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CONSUMER PREPAYMENTS ON RETAIL INSOLVENCY

Comments by the Association of Business Recovery Professionals ('R3') in response to the consultation paper issued by the Law Commission in June 2015

Introduction

1. R3 represents insolvency practitioners authorised to practise in all jurisdictions of the UK. Its 3,000 members work in firms of all sizes, from global accountancy firms to high-street practices and sole practitioners. R3's membership also includes insolvency lawyers and other professionals who work in the field of insolvency and corporate recovery.

General observations

2. We see some merit in providing an enhanced degree of protection for consumers in the event of insolvency, but not at the cost of further complicating statutory insolvency procedures or burdening other creditors of the insolvent estate with the costs of administering those protections. Most consumer claims are for comparatively small amounts, and the priority of such creditors will be to receive some repayment as quickly as possible, with minimal formality and complexity. Some enhancement of redress procedures outside formal insolvency is most likely to achieve this, and we suggest that proposals for reform should be focused on this area, together with initiatives to improve consumers' awareness of the remedies available to them. Adding complexity to existing insolvency processes will merely add cost and delays, and in most cases is unlikely to result in an increase in funds available for consumer creditors. Education of the consumer, to understand their existing rights, the options and risks they face when deciding to buy a gift voucher or pay a deposit, may prove more cost-effective and is in keeping with the policy recently expressed in the Consumer Rights Act 2015 policy paper published on 14 August 2015 which is aimed at enhancing consumers' understanding of their rights and how they should be treated by businesses.

3. It is inevitable that it will be (commercially and administratively) easier to provide protections for some categories of consumer creditors, for example those who have paid substantial deposits for the purchase of merchandise, than for others, for example holders of (typically low-denomination) gift vouchers.

Responses to the questions and comments on proposals

Q.1 Do consultees agree that the protection given to some types of consumer prepayments on retailer insolvency should be reformed?

4. There is a good argument for providing protection for some forms of consumer prepayments, for example deposits made in advance for the purchase of substantial items. (The loss of a large deposit for essential household items can have serious consequences on the living standards and well-being of the consumer, not dissimilar to tenant's rent deposits – which are already protected by the Tenancy Deposit Scheme.) However, providing special treatment for a number of very small claims can be disproportionately expensive, and we believe that there would need to be a threshold to ensure that protection is afforded only to claims above a certain value.

5. It is also open to consumers to pay by credit card, in which case they would benefit from the protections given by the Consumer Credit Act (S.75) and the chargeback provisions of many card schemes. There is a strong case for introducing measures to enable consumers to be better informed about their options when faced with a need to pay a deposit and the remedies available in each of those options.

Q.2 Apart from gift vouchers and deposits in the furniture and home improvement sectors, are there other sectors in which consumer prepayments are particularly problematic in the event of retailer insolvency?

6. The travel industry schemes are reasonably effective, but they do have some omissions – for example, payments made in advance for flights-only are not necessarily protected.

7. The leisure and hospitality industry (eg hotels and functions bookings) might also be an example as may be the deposits requested in the building trade.

Q.3a Insolvency practitioners should give information to consumer creditors about chargeback claims and make available on the retailer's website a confirmation that the company is in administration or liquidation.

8 Insolvency office holders already send creditors notification of the insolvency, and usually post a copy of the notice of appointment on the relevant website. We can see no merit in requiring an additional notice duplicating those already issued.

9 It would be reasonable and helpful for insolvency practitioners to draw the possibility of chargeback claims to consumer creditors in a general way, but practitioners should not be expected to provide details, as scheme rules vary by provider, are very complex and subject to change (and in some cases are confidential). Also, see our answer to Q3c below. Consumers should simply be advised to take the matter up with the card issuer.

Q.3b All card issuers should give consumers a brief explanation of how to raise a chargeback.

10 We agree with this suggestion.

Q.3c Card schemes such as Visa and MasterCard should provide a publicly available authoritative guide on how chargeback works.

11 This is a question for the card issuers to answer, but the rules are extremely complex, and may be challenging for non-specialists to grasp, while putting them in laymen's terms may be misleading. It is also possible that making the scheme rules public might be seen by the issuers as putting themselves at a competitive disadvantage.

12. It might be worth considering whether a guide would best be issued by an independent third party, such as the Financial Ombudsman or the Money Advice Service.

Q.4 Do you have any comments on how Proposals 1 to 3 should be implemented?

13. See comments above.

Q.5 Our provisional view is that chargeback should not be required by legislation. We seek views for and against legislating for new legal duties to be imposed on card issuers to refund payments in circumstances currently covered by chargeback.

14. This is a question for the card issuers.

Q.6 Would trusts designed to protect some rather than all prepayments be an acceptable compromise in situations where ring-fencing all prepayments is not practical or affordable for the business?

15. We think this would be impractical and unhelpful. The mechanics involved in setting up such a trust would be complex, and it would be cumbersome to operate. For example, how would a bank know where to direct the funds in the case of a combined remittance part of which represented a deposit?

16. In an insolvency, a major objection is that the trust would create a second estate which would need to be administered in parallel with the main insolvency estate by the insolvency office holder. This would introduce significant delay, without increasing the overall amount available. It would also be necessary to address the question of how the additional costs involved in dealing with the trust should be paid. Either they would have to come out of the trust assets, depleting the amount available for distribution, or they would have to come out of the general assets, which would mean the general creditors would be required to bear the costs of an exercise which brought them no benefit.

Q.7 Would it be useful to develop a series of standard trust deeds which businesses could use to protect consumer prepayments?

17. We think this would be impracticable, for the reasons given above.

Q.8 Do consultees have any experience of prepayment insurance? If so, we would be interested to learn more.

18. We have no direct experience, but would offer the following comments.

19. From a consumer's point of view, prepayment insurance would have the merit of

potentially achieving a quick payout by the insurer, rather than having to wait until the insolvency has reached the stage where a dividend can be paid. In order for this to work effectively the settlement of claims would have to be a matter between the insurer and the consumer, and not involving the insolvency practitioner as an intermediary dealing with both parties back to back.

20. It should be borne in mind that, although prepayment insurance sounds attractive in theory, there is always the possibility of unintended consequences. An example is payment protection insurance, which has given rise to complications in insolvencies, including banks' rights of set-off and the tax treatment of compensation payments.

Q.9 What can be done to overcome barriers to consumer prepayment insurance?

21. This is a matter for the industry, but it would be best if it could take the form of a bond purchased by the retailer, as suggested in R3's policy document *Gift Vouchers and Deposits: Enhancing Consumer Protection in Insolvency*[1], and not a policy taken out by, or paid for by the individual consumer.

Q.10 Is there merit in developing a new statutory 'consumer charge' to be registered at Companies House, which businesses could use on a voluntary basis to give priority to some specified classes of consumer claims?

22. We are not in favour of this suggestion. It would be difficult to determine the criteria for eligibility for inclusion in the class covered by the charge, and the work involved in administering what is in effect a new priority class would add to the cost. More importantly, before any payment could be made under the charge it would be necessary to wait until all the assets had been realised so that the resulting funds could be correctly apportioned. This would add significant delay, which would do nothing to help consumer creditors. If protection is to be afforded to consumers (as opposed to simply ensuring better education as to choices and risk) then insurance would be a preferable means because it would result in much quicker settlement and payment of claims.

Q.11 Rather than introducing mandatory prepayment protection for all gift vouchers, retailers should be encouraged to take more voluntary steps to protect consumers.

23. The purchaser of a gift voucher has no expectation of protection, so the case for providing protection in these cases is less strong than in the case of those who have paid deposits. However, there is scope for commercial self-interest to drive the development of voluntary protections schemes, as retailers who advertise that their vouchers are protected are more likely to attract custom than those who don't.

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1 https://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/R3_Gift_Vouchers_and_Deposits_Paper.pdf

Q.12 **Providers of vouchers should state in the terms and conditions of the voucher whether or not the value of the voucher is subject to any protection in the event of insolvency. Could this be introduced voluntarily, or would it require regulation?**

24. We agree that this is a sensible suggestion, although it is doubtful whether most purchasers would read the terms and conditions in full.

25.. The providers of vouchers should provide greater clarity on the credit risk buyers are taking converting money to vouchers – perhaps at the point of sale (ie at the check-out counter or till in a retail store) or more prominently in marketing literature. The consumers' lack of understanding or appreciation of the risks upon an insolvency of the provider is likely to be a factor in their (growing) popularity.

Q.13 **It should be unlawful to market a scheme in a way which suggests that it can be used as a savings vehicle without putting some form of protection in place to protect the funds.**

26. We agree with this proposal, we do not see any reason why this type of scheme should not be regulated in the same way as other financial services.

Q.14 **Legislation should provide the Government with reserve powers to regulate high-risk voucher intermediaries which hold significant funds over a long period and which may use those funds for other purposes without providing consumers with alternative protection.**

27. Care would need to be taken to ensure that excessively heavy regulation does not result in the market disappearing.

Q.15 **What would the risks and potential costs be for any voucher intermediary (whether 'high-risk' or not) if they were required to introduce protection mechanisms such as trusts, insurance or bonding?**

28. This is a question for the industry.

Q.16 **Do consultees agree that sector-specific regulation is not a suitable means of protecting consumer prepayments in the furniture and home improvement sectors?**

29. This is a question for the industry.

Q.17 **A limited category of consumer claims should be given preferential status, to rank behind employees but in front of floating charge holders. The preferential status would apply where the consumer provided a significant sum of new money to the business in the run-up to the insolvency, using a payment method which did not offer a chargeback remedy.**

30. This proposal is open to the same objection as the suggested 'consumer charge'. The proposed additional category would add both delay and cost because of the need to scrutinise a large number of small claims in order to determine their eligibility for preferential status. As noted in the answer to Question 10, any

payment to creditors would have to wait until all the assets had been realised in order to apportion funds to the correct classes. This would do nothing to help consumers.

Q.18 **Do consultees agree that the preferential status should apply to money paid within a set period before the date of entering administration/liquidation? We seek views on whether that set period should be three months.**

31. Any such thresholds increase complexity of administering the protection scheme and will encourage abuse.

Q.19 **Do consultees agree that preferential status should be limited to claims where the consumer has paid more than a certain amount, either in a single transaction or in a series of linked transactions? We seek views on whether that amount should be £100.**

32. For the reasons given above, we are not in favour of creating a new class of preferential creditors. The need to restrict claims to those falling within these limits would merely make the exercise more administratively burdensome, and would do nothing to diminish the adverse publicity which is caused by consumer losses in insolvencies.

Q.20 **We seek views on the impact of this proposal generally. We are also interested in the following issues:**
(1) Are retailers able to keep records of prepayments of (say) £100 or more made by cash or cheque, so as to present a running total of such sums to their floating charge holders?
(2) Would floating charge holders be able to monitor these sums?
(3) Do many businesses rely on these prepayments to a significant degree?

33. (1) Records always tend to deteriorate in accuracy and quality in periods leading up to insolvency.
(2) We doubt whether banks would have sufficient knowledge of day to day transactions to be able to know how possible consumer claims would affect their position as floating charge holders.
(3) This would depend on the nature of the business – in some cases the deposit will be used to help finance the purchase of the goods being sold to the consumer.

Q.21 **We are interested in hearing about examples of businesses:**
(1) which rely on these prepayments but do not have secured creditors; and/or
(2) which successfully traded their way out of financial difficulties by relying on consumer deposits by cash or cheque.

34. We do not have data to answer this question.

Q.22 Proposal 9 **For specific goods, which are identified at the time of the contract, ownership should be transferred at the time the contract is made. This should apply even if the retailer has agreed to alter the goods in some way before the consumer takes possession.**

35. The proposals on transfer of ownership are fundamental, and would have far-reaching consequences. Proposal 9 appears to have the potential to upset retention of title arrangements between supplier and retailer; security arrangements with finance-providers; insurances; and taxation. At what point will ownership change as the goods move through the chain from supplier(s) to retailer to purchaser? Transferring title at such an early stage in the transaction would cause problems in the supply chain, affect working capital requirements, which ultimately would do nothing to protect consumers.

Q.22 Proposal 10 **For unascertained or future goods, which are not identified at the time of the contract, ownership should be transferred when goods are identified for fulfilment of the contract.**

36. It is difficult to see how a consumer is going to know whether goods are identified for fulfilment of the contract, so this seems impracticable.

Q.23 **Should these rules be mandatory, so that they apply by law to all contracts? Alternatively, should the parties be able to agree alternative provisions?**

37. The proposed new rules would give rise to considerable complication and uncertainty. They would not necessarily improve the position of consumer creditors, and they would present practical difficulties for administrators and liquidators when trying to establish where ownership of remaining property lies. For this reason we are in favour of leaving the law as it is.

Q.24 **Are there any arguments for ownership of goods to be transferred immediately to consumers upon conclusion of the contract?**

38. We think this would be impracticable. It could be difficult to determine exactly what property the customer actually owns if insolvency occurs before delivery of the completed goods. See our comments in relation to proposal 9.

39. We should be happy to discuss any of the points raised in this paper.

Association of Business Recovery Professionals
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