Association of Business Recovery Professionals

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Dear Ms Clark,

Consultation - Definition of Insolvency
Moveable Transactions (Scotland) Act 2023

1. INTRODUCTION

1.1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices.

1.2. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet. Our members have direct experience of insolvencies and their impact on the UK economy and insolvent companies' stakeholders.

1.3. This response has been prepared by R3 in collaboration with members of its Scottish Technical Committee. The Committee deals with issues of general importance and significance to the profession in Scotland, keeping under re-view all UK and EU legislation, prospective and other matters relating to insolvency law. The Committee is multi-disciplinary and is made up of representatives from across the insolvency and restructuring profession, including practising insolvency practitioners, lawyers (including those specialising in advising regulated entities), academics, and others.

1.4. Our response highlights the policy choices which would determine whether a narrow or more expansive definition of insolvency is needed and the possible technical considerations thereon rather than expressing a view on which policy should be adopted.

2. CONSULTATON RESPONSE

Question One

Should the relevant definitions of insolvency capture insolvency procedures or the state of being insolvent? Please provide reasons for your views.

We consider that the relevant definitions of insolvency should rely on the formal statutory definitions set out in s388 IA86. This is on the basis that the term 'insolvency procedure' is clear and consistent within the legislation and as such would provide more certainty to those who deal with the debtor. The policy objective behind the Moveable Transactions (Scotland) Act is to enable business and individuals to use their assets to secure crucial cashflow and thus avoid workarounds. We consider that the term 'state of being insolvent' would lead to difficulties in facilitating this objective. There are various potential difficulties accessing the debtor's relevant financial information to allow an assessment of the debtor's financial position and to ascertain its solvency or otherwise, particularly as there are many indicators of insolvency. If the state of being insolvent is the desired definition, consideration would be required to clarify which of the formal insolvency tests would constitute insolvency for these purposes – be that absolute insolvency, and/or practical insolvency and/or apparent insolvency or even for the courts to determine what tests are appropriate – the timescale within which such consideration would be required, and how such a definition would be documented. This complexity of definition could potentially be far reaching and actually hinder the debtor in using their assets to secure cashflow contrary to the underlying policy objective of the Act. It should be noted that the courts have struggled to arrive at a settled position as to the point at which a company is "insolvent", even based on current statutory definitions within Insolvency legislation which applies in Scotland, as opposed to insolvency procedures which are more readily capable of definition.

Question Two

Please provide your views on the current definitions of insolvency in the Act and highlight any circumstances which are unnecessary or alternately are missing. It would be helpful if you could provide reasons and/or examples for your views.

As is acknowledged in the consultation papers, this is a complex area of law where opinions are divided. There are overlaps between features of different procedures, and in certain contexts some processes are recognised as insolvency procedures but in other contexts they are not (for example, administration). Accordingly it may not be possible to achieve a wholly consistent position.

Consideration should be given to the policy preference – is it to prioritise (1) the potential assignee/pledgee, (2) the general body of creditors, (3) the distressed debtor? Clarification of policy would determine whether a narrow or more expansive definition is needed and the processes to be included or excluded would need to be classified accordingly and be consistent to that policy. This is for government to decide.

In our opinion, the current policy appears to prioritise the interests of the general body of creditors and/or the debtor so a wider definition would seem to be more appropriate. In this context rescue processes as well as liquidation processes, viz. CVAs and Pt 26A restructuring plans should be included. Conversely, if the policy is to support financing from an assignee/secured creditor, a narrower definition would be appropriate and CVAs and Pt 26A restructuring plans would need to be excluded and careful consideration also given to excluding non-protected trust deeds.

In determining, as a matter of policy, whether to exclude or include an insolvency procedure which is prescribed by s.388 IA86, regard should be had to the technical implications for assignations of claims and/or statutory pledges (and the rights of the holders of these forms of new security interests) in that particular insolvency procedure, and considering the statutory purpose of such procedures. Insolvent liquidations, for example, generally involve the cessation of the debtor company where post-liquidation accrual of assets or claims would

not generally arise or be understood to fall within pre-insolvency security. Whereas CVAs and Restructuring Plans generally (or at least primarily) are designed to preserve the debtor company as a going concern where the security would be treated as continuing save to the extent (a) in a CVA, the security holder consents to prejudice their interest or (b) in a Restructuring Plan, the secured creditor class are subject to a cross-class cram down. In administrations, the primary statutory objective is a rescue of the company as a going concern.

So, in CVA for example, a proposal may not affect the rights of secured creditors without their consent. If the proposal is accepted, and the debtor company continues to trade subject to supervision and the terms of the CVA, a security interest which pre-dated the CVA and attached as security to future assets arising in the course of trade, would fall within the security. If the Act therefore included CVAs in the insolvency procedures for the purposes of assignations of claims, then the subsequently held claims would not fall within the assignation, despite the fact that the debtor company continues to trade and generate new invoice debt, that the assignation of claims was intended to capture. Similarly, where a Restructuring Plan is for the purpose of the rescue of the debtor company, or in an administration where the rescue of the debtor company is the statutory objective being pursued by the administrators.

The policy question is then whether the technical effect of including an insolvency procedure under IA86 such as a CVA, or under Part 26A restructuring plans, which involve the continuation of the business of the debtor, promote the legislative aim of the Act in creating these new modern forms of Scottish security. If the answer to that question is 'no', the technical analysis should inform the policy decision towards excluding that particular insolvency procedure.

However, as paragraph 2.3 of the consultation notes, insolvency is outwith the scope of the project, being too wide and unwieldy, and also so far as corporate insolvency law is concerned, a reserved matter. A further approach to consider therefore, would be to remove all references to the effects of insolvency procedures on these new forms of security, leaving it to the existing insolvency law governing the various insolvency procedures to determine the effect of each procedure on the various security interests in a particular estate, based on their relative terms and the purpose of the particular procedure employed by or in respect of the debtor.

Question Three
Should all trust deeds be included in the definition of insolvency for individuals? Please provide reasons for your answer.

We refer to our comment in answer to Question One as to the reliance on s.388 IA86, insofar as that provision concerns trust deeds (see s.388(2)(b) IA86).

We consider that this question goes to the underlying policy regarding the balance between the interests of the potential assignee/pledgee, the general body of creditors, and the debtor. Our comments made in response to Question Two refer.

There are very few unprotected trust deeds and it is also possible that a trust deed intended to become protected does not become so. Trust deeds are valid from the point of granting therefore the granting of the trust deed should be the relevant point for determining insolvency. There is no publicity of unprotected trust deeds as they are not registered. If all trust deeds are included, one option might be to limit the effect of the provisions to circumstances where the property in question is included in the trust.

Question Four
Should the terms composition and arrangement be excluded from the definition of insolvency for individuals? Please provide reasons for your answer.

Judicial composition in sequestration has been repealed but composition at common law is still possible. Composition and arrangement are terms still in use in other contexts.

If unprotected trust deeds are not excluded due to the absence of publicity (because they are not registered), it would be logical not to exclude composition and arrangement. However, if only protected trust deeds are included because of the publicity aspect, compositions and arrangements for which there is also no publicity should similarly be excluded.

Question Five
Do you agree that the definition of insolvency should include company voluntary arrangements? Please provide reasons for your response.

We consider that this question goes to the underlying policy regarding the balance between the interests of the general body of creditors, the debtor and the potential assignee/pledgee.

If a wider approach is adopted the definition should include CVAs, if it is the narrower approach they should be omitted.

One reason for inclusion would be that CVAs are widely recognised as an insolvency procedure. Also, a wider approach to include procedures such as CVAs and Pt 26As etc would support the general policy objective of encouraging corporate rescue. The interests of potential assignees or secured creditors need to be weighed against the interests of rescue.

We refer further to our comments in answer to Question Two.

Question Six
Should only company voluntary arrangements which include the claim/encumbered property fall within the definition? Please provide reasons for your response.

Again this depends on policy preferences and whether a wide or narrow approach to insolvency procedures is sought.

We note that a CVA focuses mainly on debt/liabilities and may not relate to any particular property. It would therefore probably be easier to either include or exclude all CVAs depending on the policy decision.

We refer further to our comments in answer to Question Two.

Question Seven
Do you agree that the definition of insolvency should include the making of an order sanctioning an agreement under Part 26A of the Companies Act 2006? If so, at what point in the process should the definition be aligned to? Please provide reasons for your views.

If restructuring plans are to be included, the categorisation of the relevant point in the process is of some significance.

The relevant point should be the granting of a court order under s 901F. Only once the court order is made does a restructuring plan commence and can become known to third parties. It also offers more consistency with the trigger point for CVAs.

If Pt 26A restructuring plans are included, for consistency CVAs should also be included. If either Pt 26A restructuring plans or CVAs are to be removed, the other should also be removed.

Both procedures are debt-oriented and commenced by voting approval systems. Restructuring plans require financial distress (which may involve insolvency) and although insolvency is not a requirement of a CVA, they often do involve insolvent companies.

We refer further to our comments in answer to Question Two.

Question Eight
Should only compromises or arrangements which include the claim/encumbered property fall within the definition? Please provide reasons for your views.

See above comments.

3. CONCLUSION

3.1. As rightly pointed out in the consultation paper, this is a complex area of law. We consider that the definition of insolvency in the Act would depend on government policy preferences. We have therefore provided what we consider to be the possible technical considerations of those choices.

3.2. R3 and members of R3's Scottish Technical Committee would be happy to discuss these detailed considerations further with the authors of this consultation.

3.3. If you would like to virtually meet or if you have any other queries, please contact R3's Technical Manager, Moira Fitzpatrick, at moira.fitzpatrick@r3.org.uk or on 020 7566 4210.

Yours sincerely,

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