of the pre-pack approach and an explanation of why this represented the best interests of creditors. The SIP16 disclosure is also sent to The Service for compliance monitoring purposes, and The Service reports on the outcome of this monitoring. The most recent report, for the period 1 January to 31 December 2010, showed that full compliance by IPs with the provisions of the SIP had increased to 75%, from 62% in 2009.

19. In light of continuing concern regarding the pre-pack process, in March 2010 the previous Government launched a consultation inviting views on improving the transparency of, and confidence in, pre-packaged sales in administrations.

20. The current Government reviewed and considered the responses to the consultation, engaging with interested parties in the process. Unsecured creditors have argued for some time that they are presented with little chance to influence events and insufficient information with which to determine if the pre-packaged sale was in their best interests. As many sales are to the owners or directors of the insolvent company, there is a perceived lack of transparency resulting in allegations of ‘phoenixism’. ‘Phoenixism’ describes the practice where directors or owners carry on essentially the same business successively through a series of failures, leaving unpaid debts each time.

21. In March 2011 the Government published the results of the consultation. The responses made it clear that the greatest cause for concern was where the business and assets are sold back to the current management or a connected party. In order to address these concerns and inject greater transparency into the process, the Government put forward plans for the following measures:

    - administrators to give notice to creditors where they propose to sell a significant proportion of the assets of a company or its business to a connected party, in circumstances where there has been no open marketing of the assets;

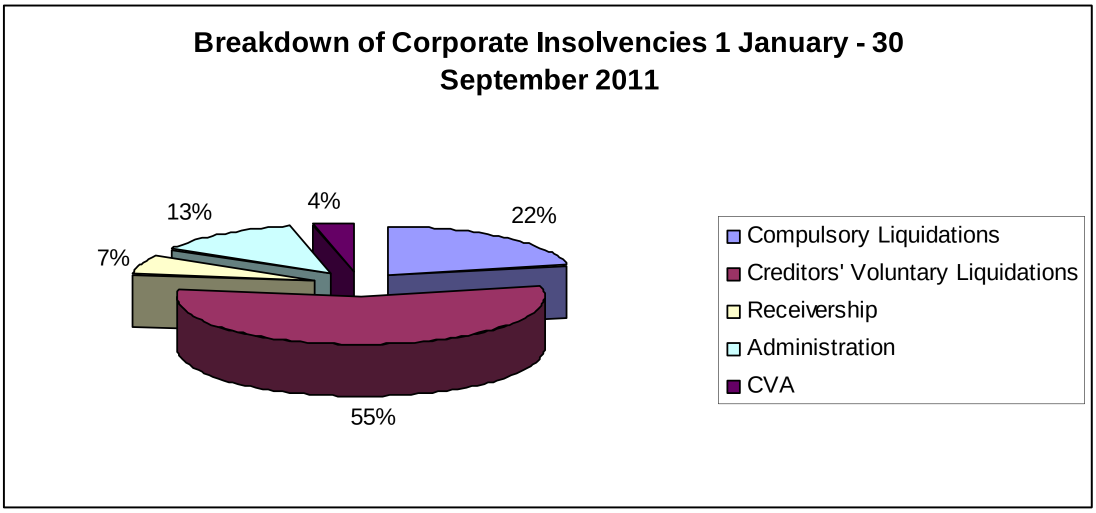
    - the detailed explanation of why a pre-pack sale was undertaken (already a SIP16 requirement) to be included in the administration proposals which are lodged at Companies House, making the information available to business as a whole, including credit reference agencies; and

    - administrators to confirm in their consent to act that the sale represents, in their view, best value for the creditors.

22. Following detailed discussion with a broad spectrum of interested parties on these measures, Ministers are now considering the way forward and expect to make a public announcement early in the new year.

23. A **CVA** enables directors of a viable company to reach a legally binding agreement with creditors, for repayment in full and final settlement of all or some debts, over a period of time. This procedure provides a light-touch alternative to administration in which the existing management stays in place.

24. Where a business cannot be rescued, the insolvency framework provides **liquidation** procedures (either **creditors' voluntary liquidation** or **compulsory liquidation)** to ensure the winding up of a company's affairs and the orderly distribution amongst creditors of any assets. In addition, **administrative receivership** allows the holder of a floating charge to appoint an IP to deal with assets subject to that charge, which can include the whole of the company's business.



Proposed reform of petitioning for compulsory insolvency

25. In November 2011, the Government launched a consultation on proposals to reform the application process for bankruptcy and the compulsory winding up of companies. The aim is to provide the most appropriate route into bankruptcy and winding up, in order to provide an efficient service and better outcomes for both creditors and debtors. The proposals suggest the creation of a new office of the Adjudicator, based within The Service, to handle applications. The Adjudicator would decide the outcome of each application where there is no disagreement between the parties, and the courts would deal with more complex matters that require judicial expertise. The consultation closes on 31 January 2012 and the Government will consider the way forward in the light of responses to consultation.

REGULATION OF INSOLVENCY PRACTITIONERS

The Framework

26. In England and Wales only IPs in the private sector and ORs can legally act as office holders in insolvency proceedings. This includes acting as trustees in bankruptcy; liquidators; administrators and administrative receivers of companies; and supervisors of IVAs and CVAs. IP regulation in Great Britain is reserved to Westminster, and IPs are able to act as office-holder in equivalent Scottish insolvency procedures.

27. The Secretary of State - through The Service - regulates and monitors seven recognised professional bodies (RPBs) who authorise the majority of IPs, and also acts as an eighth authorising body. As at the start of 2011 the total number of IPs was 1,733, although only 1,341of those took insolvency appointments. There are currently 66 IPs directly authorised by the Secretary of State – around 4% of the total.

28. The RPBs are independent bodies that make their own membership rules and regulations, but are required to have in place rules to ensure their IPs are fit and proper people to carry out their duties and meet requirements as to education, practical training and experience. For IPs authorised by the Secretary of State, legislation sets out the framework under which they operate.

29. For all IPs, one of the main requirements is that they must pass an examination – the Joint Insolvency Examination – to qualify as an IP. The law also requires them to have in place a 'bond', a form of insurance, against which a claim could be made if the IP acts fraudulently or dishonestly. Additionally, all IPs are subject to monitoring visits (at least once every six years, and earlier if considered necessary) from their authorising bodies. Monitors seek to establish that IPs are adhering to the legislation, and to accepted standards such as Statements of Insolvency Practice, the Insolvency Code of Ethics, and the relevant rules and regulations of the authorising bodies.

30. In its oversight role, the Secretary of State has agreed a set of principles with the RPBs in a Memorandum of Understanding, for the purposes of achieving consistency in the authorisation and regulation of IPs. In support of this, staff from The Service visit each RPB to monitor them, usually at least once in three years. This is to ensure that the RPB is complying with the Memorandum of Understanding. If any RPB fails to meet the requirements the matter may be referred to the Secretary of State, which could result in its status as a recognised professional body being revoked.

31. The Joint Insolvency Committee is made up of The Service together with representatives of the seven RPBs, and sets mandatory

professional standards for IPs. The Service also disseminates information about the law and practice of insolvency to IPs by way of an electronic newsletter, Dear IP.

Insolvency Practitioner Regulation Reform

32. In 2010 The Office of Fair Trading published a market study, “The market for corporate insolvency practitioners”. The results of the study found that whilst the market often functions well, unsecured creditors suffer losses as the regulatory framework does not effectively protect their interests, whilst shortcomings and inconsistencies in the regulation of IPs contribute to undermining confidence in the profession. In response to the study, in February 2011, the Government launched a consultation to consider a number of proposed reforms to the current regulatory system, principally:

    - the establishment of regulatory objectives to increase accountability and better target regulatory activity;
    - the establishment of a transparent, independent, consistent and robust complaints system to include challenges on the level of an IPs fees;
    - the withdrawal of the Secretary of State from direct authorisation;
    - to increase the range of sanctioning powers of the oversight body to make them more proportionate;
    - to improve standard setting; and
    - to make changes to particular regulations to increase the ability of unsecured creditors to influence insolvency procedures.

33. On the 20 December the Government published its response to the consultation on reforming the market for IP regulation. The successful operation of this market is important as it plays a vital role in enabling all markets to operate fairly and efficiently, by ensuring that in the event of insolvency as much as possible is fairly returned to those extending credit.

34. The present regulatory regime is a complex one involving a number of different regulators. The Government’s assessment of the regime is that it works reasonably well, and that the vast majority of insolvency practitioners do a good job in difficult circumstances. The Government also recognises the benefits self-regulation provides, including its utilisation of the expertise of the profession.

35. However the Government considers that improvements need to be made to the system to increase returns to unsecured creditors and to

deliver the vision of having a regulatory regime that is transparent, consistent, accessible, independent and accountable.

36. Responses to the consultation, along with subsequent discussions the Minister has held with stakeholders, have indicated strong support for an independent single regulator, as an effective and efficient way of achieving this vision. Although the Government is supportive of such a move and has not ruled out moving to this, it wishes to work with the profession and interested parties to see if there is a way to reform the system so that it delivers its objectives without such significant change.

37. The Government has therefore announced that it will:

- explore with interested parties how best to strengthen and simplify processes for handling complaints, including on excessive fee charging, and how best to achieve consistent and transparent sanctions where wrong doing has occurred;

- when Parliamentary time allows, introduce legislation to remove the Secretary of State from the direct authorisation of IPs, to ensure that the powers of the Secretary of State as oversight regulator are appropriate, and to ensure that the objectives of the regulatory regime are clear;

- consider the charging structure for oversight regulation, to ensure that it apportions the costs of this more fairly between the different regulators; and

- in light of any new regime for complaints, consider further the changes proposed in the consultation to insolvency secondary legislation, in order to improve the disclosure and transparency of fee charging, to modify court processes on challenges to fees and to allow unsecured creditors to exercise greater influence over insolvency proceedings.

38. A copy of the full statement can be found at http://www.bis.gov.uk/insolvency/Consultations/IPConsultation?cat=closedwithresponse.

INSOLVENCY CASE ADMINISTRATION

39. The main objectives of the work of the OR in administering bankruptcies and compulsory liquidations are to:

    - maximise returns to creditors. In addition to the realisation of bankrupts' assets, ORs also use their powers to ensure that bankrupts who have surplus income contribute further to repaying their debts through income payments orders (IPOs) and income payments agreements (IPAs);

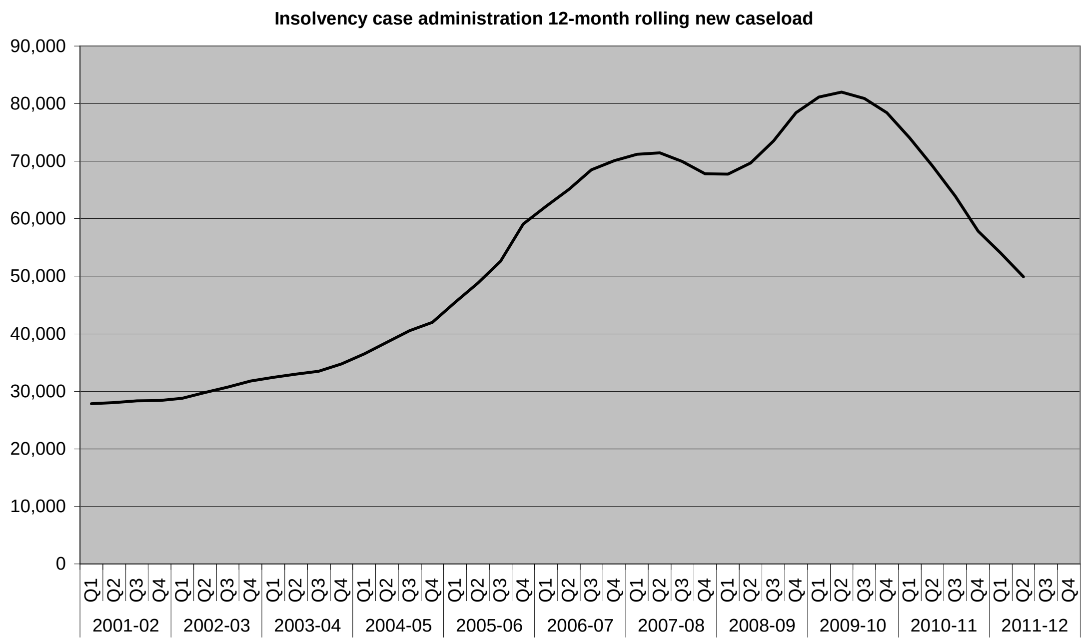
- administer bankruptcy to relieve debtors of overwhelming debts. Bankruptcy orders are made by the courts on either the petition of a debtor or creditor and ORs act (in the first instance) as trustees of the bankruptcy estate for the benefit of creditors;

- administer the winding up of companies where the court has ordered a compulsory winding up. In this case, the OR is appointed liquidator, unless the creditors have decided that that role should be taken on by an IP; and

- investigate the conduct of bankrupts and directors, whose cases they administer, and take action where appropriate.

40. This work is funded by a combination of case administration fees charged directly to each insolvent estate, and a Secretary of State fee on asset realisations. Income for the business is therefore directly dependent upon the number of new cases made each year and the assets available within those cases.

41. In 2009-10, ORs had **77,898** new cases to administer. This reduced to **58,029** in 2010-11, and in the first six months of 2011-12, **23,142** cases were received, **8,014** fewer than in the same period last year. This reduction in casework is mainly attributable to a rapid fall in the number of debtor petition bankruptcies.



42. Current projections for bankruptcies and compulsory liquidations for 2011-12 suggest a drop in the region of 45% from 2009-10 levels, in response to stabilising aggregate levels of consumer debt, increased reluctance in part as people move towards other debt relief solutions.

43. As a result of this steep decline in casework, income has dropped from £144.3 million in 2009-10 to £113.5 million in 2010-11. In October and November 2010, when it became clear that the reduction in case numbers was both significant and likely to continue, The Service introduced a range of cost reduction measures, including releasing approximately 100 temporary and agency staff, retaining only those in business-critical roles. From December 2010 to April 2011 around 360 of OR Services' 1,700 permanent staff exited under a voluntary scheme, reducing the permanent workforce by over 20%. Another 70 specialist staff were transferred into other business areas and following the continued drop in case numbers, a second voluntary exit scheme has recently been launched to deal with a projected surplus of 100 staff.

44. The significant fall in new cases in the current year, and the disruption inherent in such a large number of staff exits have impacted upon ORs' investigation of insolvents' conduct. As a result the number of bankruptcy restrictions has fallen from 1,796 (or 3.3% of total bankruptcy cases) in 2010-11 to around 800 currently projected for this year, which is above the lower range planning assumption, which was set at between 700-1000. The ORs' contribution to The Service's output of director disqualifications has also reduced from 609 in 2010-11 to an anticipated 250 in 2011-12. It is anticipated that OR Services contribution to enforcement outputs will return to normal levels (3% bankruptcies and 5% compulsory liquidations) next year.

Insolvency Service bad debt write off

45. The Service receives income for the ORs administration and investigation of compulsory insolvency cases from fees charged to each insolvency case. However, as some insolvency cases do not have sufficient assets to cover the cost of administering the case, the case administration fee includes the cost of an expected bad-debt write off, which represents fees charged that The Service is unable to collect. Since 2004 The Service has estimated the bad-debt write off, based on an asset recovery model, to amount to around 12% of the case administration fee charged.

46. The case administration fee is recovered from a deposit collected at the outset of a case and from assets in insolvent estates. Where cases have few or no assets the recovery of the case administration fee relies on a second fee, the Secretary of State fee, being applied and collected on cases where there are assets.

47. There are many different types of assets in cases and while some may be realised at the outset of an insolvency case, some may not be realised for many years after the insolvency commences. As a consequence, the balance sheet in The Service's Annual Report and Accounts, reflects an outstanding debtor for those fees not yet collected, after providing for the expected write off of 12%.

48. As case numbers increased over the period from 2004-05 to 2009-10 the amount of the outstanding debtor for fees increased. The recession has reduced the proportion of new cases containing sufficient assets to cover the fee as well as reducing the value of unrealised assets in older cases. Fee changes made in April 2010 and June 2011 have addressed this issue in new cases, but fee changes cannot be applied retrospectively. Given this it was necessary to make a one-off adjustment in The Service's accounts in 2010-11 of £81.3 million, reflecting fees that The Service no longer expects to be able to recover, as a result of the accumulated effects of the credit crunch and recession. The Service's Annual Report and Accounts set out the net cost to the taxpayer of this write off since 2004, which is £15.7 million.

INSOLVENCY SERVICE DELIVERY STRATEGY

49. The scale and pace of change, along with a decline in the value and volume of assets in bankruptcy estates, has demonstrated the relative inflexibility of The Service's current organisational and geographical structures in reducing direct and indirect costs in line with falling case numbers and fee income.

50. In recognition of this inherent inflexibility, in early 2010 The Service's Directing Board (the Board) decided to look closely at how The Service might deliver services more flexibly in the future, by exploring a number of options for restructuring the organisation, including the potential closure of a number of offices. Throughout this process the Board engaged closely with the Agency Trade Union Side. From June to August 2011,The Service consulted its staff on the future Delivery Strategy. In that consultation, the Board expressed its preferred option of separating out front and back facing functions undertaken by The Service and centralising the former in fewer locations. The consultation document issued to staff can be seen at http://www.bis.gov.uk/assets/bispartners/insolvency/docs/publication-pdfs/deliverystrategy-consultationdoc.pdf. During this period the views of a number of key external stakeholders were also sought.

51. Following the conclusion of the consultation, and having considered all the responses carefully, the Board announced to staff in September 2011 its intention to :

- adopt a new Delivery Strategy, with back-office work focused in fewer locations and the maintenance of a network of local offices across the country for necessary face-to-face customer work;

- put a case to BIS for funding support to allow The Service, subject to full public consultation, to close its offices in Medway and Bournemouth in 2012 and Stockton in 2013;

- review the funding regime for OR Services case administration work; and

- review the corporate centre, in order to ensure it is sized and structured appropriately for the current and future size of the organisation.

52. The new Delivery Strategy proposes the creation of centres to deal with the back office administration of insolvency case work, and the non face to face interactions with insolvents. Over 80% of debtor petition bankruptcies, the more volatile workload, are currently dealt with without the need for face to face contact, at least in the first instance, although much of this is currently based locally. By centralising this activity The Service will increase process efficiency and more importantly limit the impact of any future caseload volatility on its network.

53. In contrast, a network of smaller local offices will focus on the necessary face-to-face interactions with bankrupts and company directors, including any relevant investigations.

ESTATE ACCOUNTING

54. IPs acting as liquidators in voluntary liquidations have been able to choose their provider of banking services and some still use The Service's Estate Accounts Services. However, following a consultation in late 2010 this option has been withdrawn for all new voluntary accounts from 1 October 2011. Accounts in operation at 1 October 2011 can either be continued until they are closed or withdrawn and placed in a commercial account.

INVESTIGATION AND ENFORCEMENT

55. The Service's various activities in this area are summarised at paragraph 8.

56. The objective of The Service's investigation and enforcement work is to enhance the confidence of market actors by removing from markets those who are deemed unfit, by virtue of their conduct, to be market participants. The removal of bankrupts from credit markets, the disqualification of unfit directors and the compulsory winding up of disreputable companies, are all aimed at protecting those whose interests may otherwise be put at risk.

57. The ability to seek resolution of disqualification proceedings by way of a legally binding undertaking was introduced in 2001. Prior to that date disqualifications required an order of court. Corresponding provisions

58. Currently some 80% of disqualification proceedings are settled by the acceptance of an undertaking from directors, most of which are offered before court proceedings are commenced. The corresponding figure is around 83% for bankruptcy restrictions. The high undertaking rate makes the process very cost effective as early resolution saves the cost of a formal court procedure.

59. The Service operates a hotline to enable members of the public, IPs and creditors to “blow the whistle” on apparent misconduct, particularly by bankrupts and directors who are ostensibly contravening bankruptcy restrictions or disqualifications. Substantive and valid complaints are passed to ORs or Company Investigations Teams for further investigation or, where there is evidence of potential criminal activity, such as fraud or theft, to BIS prosecuting lawyers for investigation with a view to possible prosecution. The hotline therefore ensures that instances of misconduct or abuse that are of most concern to the public, are properly addressed.

60. During 2010-11, The Service conducted an evaluation of the impact of its enforcement activities, which was validated by BIS economists. The evaluation concluded that the financial and other impact of The Service’s investigation and enforcement activities support the integrity of the insolvency and corporate regimes and continue to be both substantial and integral to the maintenance of market confidence.

61. In the last 4 years (from 2008-9) The Service’s budget for investigation and enforcement has fallen by £6.6 million. Reported incidences of director misconduct have remained relatively stable, although incidences of debtor misconduct have decreased as bankruptcy numbers have fallen (see paragraph 44).

62. The funding The Service receives is currently sufficient to enable enforcement activity to be undertaken across a broad spectrum of cases. At the vetting stage, cases accepted for investigation for both insolvent cases from IPs and live company cases are prioritised in terms of the Public Interest and other factors. At present The Service is able to investigate all insolvent cases which pass vetting, though this position can change, for example, if the volume of cases passing vetting rises or if two or three especially complex cases arise. However, in respect of live company cases, in recent years The Service has not been able to investigate all cases which pass vetting. This is because of both resource constraints and more recently because of the effects of significant staff movement across The Service (see paragraph 43). Cases are rigorously prioritised. Where they are not immediately allocated for investigation they are reviewed after two months and then again each month until six months. If a case has not been allocated for investigation at month six, it is usually discontinued.

63. In 2010, the average length of director disqualification undertakings and orders was 6.1 years. The number of key enforcement outputs for The Service for the period from 2006-07 to 2010-11 was:

Outputs	2006-07	2007-08	2008-09	2009-10	2010-11
Disqualifications	1,223	1,173	1,281	1,388	1,437
Bankruptcy restriction orders and undertakings	1,867	1,827	1,781	1,948	1,796
Live Company Investigations	174	193	240	268	205

REDUNDANCY PAYMENTS

64. The Redundancy Payments Service, based in Watford, Birmingham and Edinburgh processes and pays claims for statutory redundancy and other payments from former employees of insolvent companies which the insolvent employer has not paid. Payments, and the costs of administering them, are paid out of the National Insurance Fund.

65. The current economic climate has had a significant impact on the number of claims The Service is receiving. While not at its peak (in 2008-09 165,000 claims were received) claim numbers are still running at over 50% more than the pre-recession level of 76,000 claims.

66. The Service aims for 93% of claims to be paid within 6 weeks, and 80% paid within 3 weeks.

DEVOLUTION

67. The Insolvency Service's jurisdictions within the UK, in summary, are as follows:

Personal insolvency, including enforcement	England and Wales
Corporate insolvency	Mixed: some Great Britain (including civil enforcement) and aspects England and Wales only
Companies Act investigations and inspections	UK
IP Regulation	Great Britain
Redundancy Payments	Great Britain

23 December 2011

IS 04

Written evidence submitted by the Institute of Credit Management

The 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 are key stakeholders in every form of insolvency as creditors, often unsecured. We therefore feel it appropriate to submit evidence to the inquiry.

Pre-pack administrations

The institute has engaged actively with the Insolvency Service in the recent consultation relating to pre-pack sales and the introduction of a notice period. We recognise the conflicting views and interests involved but believe the opportunity for creditors, who may have detailed and local knowledge, to provide information to the insolvency practitioner is vital. We believe the intention to allow the notice to be waived, with the Court's permission to be sensible and would only urge that adequate consultation takes place before the detailed changes are implemented to avoid the risk of unintended consequences.

We recognise the value of pre-pack sales in rescuing businesses and maintaining employment and believe, in the right circumstances, they are appropriate and useful. We are however concerned when the process is simply used as a vehicle to allow the rise of a phoenix company that has absolved itself of debts and continues to trade as if it were the former business to the detriment of unpaid creditors. Indeed, on occasions, the knock-on effect of such an administration can be the failure of other businesses.

Possible regulation and sanction of licensed insolvency practitioners

We would point out that licensed insolvency practitioners have always been regulated by their RPBs and sanctions already exist. The Joint Insolvency Committee, on which the Institute of Credit Management now sits as a lay member, has been working towards common sanctions guidance and progress is well underway.

We also believe the work towards a strengthened and simplified complaints process, highlighted by Ed Davey in his December 2011 statement, will be of benefit in creating an environment in which complaints are seen as being treated more consistently and seriously.

Creation of an Insolvency Ombudsman

The Insolvency Service should be the regulator of regulators, and the decision to remove the Secretary of State from the direct authorisation of insolvency practitioners is helpful. The proposal for a strengthened and simplified process for handling complaints (mentioned above) is welcomed by the Institute and the creation of an Ombudsman would, in our view, add little value and be likely to add a further layer of bureaucracy that we could not support.

Strengthening of the control of IP's remuneration

We believe the complaints proposal, the remit of which would include excessive fee charging will enhance control, as will measures to encourage the engagement of creditors through, for example, Creditor Committees. Anything that encourages transparency is to be encouraged but not if it adds significantly to costs and we would suggest that the revised complaints regime should be introduced and tested prior to further steps. We would also suggest that the impact of the changes to the Insolvency Rules introduced in 2010 need to be fully established, and their impact assessed, before further action is instigated.

The effects of the reductions in the Service's staff and budget

We would be greatly concerned if the reductions in budget resulted in a degradation or reduction of Disqualification Unit activity. We believe any such dilution of activity would send entirely the wrong message to delinquent directors at a time when corporate insolvencies are likely to increase.

There are occasions where the return to creditors in an insolvency in which funds are available is reduced because of the need to fund non-asset insolvencies and this inequity should be considered alongside the broader funding issues.

We hope our comments are helpful and would be happy to engage further.

Glen Bullivant
Chair of Technical Committee
Institute of Credit Management

22 December 2011

Written evidence submitted by the Joint Insolvency Committee

The members of the Joint Insolvency Committee represent the bodies that regulate the practice of insolvency in Great Britain: The Association of Chartered Certified Accountants; The Insolvency Service; Insolvency Practitioners Association; The Institute of Chartered Accountants in England and Wales; The Institute of Chartered Accountants in Ireland; The Institute of Chartered Accountants of Scotland; The Law Society of Scotland; Solicitors Regulation Authority.

The Joint Insolvency Committee (JIC) welcomes the opportunity to submit evidence to the select committee. This submission is made on behalf of the Recognised Professional Body (RPB) members of the JIC. Our evidence is restricted to those matters within the scope of the JIC, primarily consistency and standard setting, where the JIC interacts with the Insolvency Service (IS).

Set out at annex A to this submission is a brief history of the JIC and its objectives, putting the interaction between the JIC and IS into context.

The JIC meets four times each year but works through the year and with sub-groups between meetings. Each RPB is represented on the JIC, usually by an insolvency practitioner (IP) supported, where appropriate, by staff from the RPB they represent. The JIC also welcomes a number of observers who play a valuable role in updating JIC on issues from within their remit. Details of the RPBs, other JIC members and observers are detailed at annex B to this response.

The IS attends this meeting in two contexts, the first as a competent authority for the purpose of authorising IPs, and secondly as the oversight regulator of the RPBs. These roles are fulfilled by two people.

Although, there is a full public consultation involved in the development of all new standards, the JIC believes that inviting lay members to join the committee will further increase transparency and involve other interested parties in JIC's discussions from the outset. JIC contacted a number of organisations identified by the IS as having a particular interest in insolvency and as a result of that process we are delighted that the Association of British Insurers, HMRC and the Institute of Credit Management have accepted invitations to join the JIC. At its meeting in November 2011, the JIC welcomed these three new lay members to the committee.

Given the role of the JIC, and the desire of the IS to work with the JIC, it would be helpful if the IS could share its objectives, policies and agenda such that the JIC can prioritise its work and better achieve both the goals of the JIC and objectives of the IS. We hope that this will change now that the Government response to the consultation on reform of the regulation of IPs has been published.

Pre-pack administrations

The JIC developed a new Statement of Insolvency Practice (SIP) for pre-pack administrations – SIP 16, which was introduced in January 2009. The overriding aim of the SIP was to increase transparency regarding pre-packs and to ensure that creditors were provided with information on a timely basis. The SIP requires the administrator to provide creditors with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests (see paragraph 8 of the SIP).

It had always been the JIC's intention to keep SIP 16 under review and to assess its effectiveness. In 2010, the JIC consulted with users of insolvency proceedings and the profession to establish how SIP 16 was working. The feedback received was that there were few requests from creditors for further information after having seen SIP 16 information, and this feedback would suggest that SIP 16 is achieving its objective.

The JIC has not however progressed its review of SIP 16 as the Government has plans to legislate in this area. A first draft of the proposed statutory instrument was published during the summer of 2011, and members of the JIC and other interested parties made extensive comments and suggestions. It is expected that a revised statutory instrument will be in force by April 2012. It is of concern to the JIC that the profession may not see and be able to comment on the detail of the statutory instrument before it comes into force, as it will have a direct impact on SIP 16. There could be no need for the SIP going forward, but without the opportunity to scrutinise the statutory instrument, or have some further explanation from the IS, the JIC will struggle to have an appropriate standard in place. This will obviously have an impact on the profession (which will have to deal with a period of uncertainty) but in relation to other interested parties, in particular creditors, there will be no opportunity to manage expectations on the level of information they may or may not expect to receive.

Furthermore the JIC has met with the IS and other RPBs to discuss the consistency and adequacy of disclosure around SIP16, and the need for IPs to ensure that the principles outlined in paragraph 8 of the SIP are being followed, as opposed to merely providing data with no explanation. This informal working group concluded with the IS that the approaches of the RPBs in assessing submissions by their members are consistent.

Possible regulation and sanction of licensed insolvency practitioners

IPs are of course already regulated and have been since the introduction of the Insolvency Act, 25 years ago. The JIC is actively looking at common sanctions guidance for its RPBs' committees and tribunals involved in making decisions on complaints, and also common principles for the publication of disciplinary findings. These are important ingredients in the drive towards greater consistency in complaints handling and in transparency of outcomes. At its most recent meeting, JIC was able to agree many of the fundamental points of principle. Further detailed work is now underway with a view to finalising draft common sanctions guidance for the bodies.

Whilst each of the RPBs has a series of sanctions that can be applied to licensed IPs (ranging from an unpublicised caution to removal of an IP's authorisation to act), the IS as a regulator is disadvantaged in that it only has a single sanction against those IPs that it directly authorises (approximately 5% of the total IP population), which is the removal of authorisation. For that reason alone the decision of the IS to stop being a direct regulator of IPs is welcomed. The other RPBs can then ensure that there is transparency, consistency and appropriate sanctions that the IS can review as oversight regulator.

Strengthening of the control of IP's remuneration

The JIC's primary interest in remuneration is through SIP 9, which deals with payments to insolvency office holders and their associates. This SIP reflects the enhanced creditor rights introduced by the Insolvency Rules 2010, and also reinforces the need for information to be provided that is comprehensible and transparent. This an area which shows SIPs at their most effective. The law will never be able to reflect fully the nature of the relationship between the insolvency profession and the users of insolvency processes – standards enable us to build a framework that goes beyond time scales and bald facts, and requires IPs to provide information that explains why they are seeking payment of a particular sum.

The IS played an active part within the working group in developing the recent revisions to SIP9. SIP9 (England and Wales) came into force on 1 November 2011 and SIP9 (Scotland) is close to being issued.

The SIP needs to be placed into context with insolvency legislation that guides and determines the remuneration that an IP can seek. However, each of the RPBs (and indeed individual IPs) recognise that active participation of all creditors (both secured, preferential and unsecured) in the setting of insolvency fees is to be encouraged. This need for inclusion of all creditors has been made to the IS, and should be part of the general education of the wider stakeholder community – a role that falls to the IS. Discussions at the JIC have often centred around the lack of participation to date by government bodies (such as HRMC and the Redundancy Payments Service) in many cases.

The JIC believes that existing mechanisms within insolvency legislation for creditors to approve and review IPs' fees, when linked together with SIP9, are adequate and enable creditors both to influence, and ultimately approve or reject, fees in an appropriate manner, particularly given the enhanced rights for creditors introduced in the 2010 Rule changes (the full impact of which has yet to be assessed). However, as part of our ongoing review of the adequacy of existing systems and in response to the latest Government announcements, we will be giving further consideration to the extent to which complaints about the remuneration of IPs can be accommodated within the RPBs' complaints systems.

The effects of the reductions in the Service's staff and budget

The JIC operates as a standard setting body without any formal budget and relies on the members of the JIC to fund the expenses of their representatives and the costs of hosting meetings. The working groups which review SIPs are made up entirely of volunteers. Secretariat services, including the consultation processes for new standards, are provided to the JIC without charge.

The JIC's engagement with the IS is primarily with staff within the policy functions of the IS, rather than with the Official Receivers' operational staff. We may not be seeing first-hand the effects of reductions in budgets and staff, but we are conscious that those staff we primarily deal with are funded by a levy paid by every insolvency practitioner. The insolvency profession is diverse, ranging from sole practitioners to multi partner global operations, and the IS should not assume that the profession can bear increasing levy costs.

Tracy Stanhope
Secretary to the Joint Insolvency Committee

5 January 2012

Annex A

About the JIC

The JIC was formed in 1999 and provides a forum for discussion and promotes consistency of approach across bodies which authorise insolvency practitioners in Great Britain. Its mission statement is to:

- *Consider, maintain, improve, develop and promote insolvency standards and guidance of a regulatory, ethical, or best practice nature by means of debate and agreement within the Committee.*

- *Discuss any such matters with any other appropriate bodies.*

- *Facilitate discussion between authorising bodies in order to ensure that, as far as possible, insolvency practitioners are dealt with uniformly by such authorising bodies.*

The JIC has 3 primary regulatory tools by which it can fulfil its mission statement – the insolvency code of ethics, statements of insolvency practice, and insolvency guidance papers.

Statements of Insolvency Practice (SIPs) are a series of guidance notes issued to licensed insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency. All insolvency practitioners are therefore working to common standards.

SIPs are issued under procedures agreed between the insolvency regulatory authorities acting through the JIC. Where appropriate, when changes are made to SIPs affecting England and Wales, equivalent changes are made to those affecting Scotland and Northern Ireland.

The purpose of SIPs is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standards set out in the SIPs is a matter that may be considered by a practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action.

Insolvency Guidance Papers (IGPs) are issued to insolvency practitioners to provide guidance on matters that may require consideration in the conduct of insolvency work or in an insolvency practitioner's practice. Unlike Statements of Insolvency Practice, which set out required practice, IGPs are purely guidance and practitioners may develop different approaches to the areas covered by the IGPs.

Annex B

MEMBERS OF THE JIC

The Association of Chartered Certified Accountants

Insolvency Practitioners Association

The Institute of Chartered Accountants in England & Wales

Chartered Accountants Regulatory Board
(Chartered Accountants Ireland)

The Institute of Chartered Accountants of Scotland

The Law Society of Scotland

Solicitors Regulation Authority

The Insolvency Service

Association of British Insurers

Institute of Credit Management

HMRC

OBSERVERS OF JIC

Representatives of	The monitors of the authorising bodies R3 The Accountant in Bankruptcy The IS Northern Ireland Law Society Northern Ireland

IS 10

Written evidence submitted by the Legal Ombudsman

Introduction

The Legal Ombudsman was set up following the Legal Services Act 2007 to deal with service complaints in the legal sector. We have now been in existence for more than a year. Our remit is to resolve disputes in a cost effective, fair and transparent manner, providing a straightforward path to redress for consumers of legal services. Our secondary purpose is to feed back information to consumers and the legal profession to help drive up standards and improve consumer confidence in this sector.

We use technology to ensure complaints are dealt with quickly and at less cost than the previous arrangements; operating within a budget of £19.9m compared to the old system which cost £32.5m, according to independent analysis commissioned by the Ministry of Justice. The other key change from the previous arrangements is that we are an independent body, a crucial element to resolving complaints in any sector. The creation of the Legal Ombudsman was a deliberate move away from self-regulation by the legal profession, designed to improve consumer confidence in the system.

We have had a positive response from our first customer satisfaction survey, with 67% of respondents saying that they were satisfied with the professional service provided by the Legal Ombudsman. This is comparable to satisfaction with other more established bodies such as the Financial Ombudsman Services, an encouraging result for our first period of operation.

Our early learning from legal complaints is that the legal and consumer landscape is constantly changing and that our service needs to adapt to developments and provide access to redress for all consumers using legal services. As such we wished to share our experiences and expertise to assist the Insolvency Service in reforming their complaints handling structure.

We welcome the BIS Select Committee’s inquiry into the Insolvency Service. The terms of reference of the inquiry can be split into three sections: the first looks at the effectiveness of pre-pack administrations and proposed changes to pre-packs announced in March 2011; the second looks at the effects of the reductions in the Service’s staff and budget; and the third section looks at the possible creation of an independent complaints body. In our submission we will comment on the first and third sections.

Pre-pack administrations (issues of transparency, their link to 'phoenix' companies);

We welcome proposals to increase transparency within pre-pack administrations. To date, we have investigated and closed 209 cases where the company has been a successor firm. This is around 3% of our cases.

The Legal Services Act 2007 (the Act), ensures that when we order a law firm to pay compensation to a complainant; successor firms, including 'phoenix' firms, are liable to provide the redress, if appropriate. The Act states that:

> *" (1) The ability of a person to make a complaint about an act or omission of a partnership or other unincorporated body is not affected by any change in the membership of the partnership or body.*
>
> *(2) Scheme rules must make provision determining the circumstances in which, for the purposes of the ombudsman scheme, an act or omission of a person ("A") is, where A ceases to exist and another person ("B") succeeds to the whole or substantially the whole of the business of A, to be treated as an act or omission of B.*
>
> *(3) Rules under subsection (2) must, in relation to cases where an act or omission of A is treated as an act or omission of B, make provision about the treatment of complaints under the ombudsman scheme which are outstanding against A at the time A ceases to exist."*

Due to the provisions made in the Act, ordinarily, pursuing redress for complainants from successor firms is relatively straight forward. However, it can become more complicated if the firm disagrees about their status as a successor firm or if the firm has reopened under a new regulator. Take this case study:

Firm A operated for less than a year in 2009/10. In 2010, the firm was replaced by another company with the same solicitors and partners, the same premises and many of the same customers. We considered this firm to be a successor firm of Firm A and we ordered redress for the complainants who had received poor service. The case was, however, complicated by the firm's denial that they were a successor firm and the fact that they had reopened under a new regulator. Neither of the regulators involved could tell us whether they were prepared to treat the firm as a successor of firm A. It was clear that the complainants were not going to be successful in claiming their compensation on their own, so we worked with them to access it. Once the legal proceedings had been triggered, the firm unexpectedly accepted responsibility for the complaints under its previous name. So, the members of the public who have been seeking redress will now receive the compensation they are entitled to.

We are keen that any changes to the Insolvency Service should consider the needs of consumers as well as creditors. This not only creates positive outcomes for members of the public, but can also improve consumer confidence in the profession.

Part of the role of an independent Ombudsman is to feed back to the legal profession to improve the standard of legal services.

Any new arrangements should also take into account regulatory conflicts and conflicts between Ombudsman schemes. For example, if a new independent complaints handler were to be established for insolvency practitioners, there could be a situation where a successor firm reopens not just under a new regulator, but under a new Ombudsman, as many insolvency practitioners are also solicitors.

As well as making sure that any changes to the regulation of insolvency practitioners fit in with other current mechanisms of consumer redress, it is also important to make sure that they are sympathetic to likely changes in the wider regulatory landscape. We feel that it is particularly important to consider the direction of developments within the European community. The European Commission recently published their proposed directive on alternative dispute resolution (ADR) and their proposed regulation on online dispute resolution (ODR). If the proposals are adopted, this would mean that ADR mechanisms, such as Ombudsman schemes, will cover all sectors, where contractual transactions take place, including the insolvency sector.

Reforms to the regulation of insolvency practitioners

In May 2011, we responded to the Insolvency Service's consultation on the regulation of insolvency practitioners, we commented on the proposals from our perspective as an independent complaints body. We stated that we saw no reason why an Ombudsman scheme would not be successful in the insolvency sector. This view has been strengthened in light of the European Commission's ADR and ODR proposals. Indeed, there are many similarities between regulation and complaints handling in the legal sector before 2010, when the Legal Ombudsman was created, and the current arrangements in the insolvency sector. Currently, there are more than 10 overlapping organisations regulating 1,800 insolvency practitioners. The Legal Ombudsman also oversees many of the agencies who regulate insolvency practitioners.

One solution which has been touted is the possibility of creating an Ombudsman scheme to cover Insolvency Practitioners. The Office of Fair Trading (OFT) report, 'The market for corporate insolvency practitioners' June 2010, suggested:

> *"Establishing an independent complaints body to increase the efficacy and consistency of after-the-event complaint and review, restore creditor trust in the regulatory regime, and allow a cost-effective route of fee assessment*
>
> *"Setting clear objectives for the regulatory regime, and changing some of the regulatory processes and responsibilities, to increase its ability to meet those objectives, and*
>
> *"Amending some of the detailed regulations to better align the interests of the IP with the interests of the wider creditor group."*

The OFT report also pointed out that many insolvency practitioners come from a legal or a financial background. So, if it was decided that an Ombudsman scheme or independent complaints handler would be most appropriate, it would be worth considering the possibility of extending an existing scheme's purview to cover the insolvency sector. We would be happy to explore this model further with partners at the Insolvency Service and the Department for Business Innovation and Skills, if it was decided that an extension of the Legal Ombudsman's jurisdiction may be appropriate.

The Government recently announced that, although they understood that there was a lot of support for a single insolvency regulator, they are currently looking at improving the existing arrangements and making them work better. We would be very happy to share our experiences and knowledge, gained from our own set up, with interested parties to assist in the development of any new arrangements, whether they are in the form of an Ombudsman scheme, or if the decision is made to make the existing arrangements work more effectively.

3 January 2012

IS 09

Written evidence submitted by the Insolvency Branch of Prospect

INTRODUCTION

1. Prospect is a trade union representing 569 staff employed by The Insolvency Service ("The Service"). Our members are the specialist staff within The Service comprising examiners, managers, office holders and directors.

2. We do not provide an overview of The Insolvency Service's operations, as this has been done by The Service itself, nor do we comment directly on the role of Insolvency Practitioners ("IPs") and their regulation.

3. IES is funded directly by BIS to investigate all misconduct referred to it.

4. Prospect do not accept that The Service's Delivery Strategy, of reducing local offices and clustering the initial investigations of bankruptcies into "call centre" type operations, is the most cost effective way to provide the full service expected by the business community and general public . This Delivery Strategy is without the published terms of reference of this Committee.

EXECUTIVE SUMMARY

5. In this memorandum Prospect highlight:
    - the adverse affects of the 11% cash cut to the investigation budget in 2010,
    - the impact of income reduction in Official Receiver Services ("ORS") on investigation work carried out by The Service
    - flawed funding model for ORS

6. Prospect propose that:
    - the funding arrangements of ORS be amended so that there is no *requirement* to be self-funding;
    - that BIS resolve to restore by 2014 the moneys cut from the Investigation and Enforcement Service ("IES") budget in 2010;
    - BIS accept that any difference between income and expenditure is the proper price to pay for the administration and investigation of insolvent estates and live companies; and
    - that The Service does not further reduce its examining and specialist manpower.

7. This financial comfort will provide a stable platform to enable The Service to have the experienced, trained and professional in-house resource to investigate all misconduct identified or referred to it.

Investigations and Enforcement Services

8. Investigations of insolvent estates, and IES activities in particular, cannot be viewed as separate and distinct from the rest of The Service, especially ORS. Significant structural change in ORS has had an impact upon the ability of IES to investigate misconduct due to the movement of staff. These changes were necessitated by the reduction in ORS income due to the funding model applicable to ORS.

9. The Service identified in June 2010 that the savings required by the incoming government's emergency budget would "*visibly affect the delivery of front line services*". Among the main impacts identified were that the number of director disqualifications, bankruptcy restrictions and criminal allegation referrals would significantly decrease, and that this would limit the ability to handle more complex/high profile cases. Alternatively, if a complex case were investigated, then fewer *"normal"* cases would be investigated. The budget allocated for investigation and enforcement was reduced by 11%, resulting in the immediate termination of non-permanent investigators (around 40).

10. These posts were eventually filled, between June and December 2010, with permanent staff transferred from ORS, with many remaining in their existing locations, resulting in investigators being based in at least 23 offices.

11. In December 2010 The Service launched a voluntary exit scheme resulting in 470 staff leaving in April 2011, of which 45 were from within IES. The consequence of these two events was a significant organisational upheaval lasting nearly a year, with new staff arriving as experienced and senior staff in IES prepared to leave. This had a material impact on the ability of IES to progress investigations.

12. As a direct result of the 11% budget cut in June 2010, together with the voluntary exit scheme denuding sections of significant numbers of experienced staff, The Service is unable to meet its internal target for the progression of disqualification investigations as shown below: (source November 2011 IED internal performance report).

Disqualification timeliness of investigation	**Expected 2011/12**	**Actual YTD**
OR Cases - % within 15 months of order	80%	50%
OR Cases - % within 19 months of order	100%	83%
IP Cases - % within 10 months of allocation	90%	unavailable
IP Cases - % within 19 months of insolvency	100%	40%

13. The Secretary of State has two years from the date of a corporate insolvency to decide whether to bring proceedings (it is one year for Bankruptcy Restrictions). Disqualification orders and undertakings obtained in 2011 are therefore mainly a result of cases investigated in 2010.

14. At November 2011 referrals from IPs were being assessed within two months of receipt in 79.6% of cases, which is 10.4% below target. In April 2011, The Service had completed 65.5% of cases within two months. This shows that recovery from staff and structural change is not yet complete. The longer that it

takes to assess the referral, the less time an investigator has available, and the further away are the events being investigated. This increases the risk that the necessary evidence cannot be obtained and/or there are inhibitors to progressing to the point of proceedings being issued.

15. The number of cases referred for criminal investigation has dropped by a material amount, being presently 18% below the planning expectation for 2011/12.

16. There has been a significant decrease in live company investigations, with some cases abandoned for lack of resource. The Service's 2010/11 Annual Report stated at page 33 "*As a result of those complaints 180 investigations were commenced, a 39% decrease on the 295 investigations commenced during 2009-10. This decrease is as a consequence of the 11% cuts which reduced the amount available to outsource some investigation work, and replacing experienced non-permanent workers with permanent staff from other areas of The Service last autumn*". So far in 2011/12 cases referred for live investigation have not materially increased.

Official Receiver Services

17. Official Receivers' activities are described as administration and investigation. This is a false dichotomy as included within the activities described by The Service as administration are interviews with insolvents and enquiries that are fundamental to any investigatory activity. "Administration" and "investigation" are inappropriate and inaccurate cost labels, akin to classifying all police activity prior to a suspect being charged as administration.

18. The Service has provided Prospect with the following information in respect of cases identified by Official Receivers for further investigation ("FI"):

Year	Total Insolvencies	FI	%
2007/08	69,227	7,970	11.51
2008/09	74,163	7,484	10.09
2009/10	79,498	5,518	6.94
2010/11	57,385	4,158	7.25
To Nov 2011	28,036	2,179	7.77

19. The Official Receivers do not have sufficient resources to investigate every bankruptcy and liquidation identified by them for further investigation. The Service records these by way of placing them within an "investigation pool" .The Service removes cases from this "pool" to either investigate or formally abandon the investigation. Prospect does not have access to this data, but members report their unhappiness that cases they have identified for further investigation do not get investigated for lack of examining resource.

Statutory Funding Model of ORS

20. The Official Receiver deals with 3 types of cases:
    - **Debtor petition bankruptcy** cases (in which the debtor petitions for their own bankruptcy). To do so they pay a court fee of £175 and a deposit of £525.

The deposit fee was raised in June 2011 from £450 to £525, having been £335 in April 2008.

- **Creditor petition bankruptcy** cases (in which a creditor petitions in respect of monies owing to them). The deposit paid is currently £700.
- **Compulsory liquidations**. The deposit paid, currently £1,165, is used to fund the administrative cost of the case and the investigation into the company's affairs and the directors' conduct up to the point of the Secretary of State authorising the issuing of proceedings.

21. A notional fee of £1,625 is charged to each bankruptcy estate to cover the costs of administration but where, as in the majority of cases, no assets are realised there are insufficient funds to recoup this fee from the petition deposit alone.

22. The funding model allows for cross-subsidisation by cases where there are asset realisations but, given the falling bankruptcy case numbers and the lack of assets available for realisation, there is now a significant gap between fees and income.

23. This has produced the perverse effect of causing the operation of Official Receivers (a statutory office) to be "insolvent". The same result would occur if case numbers increased but asset values didn't.

24. The decline in insolvencies administered by The Service is almost entirely due to a reduction in debtor petition bankruptcies. The amount at which the deposit on the petition is set is a significant factor in a debtor's decision as this is a front-loaded cost for people who are insolvent – they have to pay for it out of their pocket, there and then.

25. In contrast an Individual Voluntary Arrangement (administered by an IP) or a debt management plan (unregulated and administered by the private sector as a business), is usually funded by a percentage of realisations made. In other words, the debtor isn't paying a lump sum up front.

26. It is the contention of Prospect that ORS should return to its former model of being funded by the taxpayer to administer and investigate, with realisations and fees providing a contribution to mitigate the costs of carrying out the statutory functions. The creditor and debtor should not bear the entire cost, much like a burglar and their victim are not expected to pay for the police investigation.

Summary

27. Despite all the pressures placed and upheaval forced upon the Service by the withdrawal of over £3m from the investigation budget in June 2010 and a notional "income deficit" with ORS, the staff throughout the Service have continued to perform professionally and meet the revised expectations. The fact remains that less is being done overall by less people with less money.

30 December 2011

IS 02

Written evidence submitted by R3

As President of R3, the professional association for Insolvency Practitioners, I am pleased to submit our evidence to the inquiry into The Insolvency Service. I should also be delighted to give oral evidence in due course.

R3 represents 97% of UK Insolvency Practitioners - the only professionals authorised to take insolvency cases. From senior partners at the 'Big Four' accountancy firms to practitioners who run their own micro-businesses, our members have first-hand experience of insolvency practice and regulation, and interact closely with The Insolvency Service.

I can speak from experience on topics such as pre-pack administrations and insolvency remuneration, as well as articulating the profession's concerns about the insolvency regime. For example,

- The Insolvency Service's record in investigating unfit directors: in 2002-3, 45% of cases reported to the Service were taken forward to investigation; this fell to just 20% in 2009-10

- Harm caused by suppliers demanding 'ransom payments' following insolvency - thereby reducing creditor returns, damaging the UK business rescue culture, and artificially increasing the number of pre-packs

I would also be pleased to offer Committee members the opportunity to visit an Insolvency Practitioner's offices as part of the inquiry, in order to see insolvency cases in operation. Our members would be delighted to host a visit at a time and location convenient to members.

Frances Coulson
R3 President

21 December 2011

Business Innovation and Skills Select Committee Inquiry into The Insolvency Service

Response by R3, the insolvency trade body

R3 represents 97% of UK Insolvency Practitioners (IPs) - the only professionals authorised to take insolvency cases. From senior partners at the 'Big Four' accountancy firms to practitioners who run their own micro-businesses, our members have first-hand experience of insolvency practice and regulation, and interact closely with The Insolvency Service (IS).

EXECUTIVE SUMMARY

The IS performs much of its role very well. We have highlighted in our response certain areas in which we believe there is room for improvement:

- The IS's investigation and enforcement regime, which is designed to protect the public from unfit directors, is suffering from a lack of funding. This leaves culpable directors free to start up other companies - putting other businesses, investors, suppliers and members of the public at risk. We urge the Committee to recommend that the Minister introduce a new reporting process to improve disqualification efforts as soon as possible; and to consider recommending increased funding for the IS's disqualification work.

- The IS proposals to stamp out 'phoenix' pre-packs will not eliminate this practice but drive it further 'upstream'. If the IS's objective is to address concerns about pre-packs, they should tackle the obstacles that currently stand in the way of more traditional business rescues using the administration procedure - ransom payments and expenses in administration.

- The key criticism of the regulatory system among creditors is that there are too many regulators - 8 for around 1,700 IPs. The IS has not identified rationalisation of regulators as an immediate priority, but the Minster, profession and regulators are working together to deliver reforms to the regulatory system to improve consistency and increase independence.

- Unsecured creditors have expressed concern about IP fees. We encourage the Committee to support IS proposals to empower unsecured creditors and to help Government departments, who are unsecured creditors themselves, to exercise their market power over IP fees more effectively.

- One of the key roles the IS performs is 'bankruptcy case administration' which mainly involves investigating the causes of bankruptcy. The funding model for this function has come under increasing pressure due to a decrease in bankruptcy numbers and an increased proportion of cases with few or no assets. It is now running a deficit - a problem we believe must be addressed.

DETAILED RESPONSE

Role of the IS: disqualifying 'unfit' directors

1. One of the IS's four main goals is to '*to deliver and promote an effective investigation and enforcement regime*'. A key part of this function is the investigation and disqualification of 'unfit' directors. R3 is concerned that the IS investigates too few cases of alleged misconduct, which leaves culpable directors free to start up other companies - putting other businesses, investors, suppliers and members of the public at risk. The IS estimates a net benefit of £88,000 to the market for every company director disqualified (in terms of potential economic damage that they would otherwise cause).

2. An IP is required to report to the IS if they believe a director of an insolvent company has been dishonest, blameworthy or is otherwise unfit to be concerned in the management of a company. The IS decide whether to take forward the case in question to investigation stage, which can result in the director being disqualified.

3. The proportion of adverse conduct reports by IPs that result in disqualification by the IS declined from 45% in 2002-3 to just 20% in 2009-10. The total potential savings to creditors from disqualifying unfit directors is estimated at £143.2 million in 2009-10. Should disqualification rates return to 2002-3 levels, the benefit to the economy would be an estimated £247.4 million in 2009-10.

   In May last year a survey of 300 R3 members found that 75% had submitted an adverse report on a director to the IS during the last year; of these, 79% believe that the IS's decision not to proceed with further investigations was wrong and/or that the director should have been disqualified. Case studies were also collected:

4. Case study 1: A joinery manufacturer based in the Midlands, employing around 30 people pre-insolvency. Aspects of the director's conduct which the IP believed warranted a report to the IS: non payment of Crown debts to finance trading, personal benefits obtained by directors and appropriation of assets to other companies. The IP stated that the director was: "*A serial phoenixer….[who] subsequently left the country…. [the] IS view was that pursuing him was not in the public interest*".

5. Case study 2: A financial services company in the South East. Aspects of the director's conduct which the IP believed warranted a report to the IS: attempted concealment of assets, phoenix operations, appropriation of assets to other companies, personal benefits obtained by directors, overvaluing assets in accounts for the purpose of obtaining loans, or other financial accommodation, or to mislead creditors, and use of delaying tactics. The IP said: "*In 20 years I have never seen such a clear cut case for disqualification and I remain bemused by the decision*".

6. A press article on the 5th November 2011 entitled 'Insolvency Service lets 'serious' cases go' contained comments from Robert Burns, head of investigations at the IS. The article states

that he '*admitted two rounds of staff cuts have "taken [their] toll" and warned of a "longer term impact"…Mr Burns said the Insolvency Service has been forced to reduce investigations. "[The cuts] will have an impact on investigations, there's no getting around that."* '

7. To ensure the public is protected from errant directors, R3 would welcome budgetary increases for the IS to fund their disqualification work, given the significant economic benefit to the economy of disqualified directors. This could be achieved at least in part by levying fines on disqualified directors (the proceeds of which could fund work on disqualification). Appreciating that budgetary increases may not be possible, we have been working with the IS on streamlining the reporting process (the 'D1 forms') - enabling the profession and IS to identify which cases should be treated as high priority. We understand the Minister will shortly decide whether this new reporting process will be introduced - we urge the Committee to recommend that it is brought in as soon as possible.

Concerns around 'pre-pack administrations' and a return to traditional administrations

8. We understand MPs' and creditors' concerns about pre-packs, especially sales to connected parties (often known as 'phoenixes'). Though we understand the political will to reform pre-packs, we should highlight that pre-packs - even to connected parties - can have real advantages. Academic research finds that these kinds of administrations are successful in preserving businesses and saving jobs, as well as delivering higher returns to secured and unsecured creditors[1]. They are best used in businesses where the key asset is the workforce (e.g. advertising agencies, software consultancies and recruitment firms), where open ended administration would result in staff being poached by competitors, destroying the business overnight.

9. The IS intend to address concerns about pre-packs by requiring IPs to give three days notice to creditors if they propose a connected party pre-pack. This will not succeed in eliminating 'phoenixes' - instead it will give rise to *'pre' pre-packs*. At the moment, directors are able to purchase their own business or its key assets through a pre-pack sale facilitated by an IP; under the new proposals, directors will simply purchase their own business or its assets through a deal either carried out themselves or facilitated by an adviser pre-insolvency. 'Phoenixing' will not be eliminated by the IS proposals, the practice will simply happen further 'upstream' instead.

10. R3 believes that the IS's efforts would be better focused on improving the 'administration' rescue regime which would in turn reduce the need for pre-packs. Administration and pre-packs are both procedures that can be used to rescue businesses. The use of trading administrations has become stunted because of two key problems - ransom payments and increasing expenses (outlined below). As a result of these impediments to trading a company in administration, pre-packs have stepped into in their place.

11. If the following two issues were addressed, the number of pre -packs would reduce:

[1] Frisby, Dr S, A Preliminary Analysis of Pre-Packaged Administrations, 2007. Frisby, Dr S, A The pre-pack promise: signs of fulfilment? RECOVERY magazine, Spring 2010.

12. *Ransom payments*: Ransom payments demanded by suppliers on insolvency as a condition of supply can crush attempts to rescue a business through administration. R3 has been calling for a change to the Insolvency Act 1986 to end ransom payments and ensure continuity of supply at the same rate (with the proviso that suppliers are paid in full for new supply). We estimate that this change would result in a 22% decline in pre-packs because businesses that would have gone into a pre-pack could be rescued through administration instead.

13. *Administration expenses regime:* When an IP is advising a company in trouble, they weigh up the pros and cons of various courses of action. Administration is a key option to rescue a business, but in order for it to be a feasible choice the costs of trading the business through administration must be reasonable. Recent case law has made trading in administration vastly more expensive than the law ever intended, as the costs that are classed as expenses rather than claims in the insolvency have dramatically increased. The Judge in the most recent case (Mr Justice Briggs in 2010) admitted that the situation is a "*legislative mess"*. Evidence from our members indicates that more than half of 'typical' administration cases are now going into a pre-pack or liquidation instead. A return to the equitable 'pay for what you use' principle could be achieved by legislative amendment. Clearly defining and reducing the expenses of administration in this way would make administrations viable in many more cases and consequently reduce the use of pre-packs.

14. One of the IS's key responsibilities is insolvency policy and legislation. If their objective is to address concerns over pre-packs, ransom payments and the administration expenses regime should be their top priority. We urge the Committee to recommend this course of action. This would have the added benefit of enabling more businesses to be saved during these fragile economic times.

Reform to the regulation of IPs

15. The key criticism of the regulatory system among the creditor community is that there are too many regulators (8 for around 1,700 IPs) which they believe breeds inconsistency and confusion. R3 would welcome a reduction in the number of regulators to address these concerns.

16. We understand the IS does not intend to pursue this as an immediate priority, other than to remove the Secretary of State from direct authorisation of IPs. In the absence of an imminent reduction of regulators, it is clearly important that the complaints system is easily accessible to potential complainants; delivers transparent and consistent outcomes; and is sufficiently independent to cultivate external confidence.

17. The Minister has asked the profession to deliver reforms to the regulatory system to achieve these goals. R3 is working with the Government and the two main insolvency regulators (covering 68% of IPs) on reforms which would deliver a single entry and exit point for complaints, see all regulators working to a common framework for processing, investigating and adjudicating on complaints, and include greater involvement of independent lay members in the complaints process. We hope these reforms will be delivered in 2012.

Remuneration of IPs

18. The fees of IPs sometimes spark criticism, with particularly large cases dominating headlines. We would encourage the Committee to view IP fees in the context of each particular case - i.e. in view of the role the IP performs, the amount returned to creditors, the size and type of business, and the complexity of the case.

19. When an IP is appointed to a case they essentially have to 'pick up' the business from scratch and decide what to do with it. There is no universal approach - a careful commercial judgement must be made in each case. Faced with a struggling company, an IP may either take over the company's reins, reverse its decline and restructure it; sell the business on; continue trading to increase returns to creditors; or, in cases where the company is extremely weak, close it down. In view of the complex role they perform, it is right that IPs are highly qualified professionals with significant skills and expertise. As such, their input carries a cost, and IP rates are comparable to those of similarly qualified professionals (lawyers, accountants, high level medical professionals). The benefit of this expertise is perhaps best put into context by looking at the number of businesses and jobs saved through insolvency work. According to the Centre for Economics & Business Research, 67% of insolvency firms are involved in restructuring or turnaround, and research by ComRes finds that the work of IPs saves close to 2 million jobs each year. World Bank data June 2011 states that the UK's recovery rate is the 6th best in the world - better than the US, France and Germany's recovery rates.[2]

20. High profile cases tend to come in for the most criticism over fee levels. But huge cases like Lehmans or Woolworths require a considerable range of resources and skills. The Zavvi case, for example, required the administrative staff from Ernst and Young to go to each of the 114 stores on the day the administration was announced; and in Woolworths, Deloitte was dealing with over 800 stores and 30,000 employees. The sheer manpower needed to deal with these cases leads inevitably to high costs, but they are necessary to ensure the job is done well.

21. It is also the case that many of the costs covered by an IP's fees come from legal requirements on formal and procedural matters designed to maintain the integrity of the insolvency regime. For example, one of an IP's duties is to report on the conduct of the directors - a cost which increases their fees (as it cannot be done for free).

22. It should also be understood that despite the headlines, more than 90% of insolvency firms are small - they tend to work on smaller cases where costs are much lower.

23. Although it is creditors who set IP fees, it is often unsecured creditors who express frustration with the fee setting process. R3 therefore supports a number of proposals from the IS to give unsecured creditors greater influence (for example, we support IS proposals which state that IPs' hourly rates should be agreed by creditors at the time of resolution and

[2] http://www.doingbusiness.org/data/exploretopics/resolving-insolvency

IPs should have to go back to creditors with a new resolution if their rates change at any point during the case).

24. We also propose that the Government departments who are major, repeat unsecured creditors better exert their considerable market power. Under existing legislation, unsecured creditors have a range of effective mechanisms open to them to engage in the insolvency process, especially following changes introduced in April 2010. Yet sadly these mechanisms often go under-used. We can understand that certain unsecured creditors may find it difficult to engage in insolvency - due to lack of experience, size of debt or unfamiliarity with the process - but it is hard to believe that Government departments cannot do so.

25. HMRC and the IS itself through the Redundancy Payments Service account for more than a quarter of unsecured debt and therefore have considerable market power, if only they would exercise it. We suggest that HMRC set up their own fee review teams to consider IP fees, based on their existing and effective Voluntary Arrangements Service (VAS). This non-regulatory solution would be self-funding and would see unsecured creditors playing a much more active role in fee-setting.

Funding difficulties within the IS

26. One of the key roles the IS performs is 'bankruptcy case administration' which mainly involves investigating the causes of bankruptcy. The funding for this important role has come under increasing pressure due to a decrease in bankruptcy numbers and an increased proportion of cases without assets. It is now running at a deficit.

27. The cost of the IS's bankruptcy case administration work is covered in part by a case administration fee (£1,715 per bankruptcy). This is recovered in part by the deposit paid by a debtor (£525) or a creditor (£700) when applying for bankruptcy. The rest is largely covered by the assets realised in bankruptcy cases.

28. The funding structure for this case administration work depends on there being a certain number of bankruptcies and, more importantly, sufficient assets in bankruptcy cases to cover the cost of the work. However, bankruptcy numbers declined by 27% in 2010/11 and a growing proportion of cases have few or no assets[3]. In 2010/2011, the IS received an income from case administration fees of just over £141 million, compared to £195 million spent administering cases - causing a funding deficit of £53 million[4].

29. The IS has undertaken considerable cost cutting measures over the last year, but the fundamental difficulty with the funding model remains unresolved. R3 would be pleased to discuss our concerns and our initial suggestions for potential reform with the Committee.

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[3] The Insolvency Service Annual Report and Accounts 2010-2011

[4] *Ibid*

RECOMMENDATIONS

30. The IS's investigation and enforcement operations should be given increased funding to protect the public from 'unfit' directors. This could be achieved, at last in part, by levying fines on disqualified directors (the proceeds of which could fund work on disqualification).

31. The Minister should introduce the proposed new reporting process to improve disqualification efforts as soon as possible.

32. The IS should address the obstacles that currently stand in the way of traditional business rescues using trading administrations - ransom payments and the administration expenses regime.

33. The Government departments that are unsecured creditors should exercise their market power over IP fees more effectively.

34. The deficit run by the IS on bankruptcy case administration must be addressed.

21 December 2011

Written evidence submitted by Professor Mark Watson-Gandy

Introduction

1. This is my personal evidence in my capacity as a barrister and academic to the inquiry into the working of the insolvency system in the United Kingdom.

2. My experience derives from advising and acting in personal and corporate insolvency cases both for office holders and for those facing their attentions and for creditors both within this country and in other jurisdictions.

3. A fuller profile is set out in Schedule to this document

The Insolvency Regime in the UK

4. Insolvency, whether personal or corporate, in the UK is in essence a court regulated regime. It is governed primarily by the Insolvency Act 1986 and the Insolvency Rules 1986.

5. The importance of the court's control, besides the self-evident human rights issue[1], is to allow an otherwise draconian regime to be tempered by judicial discretion and to ensure that there is always the possibility of recourse to a check by a higher authority when decisions by office holders cause unfairness or injustice.

6. The word "draconian" is not lightly used. For example, in the context of personal insolvency, a bankruptcy order:

    a. deprives the bankrupt of virtually all his property, which vests in his trustee[2], including any legal cause of action[3];

    b. it imposes on the bankrupt (and others) a wide range of obligations to provide information and documents[4];

[1] Article 6 of Schedule 1 Part I Human Rights Act 1998 provides for the right to a fair trial "In the determination of his civil rights and obligations…, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly […]".
[2] Section 306 Insolvency Act 1986. As to the estate, see section 283.
[3] *Heath v Tang* [1993] 4 All ER 694.
[4] See, for example, sections 312(1), 333 Insolvency Act 1986.

c. It invalidates his dealings and payments from the date the petition was presented[5]

d. it restricts the bankrupt's ability to raise credit[6];

e. it makes him susceptible to a postal re-direction order[7] which interferes with a fundamental right otherwise recognized by the law;

f. it makes him susceptible to an income payments order[8];

g. it makes him susceptible to a bankruptcy restrictions order[9];

h. it makes him potentially liable for certain criminal offences[10];

i. it renders the bankrupt and others liable to a range of legal remedies, the purpose of which is to undo certain antecedent transactions; in certain circumstances, it renders not only the bankrupt but his family and others residing with him liable to be made homeless if the trustee decides to realize property in which the bankrupt has an interest for the benefit of creditors;

j. it means that the bankrupt cannot, without the permission of the court, be a director of a limited company or carry out a range of other functions including holding certain public offices[11]

k. Finally, there is the stigma which attaches to bankruptcy itself which may affect the standing of the bankrupt during the period of the bankruptcy, which may be extended beyond the generally applicable one year period on the application of the official receiver or trustee[12].

A few words of context

7. A few words of context should be given to any examination of the insolvency regime.

   a. The first factor is that it would be wrong to look at our national regime in isolation and in so doing to fail to appreciate the importance of our retaining a court based control. Our insolvency regime has to interlock on a daily basis with other insolvency regimes.

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[5] Section 284 Insolvency Act 1986
[6] Section 360 Insolvency Act 1986.
[7] Section 371 Insolvency Act 1986.
[8] Section 310 Insolvency Act 1986.
[9] Schedule 4A Insolvency Act 1986.
[10] Chapter VI of Part IX Insolvency Act 1986.
[11] See for example section 11 Company Directors Disqualification Act 1986.
[12] See sections 278-280 Insolvency Act 1986.

This arises not merely in terms of our treaty obligations[13], jurisdiction[14], court assistance to foreign courts[15] but on a more basic level; ready access to foreign travel and the internet have made it easier for people and their businesses to enter into foreign contracts and acquire foreign assets and this requires a need to accommodate international aspects.

b. The second factor is that (whatever flaws the system may have[16]) we do have a highly efficient[17] and internationally envied insolvency regime in the United Kingdom. This can be seen in things as diverse as forum hopping by German nationals so that they can be bankrupted in the UK[18] to the fact that recently in major foreign insolvencies[19] it is English lawyers and insolvency practitioners who have been deployed. This is no bad thing. Legal and professional services are an important generator of invisible earnings for the UK economy.

c. The third factor is that insolvency is never a rarely a happy process. Inevitably any insolvency carries with it hardship, anger and a sense of betrayal. Insolvency practitioners necessarily need to have a thick skin as they are likely to face the brunt of the resentment from all sides[20]. In that context and with usually limited and fast dwindling resources, they may need to make fast commercial decisions.

d. The fourth factor is that it is a specialist regime. It is necessarily different from other court processes in that a petitioner acquires a class remedy for all creditors rather than a remedy just for himself. In 1982 Sir Kenneth Cork's committee on insolvency said this

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[13] For example EC Regulation on Insolvency Proceedings 2000 and the UNCITRAL Model Law on Cross Border Insolvency as adopted by the Cross Border Insolvency Regulations 2006

[14] under the EC Regulation on Insolvency Proceedings and section 265 Insolvency Act 1986 See, for example, *Shierson v Vlieland-Boddy* [2005] EWCA Civ 974 but also the many recent cases arising out of the phenomenon of German insolvency tourism.

[15] Section 426 Insolvency Act 1986

[16] Flaws undoubtedly exist in the present system (for example the absence of a power to cure procedural defects on paper – as opposed to court - appointments of administrators). However there is an existing mechanism to allow for the correction of the Insolvency Rules 1986 as and when problems are identified through the Insolvency Rules Committee, a specialist panel of lawyers and judges.

[17] Winding up petitions are dealt with in an astonishingly efficient and cost effective manner. The High Court in London hears them once a week, disposing of 250 odd petitions in a single morning, yet providing each company with a hearing at which companies do appear or are represented.

[18] There has been press comment about Germans moving to the UK to fall within the jurisdiction of the UK's bankruptcy laws. The most conspicuous example has been with Schefenacker AG which moved its company's base of operations to the UK. See article at http://www.telegraph.co.uk/finance/2950351/German-bankruptcy-laws-drive-car-mirror-firm-to-UK.html

[19] Most graphically in relation to the collapse of foreign banks such as the Icelandic bank, Kaupthing.

[20] The insolvency practitioner will face pressure from many quarters. The bankrupt or director of the insolvent company and his family will face reduced circumstances. Employees will lose their jobs. Suppliers may have their business crippled when they find that goods they have supplied in good faith will never be paid for. Her Majesty's Revenue and Customs will have claims for unpaid duty and taxes.

about the need for specialization, the nature of insolvency work and the desirability of keeping personal and corporate insolvency in line with one another[21]:

> "The exercise [of the insolvency jurisdiction] must almost invariably be concerned with commercial matters and frequently with the analysis of business accounts, culminating in the making, by the court itself, of decisions or judgments of an essentially commercial nature. Its philosophical orientation in this respect is akin to that of the Commercial Court of the Queen's Bench Division."
>
> "Insolvency law is frequently complex and technical, and may require the analysis of transactions displaying elements of commercial sharp practice and dishonesty. It is almost always concerned with the breakdown of commercial contracts and with accountancy problems and often requires important decisions to be taken."
>
> "[T]he exercise of the newly-conferred discretions can only receive acceptance if there is consistency shown in their exercise. It is therefore desirable to concentrate insolvency court business, so far as practicable, for hearing before the minimum number of judicial officers consistent with its effective and expeditious discharge…"
>
> "The harmonisation of corporate and personal insolvency will, we are convinced be more effective if the same judicial officer deals with both types of administration. We therefore recommend that whoever is appointed to hear insolvency matters should deal with all types of insolvency.[22]"

8. The Cork Committee recognized the importance of insolvency work, its commercial nature and the need for specialist skill in dealing with it. The insolvency work undertaken now is largely the same as that done then[23]. It also underscored the importance of keeping insolvency proceedings in the hands of a limited group of judicial officers.

9. The present system functions well, with petitions being dealt with by existing structures, namely the High Court and the county courts. There are judges in place, therefore, who are already dealing with these petitions which are absorbed efficiently and satisfactorily in an existing system of justice.

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[21] *Report of the Review Committee, Insolvency Law and Practice*, 1982 (Cmnd. 8558).
[22] Paragraphs 972 and 994-996.
[23] Although until the Insolvency Act 1986 came into force winding up petitions were dealt with by a High Court judge.

Phoenix companies

10. Phoenix companies have inflamed the public imagination. Typically, the “phoenix syndrome” or “phoenixism” involves a person trading through successive companies with similar names, leaving creditors behind as each company becomes insolvent.

11. As Mr. Gabriel Moss QC described[24]:

> “Honest creditors have been plagued by the phenomenon of phoenix companies for over 100 years. The position was eloquently satirized in the 19th century in Utopia Ltd, a Gilbert and Sullivan operetta which contains the following:–
>
> > ‘“You merely file a winding-up petition,
> > and start another company at once!
> > Though a Rothschild you may be
> > in your own capacity,
> > As a Company you've come to utter sorrow –
> > but the liquidators say “never mind–you needn't pay”,
> > So you start another Company tomorrow!”[25]’

12. Yet to suggest that this can be done today with impunity and without consequence is simply wrong.

13. Section 216 of the Insolvency Act 1986 creates civil and criminal restrictions on the re-use of company names where a company has gone into insolvent liquidation. It only applies to a person who was a director or shadow director of the liquidating company within the period of 12 months immediately prior to liquidation, and only to names by which the liquidating company was known within that period of 12 months or a name so similar as to suggest an association with the liquidating company. Section 216(3) of the Insolvency Act 1986 effectively imposes a five-year bar on the director of the liquidating company from reusing the liquidating company's actual or trading name without the court’s permission.

14. Moreover phoenix operations have been held to ground an order being made disqualifying a director from acting in the management of a company under section 6 Company Directors

[24] sitting as a Judge of the High Court in *Official Receiver v Zwirn [2002] BCC 760, [2001] All ER (D) 375 (Jul) at [10]*
[25] (W.S. Gilbert Complete Operas, Dorset Press 1932, page 622—quoted in the Law of Reinsurance by O'Neill and Woloniecki, 1998)

Disqualification Act 1986. Indeed it has been held to fall within the most serious bracket of misconduct and therefore justify the longest period of disqualification[26].

15. The real objectionable aspect of the reincarnated phoenix is that it may seek to utilize the name, goodwill and intellectual property rights of the old company without any payment to the old company for the benefit of its creditors. Yet even then liquidators have powers to seek relief from the court to reverse transactions at an undervalue or preferential arrangements[27]. Victims can apply for relief from the court to reverse any transaction where assets have been transferred off or sold at an undervalue to defeat creditors[28] and creditors can sue the directors for breach of duty[29].

Pre-packs and phoenixism

16. As I have indicated the real objectionable aspect of the reincarnated phoenix is that it may seek to utilize the name, goodwill and intellectual property rights of the old company without any payment to the old company for the benefit of its creditors.

17. Yet that the old business should be sold is not of itself a bad thing.

18. The business of a failing company may represent a valuable asset which could be sold for the benefit of the creditors. Such a sale would be likely to operate to transfer the jobs of employees of the failing company to the new owners[30] of the business which would spare the creditors a further dilution of their dividend.

19. Nor is the fact that the proposed purchaser is the present management, of itself, objectionable given that they are often (whether through optimism, hope or affection) prepared to pay more for the business than a third party.

20. In the cited case, even the judge recognized that the shades of grey were very real:

> "Although "phoenix" companies are often a menace to the public, I would introduce one note of caution. There are also honest phoenix companies where a failure has occurred through no fault of the management and the business has been rescued into a successor company in the interests of creditors and the public. The "bad" phoenix

[26] *Official Receiver v Zwirn [2002] BCC 760, [2001] All ER (D) 375 (Jul)*
[27] Section 339, 340 and 423 Insolvency Act 1986
[28] section 423 Insolvency Act 1986
[29] Under the summary remedy under *section 212, Insolvency Act 1986* they can sue to recover damages and assets for the company where the director has been negligent or acted in breach of fiduciary duty. Directors, at common law, will owe a duty to the general body of creditors where the company is insolvent or the creditors are at risk: *Yukong Line v Rensburg* and *Re MDA Investment*.
[30] Transfer of Undertakings (Protection of Employment) Regulations 2006

> company is by contrast characterized by the selfish and dishonest behaviour of the management in looking after their own interests and ignoring those of the creditors and/or the public."

21. It is desirable that such a sale of the assets of an insolvent company to a new company controlled by the directors of the insolvent company be through an office holder as the transaction is at arm's length. In another case Mr. Justice Harman recognized[31]:

> "Advice … which is wholly beyond reproach or criticism [would be] that if it proved impossible … to keep Douglas going the sensible thing would be to have a company available to take over the business of Douglas, to urge the bank which had a debenture to appoint a receiver, and to arrange to purchase from the receiver at a proper arm's length sale on a full price the assets of Douglas which were desirable to keep the business going."

22. Since the sale of the business as a going concern is made possible by the statutory moratorium in administration, it is unsurprising that administrators find themselves in this position.

23. Controversy arises in respect of "pre-pack" sales to the existing management because the administrator completes the sale[32] before it can be placed before the creditors meeting for their approval.

24. This might attract the unattractive perception that the administrator is somehow "in bed" with the directors and trying to "stitch up" the creditors. However, more often than not, a pre-pack will however result in a better deal for the creditors. It eliminates uncertainty as to the outcome of the administration (you have a buyer on day one), it pares out ongoing trading risk / cost (the longer the sale is delayed, the greater burn rate to the company as it will be, by definition, insolvent) and pares the professional costs to the bone (no need to trade the business and no advertising costs).

25. The introduction of Statement of Insolvency Practice 16 has set out a code of conduct for administrators to ensure that this process is not abused and creditors are kept informed. It provides a way to trying to ensure that the administrators do still get the best available price for the business assets even though the deal is undertaken at speed[33].

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[31] *Re Douglas Construction Services Ltd [1998] BCLC 397 at 400*
[32] para 67, Schedule B1 Insolvency Act 1986
[33] My personal experience on court appointment of administrators is that the judges do now examine SIP 16 compliance as part of their considerations.

26. Moreover it is important to remember that, if the circumstances that relate to the transaction create any cause for suspicion about its genuineness or give any cause for concern about its appropriateness, the fact that it is entered into by an office-holder will not make it free from scrutiny by the court[34].

27. Indeed it is not beyond the Court's powers to intervene in a sale, for example in *Re Ulva*[35] where the court compelled the administrator to unscramble a sale[36]. There the application was brought under *paragraph 74, Schedule B1 Insolvency Act 1986* which gives the court discretion to make orders if the administrator has been acting or threatens to act in a way which will unfairly harm the applicant.

28. Nor should it be forgotten that when an insolvency practitioner holds office as administrator he acts as an officer of the court (whether or not he was in fact appointed by the court). This places him under the supervision of the Court itself and places upon him duties

    a. To be candid with the court

    b. To exercise reasonable care and skill

    c. To act speedily and efficiently

    d. To select the purpose of the administration

    e. To act with good faith, independence impartiality and loyalty (to the company)

    f. Not to act dishonourably

    g. To act within powers

    h. To act for a proper purpose and not a collateral one

    i. To seek information which is necessary

    j. To make his decisions rationally

[34] *Re Keypak Homecare Ltd (No 2) [1990] BCLC 440*
[35] Sub nom. Coyne v DRC [2008] EWCA Civ 488
[36] The application was brought under *paragraph 74, Schedule B1 Insolvency Act 1986* which gives the court discretion to make orders if the administrator has been acting or threatens to act in a way which will unfairly harm a creditor.

29. The principle in *ex parte James*[37] moreover creates an obligation upon him to temper his strict adherence to the rules with a respect for honest dealing and justice. Thus he must not take advantage of creditors without giving credit for their debts nor insist on taking windfalls from another's mistake[38].

30. Moreover an administrator can be sued by creditors or subsequent office holders if it is found that he has misapplied or retained money or other property of the company, has become accountable for money or other property of the company, has breached a fiduciary or other duty in relation to the company or has been guilty of misfeasance[39].

Insolvency Ombudsmen and the regulation of insolvency practitioners

31. It is mooted whether an insolvency ombudsman should be appointed. I have serious reservations as to whether this is either necessary or desirable.

32. There are already three distinct levels of regulation and control already in play.

    a. Firstly the insolvency practitioner is answerable to his professional body as regards his professional conduct much as any other professional might be. If he breaks the rules of his profession, he may be disciplined and his livelihood may be taken away. The professional bodies have risen to that challenge and have done much to enforce increased professionalism in the industry[40].

    b. Secondly the insolvency practitioner when acting as an officer of the court (such as when acting as a liquidator, trustee in bankruptcy or administrator) is answerable to the Court and expected to deploy a higher standard of propriety and fairness[41].

    c. Thirdly those affected by the acts or decisions of the insolvency practitioner have remedies in the courts for damages[42] or to reopen or reverse their decisions[43].

33. It might be said that having to have recourse to the courts in the last two contexts may act as a deterrent for a complainant.

34. This is no bad thing.

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[37] *Re Condon ex parte James* [1874-80] All ER Rep 388
[38] *Re T & N Ltd* [2004] EWHC 2361
[39] *para 75, Schedule B1 Insolvency Act 1986*
[40] The only criticism I have is that there is presently considered to be a disparity of sentencing between the regulators however this is a matter which is best sorted between themselves.
[41] The principle in *ex parte James* see above.
[42] For example under section 212 Insolvency Act 1986 and paragraph 75 Schedule B1 Insolvency Act 1986
[43] For example sections 108(2), 112, 303 and paragraph 74, Schedule B1 Insolvency Act 1986

35. Insolvency is a collective remedy. What suits some may well not suit others. The office holder has the unpopular role of trying to achieve a fair result for all.

36. In a context of limited resources and time, forcing complainants to seek their remedy before the courts provides a natural filter of commercial common sense. The complainant should know he runs a personal costs risk if he is to divert the office holder's time and limited resources by minor or meritless gripes.

37. There are a number of reasons why an ombudsman is an unattractive addition to these existing remedies:-

    a. There is a risk that without these commercial restraints that the floodgates will open to a deluge of unhappy creditors who see this as a chance to voice complaints that they would not have considered serious enough to trouble a court with.

    b. An ombudsman still it might be seen as an alternative source for recovery when the pot for division in the insolvency is otherwise empty.

    c. It might be considered to act as a brake on the insolvency practitioner's commercial judgment and willingness to take calculated risks. The Court has, with good reason, been particularly cautious about intervening to second guess an office holder's decision making. Experience teaches that allowing the office holder to provide a rough and ready solution in the face of the facts that present themselves to him or her on the ground usually lead to a better result for creditors[44].

29 December 2011

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[44] A graphic contrast is seen when one compares this to Law of Property Act receivers where one sees notoriously high fees and little recovery for either creditor or debtor in the context of an overly cautious approach to the management of the property they are appointed over.

Mark Watson-Gandy

Professor Mark Watson-Gandy was called to the Bar in 1990 and was made a Junior Counsel to the Crown in 2000. In 2004 he joined the Bar Council's panel of Young Spokesmen for the Bar.

He is a tenant at Thirteen Old Square Chambers.13 Old Square is a specialist chancery/commercial barristers' chambers in Lincoln's Inn founded by leading chancery silk, John McDonnell QC. Mark's work is primarily in the areas of insolvency and company law. He was a finalist in Credit Today magazine's Insolvency & Rescue Awards 2009 and 2010 as "*Barrister of the Year*".

He is a Visiting Professor at the University of Westminster (teaching on their Corporate Finance Law LLM) and a Visiting Lecturer at Cass Business School (teaching the business law elective on their Executive MBA). He holds the Institute of Chartered Accountant's Corporate Finance qualification. He is the author of "*Watson-Gandy on Accountants*", "*Corporate Insolvency Practice: Litigation Practice and Procedure*" and the ICAEW Guide "*Tax Advocacy*". He is one of the Editors of the Company Law volume of the "*Butterworths Corporate Law Service"*. He is Head of Professional Standards for the Institute of Certified Bookkeepers. He has acted for three of the UK's accountancy institutes and two of its second tier bodies and drafted the legislation on auditors for Dubai.

Cases include: *DTI v Daniel* (2002) The Times 8th April (instructed for the Secretary of State for Trade and Industry both at first instance and before the Court of Appeal in this human rights test case on the reverse burden of proof in bankruptcy prosecutions), *Society of Lloyds v Levy* [2004] 3 CMLR 56 (Lloyds Names challenge to premium claims under the Audit Directive) and *Feetum v Levy* (2005) The Times 28th February (the first case on the £50 million project finance exception to the bar on administrative receivers under the Enterprise Act 2002), *Khan v Nallamothu* [2005] All ER D (Oct) 60 (company hi-jack), *Watersheds v Da Costa* [2010] Bus LR 1 (FSMA implications when raising corporate finance for clients), *Kaupthing Capital Partners* [2010] Lawtel (validity of the administration of the investment fund of Iceland's largest Bank) and *Re Marrache* [2010] (specially admitted to the Gibraltar Bar to appear as leading counsel in this high profile bankruptcy case before the Gibraltar Court of Appeal).