



The Insolvency
Service

Call for Evidence:

European Commission Recommendation
on a new approach to business failure
and insolvency

February 2015

1. General Information

1.1 This call for evidence will be of interest to entrepreneurs, business owners and directors, investors, financial institutions, insolvency practitioners, rescue professionals and the legal profession.

How to Respond

1.2 When responding, please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the call for evidence response form and, where applicable, how the views of members were assembled.

1.3 If responding in writing please email to: policy.unit@insolvency.gsi.gov.uk, or post to:

Nicholas Blaney
The Insolvency Service
4 Abbey Orchard Street
London
SW1P 2HT

1.4 Alternatively, for your ease, a template response form can be accessed here: <https://www.gov.uk/government/consultations/european-commission-recommendation-on-business-failure-and-insolvency-call-for-evidence>

Confidentiality and Data Protection

1.5 Information provided in response to this call for evidence, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.6 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

What Happens Next?

1.7 The responses to this call for evidence will be used to inform the UK's response to the Commission's review of the Recommendation, which is likely to occur in autumn 2015. The responses will also be used to inform the Government's contribution to any further discussions the Commission may seek to have on business failure and insolvency in the EU.

2. Introduction

2.1 The UK Government believes in the promotion of entrepreneurship, investment and employment. Having an efficient and effective insolvency regime is one of the ways through which Government has sought to achieve this. It helps to create a business environment that supports growth and employment by ensuring that viable businesses that are distressed can be rescued.

2.2 In March 2014 the European Commission issued a Recommendation considering a new approach to business failure and insolvency. The objective of this Recommendation was: “to encourage Member States to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty” and to “give honest entrepreneurs a second chance”. It sets out minimum standards for how it suggests this could be achieved.

2.3 The commission believes that:

‘The discrepancies between national restructuring frameworks, and between the national rules giving honest entrepreneurs a second chance lead to increased costs and uncertainty in assessing the risks of investing in another Member State, fragment conditions for access to credit and result in different recovery rates for creditors. They make the design and adoption of consistent restructuring plans for cross-border groups of companies more difficult. More generally, the discrepancies may serve as disincentives for businesses wishing to establish themselves in different Member States.’

2.4 The Commission suggests that, by adopting the minimum standards it sets out, the cost of assessing the risks of investing in another Member State will be lowered, recovery rates for creditors will improve and the difficulties in restructuring cross border groups of companies will be removed. It is the Commission’s belief that this will promote entrepreneurship, investment and employment as well as contributing to the reduction of the obstacles to the smooth functioning of the internal market.

2.5 The Government invites industry experts and other stakeholders to consider two main points throughout the call for evidence:

- a) Whether implementation of the minimum standards set out in the Recommendation, by member states, would really have the effect the Commission desires, and
- b) How the UK currently compares against the minimum standards set out.

2.6 The Recommendation is in five parts:

- I. Objectives and Subject Matter
- II. Definitions
- III. Preventative restructuring framework
- IV. Second chance for entrepreneurs
- V. Supervision and reporting

2.7 This call for evidence will broadly mirror this structure in its analysis of the recommendations, although the recommendation's objective and subject matter have been dealt with in this introduction.

2.8 In light of any future discussions the Commission may want to have, this call for evidence will look beyond those minimum standards suggested by the Recommendation towards other measures that could also achieve the Commission's aims.

1. In general do you think the Commission's Recommendation, if implemented by Member States, would meet the objectives as set out in Section 1 of the Commission's Recommendation?

3. Definitions

3.1 For the purposes of the Recommendation the Commission laid out the following definitions:

(a) 'debtor' means any natural or legal person in financial difficulties when there is a likelihood of insolvency;

(b) 'restructuring' means changing the composition, conditions, or structure of assets and liabilities of debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activity;

(c) 'stay of individual enforcement actions' means a court ordered suspension of the right to enforce a claim by a creditor against a debtor;

(d) 'courts' includes any other body with competence in matters relating to preventive procedures to which the Member States have entrusted the role of the courts, and whose decisions may be subject to an appeal or review by a judicial authority.

3.2 Government seeks to understand whether any of the terms used in the Recommendation are unclear, or problematic, from a UK perspective. In particular, two concepts that have been highlighted as being potentially unclear or problematic are:

- a) 'an honest bankrupt'
- b) 'a second chance'

3.3 It is the Government's view that the UK system already makes some distinction between bankruptcy cases. If a bankrupt's behaviour is deemed to have been dishonest or blameworthy, they can be made subject to a Bankruptcy Restriction Order (BRO). This can extend some of the conditions of bankruptcy for up to fifteen years and the BRO is placed on a public register¹.

3.4 When a company enters into administration or liquidation, office holders have a duty to report upon the conduct of the director(s) to the Secretary of State. If a director's conduct is deemed 'unfit' they can be disqualified, for a specified period, from becoming a director of a company, or directly or indirectly being concerned or taking part in the promotion, formation or management of a company without permission from the court.

3.5 It is also the Government's belief that the UK insolvency system is strongly focussed on giving entrepreneurs 'a second chance'. In personal insolvency, the restrictions laid upon a bankrupt are normally lifted and debts generally discharged in full after 12 months.

¹ www.insolvencydirect.bis.gov.uk/IESdatabase/viewbrobrusummary-new.asp

3.6 People who are subject to bankruptcy and who are self-employed are generally not prevented from carrying on business during their bankruptcy, subject to some disclosure restrictions².

3.7 With regards to company insolvency, administration, company voluntary arrangements (CVA) and schemes of arrangement are geared towards giving the entity a second chance as their primary focus is the rescue of the business. The use of pre-packs in the administration process can facilitate a quick sale of the business to preserve value and jobs and ensure continuity of a business.

3.8 If a company enters into either compulsory or voluntary liquidation there is still nothing to stop the entrepreneur(s) associated with that company from starting a new business, as long as their conduct has not been deemed unfit and they have not been disqualified.

2. Are the terms used by the Commission that are explicitly defined, clear?
3. Are any of the explicit definitions problematic in a UK context?
4. Are there any other terms, aside from 'an honest bankrupt' and 'a second chance', used in the Recommendation that would benefit from being better defined or that could be problematic if they were developed into law?

² See Insolvency Act 1986, Section 360.

4. Preventive Restructuring Framework

4.1 This part of the Recommendation sets out the elements for a restructuring framework to enable a debtor to restructure a business in order to avoid insolvency.

4.2 The Commission has proposed four different strands:

- i. Availability of a restructuring framework.
- ii. Facilitating negotiations on restructuring plans.
- iii. Restructuring plans.
- iv. Protection for new financing.

Availability of a Restructuring Framework

4.3 The Commission's Recommendation states:

Debtors should have access to a framework which allows them to restructure their business with the objective of preventing insolvency. The framework should contain the following elements:

(a) the debtor should be able to restructure at an early stage, as soon as it is apparent that there is a likelihood of insolvency;

(b) the debtor should keep control over the day-to-day operation of its business;

(c) the debtor should be able to request a temporary stay of individual enforcement actions;

(d) a restructuring plan adopted by the majority prescribed by national law should be binding on all creditors provided that the plan is confirmed by a court;

(e) new financing which is necessary for the implementation of a restructuring plan should not be declared void, voidable or unenforceable as an act detrimental to the general body of creditors.

The restructuring procedure should not be lengthy and costly and it should be flexible so that more steps can be taken out-of-court. The involvement of the court should be limited to where it is necessary and proportionate with a view to safeguarding the rights of creditors and other interested parties affected by the restructuring plan.

4.4 The Government believes the UK already has a strong preventative framework, which is aimed at business recovery where possible rather than liquidation. In addition to the many companies restructured upstream of formal insolvency, the UK's administration, company voluntary arrangement and schemes of arrangement procedures help rescue thousands of businesses each year.

4.5 Secondly, UK procedures are generally considered to rescue businesses faster and at lower cost than many other regimes around the world³. Often the role of the court is less in a UK procedure than procedures found in other legal systems. This is considered to increase speed and flexibility for business rescue as well as helping to keep costs down.

4.6 Whilst the UK has an insolvency regime which is highly regarded, and contains elements adopted by many other countries, evidence and views on the Commission's recommended elements would be helpful to establish whether and to what extent the UK regime differs from the Commission recommendation in any way or delivers the same objectives in other ways.

5. To what extent does the UK regime adequately provide for elements (a) to (e) of the Commission's Recommendation?
6. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objectives?
7. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

Facilitating Negotiations on Restructuring Plans

4.7 The Commission has two broad aims as to how restructuring plans should be negotiated: firstly, debtors should be able to use the process without having to commence court proceedings. Secondly, the appointment of a mediator or supervisor by the court should not be compulsory, but rather made on a case by case basis.

4.8 The Recommendation argues that debtors should have the right to request that a court grant a temporary stay of individual enforcement action lodged by any creditors, with the exception of on-going contracts. The Recommendation states that allowing enforcement action may hamper the restructuring plan, but that any stay should not exceed four months, but be extendable to a maximum of 12 months.

4.9 There is some discretion in the Recommendation to permit the stay to being subject to certain conditions. Those are:

³ See world bank Report *"Doing Business 2015: Going Beyond Efficiency"*, www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Full-Report.pdf

(a) creditors representing a significant amount of the claims likely to be affected by the restructuring plan support the negotiations on the adoption of a restructuring plan; and

(b) a restructuring plan has a reasonable prospect of being implemented and preventing the insolvency of the debtor.

4.10 It is the assessment of the Government, that the UK regime already offers great flexibility with many restructuring plans negotiated outside of formal insolvency proceedings often with the assistance of insolvency practitioners or turnaround professionals. Where formal proceedings are commenced a licenced insolvency practitioner will always be appointed, either as supervisor of a voluntary arrangement or administrator.

4.11 Secondly, court approval is not always required to commence a restructuring plan. In the scheme of arrangement process, once a scheme is formulated, court approval is required to convene creditors' meeting(s). In contrast, the CVA process may be commenced without the need for court approval.

4.12 However, implementing a lengthy stay of individual enforcement would be a move away from the existing domestic regime which currently provides for a moratorium for small companies planning a voluntary arrangement and a short stay when a notice of intention to appoint and administrator is filed.

8. To what extent does the UK regime already deliver the elements in this section of the Commission's Recommendation?

9. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objective?

10. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime, for example by introducing additional options for a stay on enforcement action by creditors?

11. Do you agree with the Recommendation that a restructuring plan process should be commenced without court involvement?

Restructuring Plans

4.13 The Recommendation states that courts should be able to confirm plans swiftly, principally in a written procedure, and that any plans should contain a detailed description of the following elements:

(a) clear and complete identification of the creditors who would be affected by the plan;

(b) the effects of the proposed restructuring on individual debts or categories of debts;

(c) the position taken by affected creditors on the restructuring plan;

(d) where applicable, the conditions for new financing; and

(e) the potential of the plan to prevent the insolvency of the debtor and ensure the viability of the business.

4.14 The Recommendation argues that it should be possible to adopt a restructuring plan by the affected creditors, regardless of whether they are secured or unsecured. It goes on to argue that a restructuring plan should be adopted by a class on a majority vote of creditors in that class. Where there are more than two classes of creditors, courts should be able to confirm restructuring plans which are supported by the majority of those classes of creditors.

4.15 The Government's assessment is that this would be a shift away from the existing domestic regime. For example, in CVAs unsecured creditors have to be in favour of a restructuring plan and in schemes of arrangement, all classes have to be in favour of a restructuring plan before it can be implemented, although each class votes on a majority basis. The Recommendation, however, believes that to make restructuring plans more effective, they should be able to be adopted by certain creditors, or certain classes of creditors, as long as it is not to the detriment of other creditors.

4.16 The Commission argues that restructuring plans which affect the interest of dissenting creditors, or make provision for new financing should be confirmed by the court. The conditions under which a restructuring plan can be confirmed by the court, should be clearly specified in the law of Member States, and contain the following:

(a) the restructuring plan has been adopted in conditions which ensure the protection of the legitimate interests of creditors;

(b) the restructuring plan has been notified to all creditors likely to be affected by it;

(c) the restructuring plan does not reduce the rights of dissenting creditors below what they would reasonably be expected to receive in the absence of the restructuring, if the debtor's business was liquidated or sold as a going concern, as the case may be;

(d) any new financing foreseen in the restructuring plan is necessary to implement the plan and does not unfairly prejudice the interests of dissenting creditors.

4.17 The recommendation states that courts should be able to reject restructuring plans which clearly do not have any prospect of preventing the insolvency of the

debtor. In turn, all creditors likely to be affected by the restructuring plan should be informed of the content of the plan and be able to appeal.

- 4.18 Lastly, restructuring plans should be binding on all those affected creditors where they have been adopted by unanimity. Restructuring plans which are confirmed by a court should be binding upon each creditor affected by and identified by the plan.

12. To what extent does the UK regime deliver the elements in this section of the Commission's Recommendation?

13. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objectives?

14. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime, for example the ability to 'cram down' classes?

Protection for New Financing

- 4.19 The Recommendation argues that new financing which is agreed in the restructuring plan should not be able to be declared void or unenforceable as an act detrimental to the general body of creditors. In turn, the providers of new financing should be exempted from civil and criminal liability relating to the restructuring process. The exception is where fraud is subsequently established.

15. To what extent does the UK regime already provide protection for new financing?

16. Is there anything in the UK regime which supports rescue finance which is not in the Commission's Recommendation but delivers the Commission's objective?

17. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

5. Second Chance for Entrepreneurs

5.1 This section of the Recommendation focuses on discharge periods for bankrupt entrepreneurs, and suggests that:

Entrepreneurs should be fully discharged of their debts which were subject of a bankruptcy after no later than three years starting from:

(a) in the case of a procedure ending with the liquidation of the debtor's assets, the date on which the court decided on the application to open bankruptcy proceedings;

(b) in the case of a procedure which includes a repayment plan, the date on which implementation of the repayment plan started.

On expiry of the discharge period, entrepreneurs should be discharged of their debts without the need in principle to re-apply to a court.

5.2 The Recommendation goes on to qualify this by saying that:

A full discharge after a short period of time is not appropriate in all circumstances. Member States should therefore be able to maintain or introduce more stringent provisions which are necessary to:

(a) discourage entrepreneurs who have acted dishonestly or in bad faith, either before or after the bankruptcy proceedings were opened;

(b) discourage entrepreneurs who do not adhere to a repayment plan or to any other legal obligation aimed at safeguarding the interests of creditors; or

(c) safeguard the livelihood of the entrepreneur and his family by allowing the entrepreneur to keep certain assets.

18. To what extent does the UK regime deliver a second chance for entrepreneurs through existing insolvency laws?

19. Is there anything in the UK regime which is not in the Commission's Recommendation but delivers the Commission's objective?

20. Where you believe the UK regime does not meet the criteria, would the Commission's Recommendation improve the UK regime?

6. Forward look

6.1 As part of the preparations for the Commission's Review, the Government is also interested to receive views on any additional areas which the Commission should consider focussing on.

21. In addition to the issues considered in the recommendation, are there other aspects of insolvency across the EU which the Commission should consider? For example:

- Developing EU principles for fast, efficient out of court rescue procedures for small companies.
- Developing the conditions for rescue finance.

If so, what should the Commission consider?

22. Does the current EU landscape of different domestic insolvency laws create problems in practice? Is it a barrier to cross-border trade and investment in the EU?

23. Should there be greater harmonisation or convergence of insolvency regimes across the EU? What are the benefits and risks to UK businesses?

24. Do you have any other comments?