Enterprise and Regulatory Reform Bill

Written evidence from R3, the insolvency trade body

Introduction

1. 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 extensive experience of both corporate and personal insolvency.

Executive Summary

2. R3 has two principal concerns regarding the Enterprise and Regulatory Reform Bill. Firstly, we do not believe that the special circumstance of a company's insolvency has been adequately taken into account, particularly with regard to the provisions of Part 2 relating to employment tribunals. Secondly, we view the Bill as a missed opportunity to bolster the UK business rescue culture and help to protect the UK economy from the actions of unfit company directors. Addressing these two issues would play a crucial part in delivering a key aim of the Bill – encouraging long term growth.

3. Many of the claims brought before employment tribunals relating to an insolvent company continue to be for a failure to consult adequately prior to making redundancies. This duty to consult fails to recognise the constraints that exist in an insolvency situation which often make consultation impossible. This is due not only to the limited resources available to the office holder, but also to their statutory duty to maximise returns to all creditors (including employees). Continuing to trade whilst the company's already dire financial position further deteriorates, in order to meet redundancy consultation requirements, would put them in breach of this duty.

4. R3 strongly supports engagement with employees at the earliest possible stage in these often extremely difficult circumstances. We initiated a Memorandum of Understanding with the Insolvency Service and Jobcentre Plus to encourage IPs to inform Jobcentre Plus as soon as they know redundancies are to be made, and nearly 80,000 individuals have been supported by this initiative since it began in October 2009. Nevertheless, it is vital that the special circumstance of insolvency is recognised with regard to the duty to consult prior to making redundancies, and that this conflict between insolvency law and employment law is resolved. R3 believes that this Bill provides an appropriate vehicle to make the necessary legislative change.

5. R3 has serious concerns regarding Clause 13 and its potential impact on insolvent companies. The aim of issuing a financial penalty would seem to be to act as an additional deterrent to a company from repeating such a breach of employment law. When a company enters a formal insolvency procedure, the management is no longer in place and the cost of any financial penalty would be borne by the Estate – in effect, the creditors, including the Crown and employees in most cases. R3 therefore believes that a specific exemption should be introduced in Clause 13 for companies in formal insolvency procedures other than Company Voluntary Arrangements.

6. R3 supports the move in Schedule 17, Part 3 (enacted by Clause 54) to abolish the procedure for early discharge. This would provide further clarity for all parties over the exact term of an individual's bankruptcy, giving a fixed deadline by which Income Payments Agreements or

Orders (IPA/Os) and Bankruptcy Restrictions Orders or Undertakings (BRO/Us) must be obtained. This is likely to result in increased returns for creditors, as well as increased protection for the public.

7. R3 believes that a further amendment to this Bill could bolster the rescue culture in the UK, which is key to achieving the draft legislation's stated aim of encouraging long-term growth, by addressing the issue of the behaviour of some suppliers towards insolvent companies. Continued supply on reasonable terms is vital for the rescue of a potentially viable business. The current situation, in which suppliers can, in the event of insolvency, charge extortionate ransom payments, move the company onto a higher tariff or withdraw supply altogether means that businesses that could otherwise be rescued in whole or in part are being liquidated. We estimate that addressing this situation by amending Section 233 of the Insolvency Act 1986 could save as many as 2,000 businesses each year.

8. R3 also believes that the Bill represents an opportunity to make the necessary changes to the Insolvent Companies (Reports on Conduct of Directors) Rules 1996, which would allow for the introduction of an electronic D1 report – a form that must be submitted by an IP in a company's insolvency where they believe that a director is unsuitable to be concerned in the management of a company. Moving to an electronic form would reduce the administrative burden on both IPs and the Insolvency Service (IS). It would also allow for more information to be included in the report, which would in turn allow the IS to re-allocate resource from "review" to "investigation". This could increase the number of unfit directors disqualified, having stagnated in recent years due to a lack of resource in the IS, at an estimated benefit to the economy of £88,000 for each disqualification.

Employment Tribunals (Part 2)

Redundancy consultation period in insolvency

9. In relation to Part 2 of the Bill, R3 feels it is important to highlight an issue which leads to many of the claims brought before employment tribunals by employees made redundant following a company's insolvency. We have raised this issue previously in response to the Government's consultation in November on the collective redundancy consultation rules, but see it as wholly relevant to the provisions in this Bill, as they relate to an insolvent company. We give a short summary of the issue here, but provide a copy of our submission to the Government's consultation, for the Committee's attention, at Annex A.

10. Section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992 (TULRCA 1992) requires an employer who is proposing to make mass redundancies within 90 days or less to consult about the redundancies with appropriate employees' representatives. The provisions apply where it is proposed to dismiss 20 or more employees. Where it is proposed to dismiss 100 or more employees, consultation must begin at least 90 days before the first dismissal. In other cases it must begin at least 30 days before the first dismissal. Failure to consult within the prescribed time limits can lead to a protective award being made against the employer. Section 188(7) provides that where there are exceptional circumstances making it impossible to comply, the employer shall take all such steps towards compliance as are practicable in the circumstances.

11. In an insolvency situation, by the time an IP is appointed administrator to a company, it will be in extreme financial difficulty with, by definition, little or no funds available. The administrator will make a commercial judgement over whether to continue to trade, in the hope of selling the business as a going concern. This can, of course, only be done within the available resources and it is thus likely that trading will continue for only a short time, and possibly only in the more viable parts of the business. Often, the dire financial situation of the business at the time of an IP's appointment makes continuing to trade impossible.

12. An IP has a statutory duty to act in the interests of creditors as a whole. Were they to continue to trade a business in the knowledge that to do so would diminish the return for creditors, they would be in breach of this duty. Even any delay in action on the part of the IP in these circumstances would have a large material effect on returns to creditors. The circumstances in which an IP is usually appointed, together with this duty to act in the interests of all creditors, makes it impossible for them to comply with statutory consultation requirements. Were they to do so, it would result in dramatically reduced returns for creditors, undermining both the rescue culture and the lending environment in the UK.

13. This tension between insolvency law and employment law can be resolved by defining formal insolvency proceedings as 'special circumstances' under Section 188 of the TULRCA 1992. R3 believes that this Bill presents an ideal opportunity to make the necessary change.

14. IPs are keenly aware of the effects which their actions will have on employees, and endeavour to keep the workforce informed of developments and comply with consultation requirements as far as possible in the circumstances of the case. In most insolvency assignments there will be a dedicated team of staff from the IP's office dealing with the employees, and helping them submit their claims for their statutory entitlements. R3 has initiated a Memorandum of Understanding with Jobcentre Plus and the Insolvency Service with the aim of encouraging IPs to inform Jobcentre Plus as soon as they know that redundancies are to be made, with nearly 80,000 individuals supported by this initiative since it began in October 2009.

Financial penalties

15. R3 has serious concerns about the implications of Clause 13 in the case of insolvent companies. The intention behind the granting of this power to employment tribunals appears to be for such penalties to act as an additional deterrent to the employers concerned from repeating a similar breach.

16. In the case of a company in formal insolvency, with the exception of Company Voluntary Arrangements, the company management is no longer in place. The cost of any financial penalty would instead be borne, effectively, by the company's creditors including the Crown and, in the majority of cases, employees. This would have no effect on compliance with employment regulations and would seem entirely to contravene the intention behind the financial penalty.

17. R3 therefore believes that Clause 13 should contain an exemption for companies in insolvency proceedings, other than Company Voluntary Arrangements. Granting employment tribunals the power to issue financial penalties against insolvent companies where the management is no longer in place would harm returns to creditors, including employees, whilst having no effect at all on compliance with employment regulations.

Schedule 17, Part 3: Early discharge from bankruptcy

18. Schedule 17, Part 3 - enacted by Clause 54 of the Bill – amends the Insolvency Act 1986 to abolish the procedure for early discharge from bankruptcy. R3 strongly supports this provision, due to the clarity it provides over the duration of each bankruptcy case.

19. During the term of bankruptcy, the Trustee in bankruptcy has the ability to apply for an IPA/O, which ensures that a bankrupt individual makes a contribution to their creditors from their surplus income, both during the term of their bankruptcy and for a number of years afterwards. The IPA/O must, however, be obtained prior to the individual's discharge from bankruptcy.

20. It is not always immediately apparent, on the commencement of the bankruptcy, whether a bankrupt has sufficient surplus income to support an IPA/O. Equally, it may be clear that an IPA/O is not possible at the outset, but a change in circumstances over the course of the term of bankruptcy could make it so.

21. The current situation, in which a bankrupt can be discharged early if the Official Receiver (OR) takes the decision to close their file, causes a lack of clarity over the deadline by which the Trustee must have applied for an IPA/O. This inevitably leads to cases where an individual would have been capable of making further contributions to their creditors, but are not required to do so because they have been discharged prior to an IPA/O being obtained.

22. Abolishing the process for early discharge from bankruptcy ensures clarity over the deadline to which all parties must work, resulting, we would expect, in more IPA/Os and thus higher returns to creditors.

Supporting business rescue

23. A key stated aim of the Bill, presented in the Explanatory Notes which accompany it, is to encourage long-term growth. R3 believes that long-term growth depends as much, if not more, on rescuing existing businesses as it does on new business start-ups. We view the Bill, if left unamended, as a missed opportunity to bolster the UK's business rescue culture, which could be achieved through minor amendments to the Insolvency Act 1986.

24. R3 believes the Bill provides a timely opportunity to address an issue over the behaviour of suppliers towards insolvent companies. This could make a real difference to the UK rescue culture – preventing unnecessary liquidations and their attendant job losses.

25. Suppliers are a company's lifeblood, without whom they simply cannot continue to operate. Under existing legislation, however, suppliers can currently take a number of unreasonable actions when a business becomes insolvent, including demanding extortionate ransom payments prior to continuing supply, moving the company onto a more expensive tariff or, for suppliers not listed in the Insolvency Act 1986, withdrawing their services altogether.

26. Trading a business in administration is only possible where key supplies are maintained and where resources allow. If the cost of supply increases in the event of insolvency, or supply is withdrawn altogether, it becomes more difficult and often impossible to rescue or retain value in a business through trading in administration. As a result of this situation, struggling companies that would otherwise have gone down this route are currently being forced into liquidation.

27. There is also little reason for suppliers to take such action as any charges for supply during administration are paid as a priority, and suppliers have the right to require a personal guarantee from the administrator. There is thus little risk to continuing supply during an administration – in fact, by helping to rescue the business, suppliers are increasing the possibility that it will be retained as a customer.

28. A survey of R3 members suggests that as many as 14% of businesses that are currently liquidated could be traded in administration if suppliers continued to supply on the same tariffs as they did prior to insolvency. With 16,886 liquidations in the UK last year, tackling this issue could mean that a further 2,364 companies could be traded in administration, rather than facing liquidation, each year. Not only would this increase returns to creditors in these cases, it is also likely to result in jobs saved as companies are rescued – either in whole or in part.

29. This could be achieved through amending Section 233 of the Insolvency Act 1986 preventing insolvency being used by suppliers as a sole reason for the termination of supply or increase in tariff. Suppliers would, of course, retain the right to require a personal guarantee, as well as being able to withdraw supply should payments cease.

Disqualification of unfit directors

30. When an IP is appointed as administrator or liquidator to a company, they have a statutory duty, as set out in Section 7(3) of the Company Directors Disqualification Act 1986, to make a report to the Secretary of State if they believe that the conduct of a director of that company makes them unfit to be concerned in the management of a company. How that report is to be made is set out in Rule 3 of the Insolvent Companies (Reports on Conduct of Directors) Rules 1996, including specifying in the Schedules the form that should be used to make the report (form D1).

31. Disqualifying those who are unfit to be company directors is absolutely essential to the health of our economy. The Insolvency Service (IS) estimates that for every unfit director disqualified, the economy benefits by £88,000 through avoiding the economic damage that would otherwise have been caused.

32. In recent years, the percentage of D1 reports submitted by IPs taken forward by the IS for disqualification proceedings has declined substantially, from 45% in 2002 to 27% in the last available year. In terms of the actual number of reports, the volume submitted by IPs has increased markedly from 2002, but the number taken forward has remained essentially stable. This indicates, and this is confirmed by IS, a capacity constraint both in the investigations department of the IS and in the legal department of the Department for Business, Innovation and Skills (BIS).

33. R3 understands the constraints on the resources of both BIS and the IS. Though we believe that a strong argument can be made for increased resource in this area due to the economic benefits derived from it, we are also of the view that more can be done within existing capacity if certain changes are made.

34. R3 is currently working with the IS with a view to updating the current D1 form, set out in the Schedules to the Insolvent Companies (Reports on Conduct of Directors) Rules 1996. The outcome of this work will be the issuing of new guidance from the Insolvency Service on the

information required in a D1 form. We do not believe that these changes go far enough and would argue that the introduction of an electronic D1 form would be less onerous for IPs to complete – as company information could be copied across directly from Information Management Systems – and that it would also result in administrative cost savings for the IS, who would no longer have to distribute paper copies of reports by post. Crucially, as filling out the D1 form would become more efficient, it would allow IPs to input more information which would make it clearer to the IS which cases merited further action. This would allow resources within the IS to be shifted from “review” to “investigation”, increasing capacity in this area, allowing more cases to be taken forward.

35. Changes to the content and format of the D1 form necessitate amending the Insolvent Companies (Reports on Conduct of Directors) Rules 1996. R3 believes that this Bill is an appropriate vehicle to make this change.

R3: Association of Business Recovery Professionals
26th June 2012

ANNEX A: R3 response to the Call for Evidence on the Collective Consultation Rules, January 2012
ANNEX B: List of proposed amendments