RESPONSE TO THE CONSULTATION: INSOLVENCY RULES 1986 – MODERNISATION OF RULES RELATING TO INSOLVENCY LAW

BY MICHELLE BUTLER

Overview

This response reflects my own views as an individual. I am drawing on my experience in working as a consultant to insolvency practitioners, assisting them to comply with existing insolvency legislation, and previously as the Head of Regulatory Standards and Monitoring at the IPA.

I welcome this opportunity to comment on the draft, which I note is work in progress and parts of which are likely to change significantly, particularly in view of the conclusions of the Red Tape Challenge.

Whilst I welcome the decision to carry out a wholesale review and consolidation of the Rules, I would stress the need to ensure that insolvency practitioners and others working in and associated with the insolvency profession are given adequate time and support to become familiar with the Rules and to incorporate them into their systems and processes. Although I have commented below on the fact that the relative costs in assimilating the Rules will be suffered disproportionately by micro-businesses, I do not believe that this is a reason not to press ahead with the changes, but I merely emphasise the need to support smaller businesses in particular in this endeavour.

It is recognised that there are a number of initiatives in train that will, or may, affect the Rules, e.g. the Red Tape Challenge, the outcome of the Government's considerations of Professor Kempson's report on insolvency practitioners' fees and the Transparency and Trust consultation, and Teresa Graham's review of pre-packs. Whilst a sensible balance must be achieved, it is hoped that, wherever reasonable, the release of any further draft Rules incorporate such initiatives and that the final implementation of the new Rules occurs when all these initiatives have been concluded. With this in mind, it would be helpful if draft Rules are released and comments invited periodically before the Rules are finalised.

In the time available, I have had opportunity to review only Parts 3 and 17 of the draft Rules in detail and I have concentrated particularly on the administration process. I have provided my comments on the detail of these two Parts and I intend to examine the other Parts in detail in the months to come. Consequently, whilst I have answered the consultation questions in general terms, it is entirely possible that my more detailed examination of the draft Rules may cast a new light on the topics covered by the consultation questions, for example where further definitions may be helpful.

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Responses to the Consultation Questions

Q1. Do you agree that replacing the current instruments with a single set of rules will make the legislation;

- **less confusing?**
- **easier to use?**

Whilst I agree that a single set of rules will make the legislation less confusing and easier to use in the long term, the enormous upheaval that such a change will bring for insolvency practitioners, their staff, and others working in and affiliated to the insolvency profession, should not be under-estimated. The costs associated with this major change, e.g. staff training costs and revision and re-drafting of standard documentation for case administration, will be suffered disproportionately by micro-businesses. Therefore, it will be imperative that all measures to support the implementation of the Rules be taken. For example, I recommend that the final Rules be made public at least six months before they come into effect.

Consideration should also be given to managing the transitional period in the event that it is planned that the Rules will apply only to new appointments, as this will result in practices needing to operate two systems perhaps for several years with significant potential for confusion and error. If at all possible, it is suggested that the Rules should apply to all existing cases on the date that the Rules come into effect.

It is disappointing that this opportunity has not been taken to include other statutory instruments, such as the Insolvency Practitioners Regulations and those relating to insolvent partnerships, into this single set of Rules.

Q2. Do you think that all of the definitions included are clear?

They appear to be clear, although their adequacy will only be certain when their application to all Rules is scrutinised.

Q3. Are there any further definitions that should be included?

Suggested additional definitions:

- Creditor (and whether they remain so once paid i.e. when does a creditor cease to be a creditor?)
- Secured creditor and security (which have wider application than S248 of the Insolvency Act 1986)
- Release and discharge

Q4. Is the guidance in Part 1 (e.g. about standard content of notices, delivery of documents) helpful?

It is not clear why the date of the office holder's appointment need be included in all Gazette notices (except, of course, notices of appointment). It is also suggested that

there should be no difference between the content of Gazette notices and other statutory advertisements.

It is assumed that the welcomed Red Tape Challenge outcome – extending the use of websites and other electronic communication – will be accommodated by appropriate changes to Part 1.

Q5. Do you agree that grouping processes common to different types of insolvency procedures (common parts) is helpful to users?

Generally yes. There would appear to be other opportunities for common parts, e.g. disclaimers, despite the fact that these processes may not be common to all insolvency procedures.

Q6. Do you find the way that liquidation parts have been set out helpful?

Yes, except that the disclaimer provisions have been replicated in three places. The separation of the fundamental processes of the three liquidation procedures is most welcome.

Q7. Do you agree that the structure of the rules as drafted is clearer and more logical?

Yes.

Q9. Is the plainer, modern language used easy to understand?

Generally, yes.

Q10. Are there any examples where you believe that the language used could be made simpler?

“Winding up” should be replaced by “liquidation”.

Q11. Do you agree that the draft rules improve consistency across insolvency procedures?

There has been insufficient time to consider the full practical implications of the changes.

Q12. Do you have any suggestions as to how consistency could be further improved?

There has been insufficient time to properly ascertain the consistency of the draft Rules.

Q13. Do you agree that prescribing <u>content</u> instead of the form on which that information must be provided will make it easier to use electronic forms of communication?

No.

Where practitioners use email and websites, invariably they use pdfs of completed standard forms. Therefore, it is not clear how prescribing content instead of the form may make electronic communication easier. Of course, it is not known how electronic forms of communication may develop in the future. Therefore, perhaps the most helpful approach would be to provide standard forms, but make their use optional, prescribing that, if they are not used, then all the information they convey must be included in any alternative medium used.

It should also be remembered that, particularly for micro-businesses, the relative costs of implementing the Rules will be substantial. The avoidance of freely accessible standard forms will only add to the costs, as practitioners will need to pay commercial firms to provide Rules-compliant forms or they will need to incur significant internal costs in creating such forms themselves, which would be an unnecessary multiplication of costs across businesses.

It is also considered likely that Companies House will require documents that are to be filed on companies' registers to be in a standard, approved, format. Therefore, it would seem simpler to ensure that any prescription as regards information to be provided to Companies House meets with the Registrar's approval.

Q.14 Do you find the write–out of the contents requirements in the rules to be helpful?

No. As mentioned above, it would be more helpful to provide standard forms, which prompt for all information required by the Rules and which Companies House will accept.

Q.15 What problems do you encounter with the delivery of documents by post?

Successful and timely postal delivery of documents cannot be guaranteed and, although emails would appear to be a more successful, and swifter, method of communication, it is suggested that website communication is the most reliable and

should be used as the default. Few individuals engaging with entities that become insolvent and even fewer businesses do not have access to the internet and these numbers will decrease further over time. Providing information via websites would appear to be the cheapest and most effective method of communication.

Q.16 Do you agree with the estimated savings outlined?

Although avoiding the necessity of using first class post will result in savings and thus is welcomed, enabling communication to be by second class post will create its own complications: practitioners' systems are set up to ensure statutory deadlines are met, but if documents may be sent by second post, this additional delay will need to be accommodated. Monitoring whether statutory deadlines will be met if second class post is used in individual cases will incur its own cost.

Far greater savings will be achieved by the Red Tape Challenge outcome removing the necessity for physical delivery of documents in most circumstances.

Q.17 Are you aware of any other savings or benefits associated with removing the requirement for first class postal delivery?

No.

Q.18 Do you agree that the technical changes listed should be made? If not, please identify which change(s) you do not think should be made and explain why.

I am surprised at the list of technical changes, as my review of Parts 3 and 17 alone have identified far more and far more significant technical changes, for example the change in the process of non-meeting approval of administrators' proposals as provided by Rule 3.37 with the apparent result that the basis of administrators' remuneration may only be considered by a resolution of creditors at a meeting and not by correspondence.

It would seem that the technical changes listed in the consultation document are largely uncontroversial and welcomed.

Q.19 Do you agree that contributories should not be able to form part of liquidation committees? If not, what value do contributories bring to a committee?

I do not believe that there is any advantage in allowing contributories to be members of liquidation committees.

Q.20 Do you have any other suggestions or comments on the structure or content of the rules?

I provide below a summary of my observations on the content of Parts 3 and 17 of the draft Rules. In the time allowed, I have been unable to review in detail the other parts. Given that the document is a working draft, the opportunity to consider at length a more settled and complete draft would be most welcome.

OBSERVATIONS ON THE DETAIL OF PARTS 3 AND 17 OF THE DRAFT RULES

PART 3
ADMINISTRATION (SCHEDULE B1)

3.2 Proposed administrator's statement and consent to act

The heading does appear to correspond to the rest of the Rules: it is noted that all other references to this document throughout the draft Rules, e.g. at Rule 3.17(1)(a), are to "the administrator's consent to act".

3.3 Administrator's security

Rule 3.3(1) states that a person appointing an administrator "must be satisfied that the appointee has security for the proper performance of the office". This is a new additional requirement, the need for which does not appear to have been explained or previously consulted on.

3.16 Notice of appointment

Draft Rule 3.16(1)(vii) provides a variety of options as regards obtaining consent from prior floating charge holders, but it does not accommodate a combination, i.e. that one prior charge holder may have provided consent and another may have remained silent. A similar issue arises at Rules 3.20(vi) and 3.24(1)(x).

3.25 Notice of appointment without prior notice of intention to appoint

It seems that the words "by holder of a qualifying floating charge" should be removed from Rule 3.25(1)(a).

3.34 Administrator's proposals: additional content

The decision in *Re Parmeko Holdings Limited* illustrates the lack of clarity as regards the statutory provisions on the administrator's proposals, as set out in the existing Act and Rules, and it would seem that this Rules revision is an opportunity to improve the clarity.

Rule 3.34 requires the statement of proposals to include substantial detail and Rule 3.37 refers to an administrator seeking approval of this "statement of proposals". However, is it really the intention that creditors are being asked to approve the entire statement or simply the administrator's proposed actions? For example, Rule 3.34(1)(h) requires "a statement of how it is envisaged the purpose of the administration will be achieved": given that administrators are required by statute to pursue the hierarchy of objectives listed in Paragraph 3(1) of Schedule B1 of the Insolvency Act 1986, is it really so that creditors are asked to approve how the administrator envisages meeting this statutory requirement and are they entitled to reject an administrator's proposals if they do not agree with the administrator's vision?

This difficulty becomes more acute when considering Rule 3.34(5), which states that "the document containing the statement of proposals must also include (but not

as part of the proposals) the basis on which it is proposed that the administrator's remuneration should be fixed…" I believe I understand what this is intended to achieve – that creditors' approval by resolution of the basis of the administrator's remuneration should be a separate matter to the creditors' approval of the administrator's "proposals" – but this is a highly unsatisfactory approach in achieving that end. It seems to me that what is required is a clear distinction between the administrator's *statement*, which effectively would be a report on the administration and its anticipated/planned outcome, and his *proposals*, which creditors are asked to approve, with any request for creditors to consider the basis of the administrator's fees being an entirely separate matter, albeit that the administrator may seek creditors' votes on this matter at the same time as he presents his proposals.

3.37 Approval of administrator's proposals

It is unclear why it was felt appropriate or necessary to alter the process of approval of administrators' proposals by correspondence: the current Rule 2.48 provides an adequate and generally successful method of seeking votes, but this draft Rule 3.37 would result in a far less satisfactory process.

Paragraph 53(1) of Schedule B1 of the Insolvency Act 1986 provides that the administrator's proposals may be approved at a creditors' meeting with modification and, under the current Rule 2.48, such modifications may be agreed via correspondence. It would appear from draft Rule 3.37 that the creditors may only deliver a "notice of objection" and, in the event that the administrator receives objections from 10% or more of the creditors by number or by value, the administrator may convene a meeting of creditors to seek approval of the proposals. This would appear to lengthen unnecessarily the process of achieving approval of the proposals, as creditors cannot approve the proposals with modifications at the correspondence stage.

I would also question how an administrator should calculate whether the 10% threshold has been reached, given that many creditors will not have submitted proofs of debt: does he work from the information provided on the statement of affairs? If so, what should he do if no statement of affairs has been submitted? If he is to work from the company's records, is he required to make efforts to satisfy himself that the information is reasonably accurate? Or is he expected to review whatever proofs of debt he has received to establish the value of claims? In effect, is he expected to adjudicate on claims, including complex contingent claims, in order to calculate whether the 10% threshold has been exceeded? With these questions in mind, I would suggest that a far simpler, and cheaper, process may be to ask creditors to vote for or against the proposals, preferably with or without modifications, and retain the current process that a percentage of votes cast results in approval.

It is not clear how this Rule operates alongside the mechanism for conducting business by correspondence set out in Part 15. Rule 3.37(1) states that the administrator may seek approval of the statement of proposals either by correspondence or by convening a meeting of creditors. Rule 3.37(2) then sets out a process if the administrator seeks approval by correspondence. Rule 15.2(1) states that "this chapter applies where the Act or these Rules allow an office holder to invite the creditors or contributories to pass a resolution by correspondence", but the process set out in that chapter is significantly different. In addition, given that it

does not appear that creditors can pass a resolution regarding fees by correspondence (see comment on Rule 17.15), it is likely that, other than where a Paragraph 52(1)(b) statement has been made, a meeting of creditors will be convened to consider the administrator's proposals in any event.

3.50 Pre-administration costs

Rule 3.50(4) requires the administrator to call a meeting, "if so requested for the purposes of paragraphs (1) to (3) by another insolvency practitioner" who worked pre-administration. Paragraph (3)(b) provides for approval to be sought by secured creditors (and preferential creditors) outside of a meeting. It is unclear how a creditors' meeting may be convened with a view to seeking all relevant creditors' approval (or otherwise) of pre-administration costs in a case where paragraph (3)(b) applies.

Rule 3.50(3)(b) is the same as the current Rule 2.67A(3)(b), but I will take this opportunity to highlight some ongoing practical difficulties with this Rule.

The Rule requires the approval of "each secured creditor". Some practitioners have reported difficulties in obtaining the approval, or indeed any response, from secured creditors who have closed their file on a matter, which often occurs when they have established that they will see no, or no further, recovery from their security either because there are secured creditors ranking in priority to them or because the property over which they held security has long ago been disposed of. Some secured creditors also feel that the approval of insolvency costs to be paid from realisations in which they have no interest – for example, where they held security only over a freehold property, but the administrator is seeking to discharge costs from floating charge realisations – is none of their concern, despite this Rule making clear that the administrator requires their approval. I would also draw your attention to the definition of "secured creditor" under S248(1) of the Insolvency Act 1986, which would suggest that the approval of creditors who have the benefit only of a rent deposit deed or lien needs to sought. It has even been suggested that approval needs to be sought from parties who had a secured claim at the date of appointment but their claim has been discharged in full from the company's assets by the time the administrator makes his request. It would seem that the policy objective – that the creditor(s) whose recovery is affected by reason of the fees or costs should have the power to decide on those fees and costs – is not achieved by this Rule. Requiring positive approval from all secured creditors also appears burdensome and unnecessary in view of some creditors' reluctance to engage in a matter which they feel does not concern them. It would seem that, in the face of silence, an administrator's only option is to seek approval from the court, which would seem to be a further unnecessary drain on the insolvent estate.

A similar issue arises in relation to Rule 3.50(3)(b)(ii)(bb) as regards seeking the approval of creditors whose preferential claims have been discharged in full: it would appear to be contrary to the policy objective, given that their prospects of recovery are not affected by the fees and costs. In addition, in the event that these creditors may have non-preferential unsecured claims, it appears inequitable that they alone of their class are entitled to decide on fees and costs when their status as preferential creditor has fallen away because of already having received a distribution in full on their preferential claim.

3.56 Creditor's application for order ending administration

Rule 3.56 states that the application must be delivered to "the person who made the administration application or appointment, and where the appointment was made under paragraph 14 of Schedule B1, the holder of the floating charge by virtue of which the appointment was made". In paragraph 14 cases, these parties would appear to be the same and thus it seems to me that Rule 3.56(1)(c) is unnecessary.

3.58 Moving from administration to creditors' voluntary winding up

Firstly, I am not sure why "liquidation" (as per the current Rule 2.117A) has been replaced by "winding up", particularly when "liquidation" is used as the heading of paragraph 83 of Schedule B1.

I am aware of the difficulties in creating a cost-effective and transparent process for effecting this exit from administration, however I do not believe that this draft process is an improvement over the current. Under this draft Rule, the notice of moving to liquidation is accompanied by a final progress report and, "if anything happens" before this notice is registered by the Registrar of Companies, "which the administrator would have included in the report had it happened before then", the former administrator must issue to all relevant parties "a statement of appropriate amendments to the report". The likelihood is high that something reportable will happen in most cases: for example, bank interest may be earned, the administrator or his staff may incur time costs, a VAT refund may be received, or a book debt may be recovered. It would seem an unnecessary expense to the estate for a statement to be issued in these cases. Regrettably, I believe the simplest solution lies with a change to the Insolvency Act 1986: it would seem far more practical for the move from administration to liquidation to take effect when the notice is signed, and not when it is registered by the Registrar. However, in the absence of a swift amendment to the Act, perhaps consideration may be given to requiring the liquidator, in his first progress report, to disclose any reportable events from the date of the administrator's progress report, which was generally the process adopted by practitioners prior to the Insolvency (Amendment) Rules 2010 in order to bridge the gap to the date that the liquidator took office.

PART 17
PROGRESS REPORTS AND REMUNERATION

17.1 Progress reports in administration etc.

Although Rule 17.1(2)(d)(i) is not a new requirement, it does appear that providing the address of the appointor of the administrator is unnecessary. It is also difficult to see what is expected in the event that the administrator has been appointed by the company directors – do all the directors' residential addresses need to be disclosed? Are administrators expected to ensure that they have up to date information on the directors' residential addresses?

17.2, 4, 5 Progress reports

It is unclear why the time period within which progress reports must be filed is different depending on the insolvency procedure: administrators have one month,

but liquidators and trustees have two months.

It is difficult to see why it is only acceptable for a successor liquidator to report on his predecessor's activities for the first year, as described in Rule 17.5(3), but for subsequent years there must be a progress report ending with the liquidator's ceasing to act (per Rule 17.5(4)). If Rule 17.5(3) is considered appropriate where a Centrebind occurs and the members' liquidator is replaced with the creditors' choice, perhaps this should be reflected more clearly in the Rules. Alternatively, if an annual progress report is considered sufficient for the first year, then perhaps this principle might be applied also to subsequent years.

It is pleasing to note that Rule 17.5(6) states that a progress report is not required for any period that ends after the last date covered by an issued final report. In view of the fact that an office holder has two months after the end of the period of a progress report in which to issue the report, I wonder if this provision may be extended so that, if a progress report has not been issued by the time that the final report is sent, no such progress report is necessary even if the period ended prior to the final report date, provided that the final report is issued not more than two months after the end of the period. If this is not the case, it may result in the perverse outcome that creditors receive a final report and, up to two months' later, they receive a progress report for the period preceding the final report.

There seems to be a typographical error in Rule 17.5(6): "… under rule 17.11 or 17.11".

Rule 17.5(12) requires progress reports to be copied to creditors (et al). Given the view of some that a party is a creditor if they had a claim at the date of the commencement of the insolvency, to avoid progress reports being sent unnecessarily and particularly in Members' Voluntary Liquidations, it would seem that some qualification of this requirement may be necessary.

17.6 … request for further information

It is not clear why creditors should not be entitled to receive further information about remuneration or expenses from any official receiver in office, as explained in Rule 17.6(5).

17.7 … reports by official receiver

It is not clear why it was felt necessary to clarify that "in this Rule, 'creditors' does not include those of whose address the official receiver is not aware" when this is not included in the Rules covering reports by other office holders.

17.11 … final report to creditors etc.

It is anticipated that there may be significant practical difficulties in ascertaining whether the threshold of objections to the office holder's release has been reached. As described in the comment on Rule 3.37 above, setting a threshold of "10% in value of the creditors" suggests that the office holder needs to consider the value of claims of silent creditors and it is not clear how he may do this without incurring significant costs. It is not clear why it was felt that the value of creditors voting was no longer appropriate.

17.15 Remuneration: procedure for initial determination

My points in relation to Rule 3.50(3) above apply equally to Rule 17.15(3) and to Rule 17.16(2), namely the practical difficulties of engaging with every secured creditor and the appearance of running counter to the policy objective as regards seeking approval from creditors who have been paid in full.

It does not appear that the Rules allow resolutions on remuneration to be passed by the general correspondence procedure set out in Part 15. Given that this is the main purpose behind the convening of most meetings, it is evident that one outcome of the Red Tape Challenge - the reduction in the number of meetings convened in insolvency proceedings - will not be achieved.

It is not clear why the remuneration of the official receiver is excluded in Rule 17.15(10)(b)(i), but then included in Rule 17.15(10)(d).

17.17 Remuneration: recourse… to the court

Rule 17.17(2) enables an administrator to apply to court if he feels that the decision of the creditors, as per Rule 17.16(2), is inappropriate. It would appear sensible to allow the administrator to apply to court if these conditions apply to the creditors' decision also made in accordance with Rule 17.15(3).

17.18 Remuneration: review…

Rule 17.18(2)(b) states that, where creditors fixed the basis of the remuneration, any request to change the basis must be made to the creditors. It is assumed that, in the event that the administrator has made a Paragraph 52(1)(b) statement, he need send a request only to the secured creditors (and in some cases to the preferential creditors) and not to all creditors. If this is the case, it might be appropriate to make this clear.

17.21 … claim that remuneration is, or other expenses are, excessive

Rule 17.21(2)(a) states that an application may challenge the basis of the office holder's remuneration fixed under Rule 17.14 and 17.15. It may be appropriate to extend this also to the remuneration fixed under Rules 17.16 and 17.18.

17.22 Remuneration in winding up and bankruptcy where assets realised on behalf of charge holder

It is not clear why these principles do not also apply to administrations.

It is also unclear how these provisions work alongside the Rules relating to the fixing of the liquidator's or trustee's remuneration in general, e.g. Rule 17.15. For example, if creditors have fixed the basis of a liquidator's remuneration by reference to the time given, does this Rule's allowed remuneration take precedence or is the liquidator's remuneration limited to the time costs incurred in realising the charged assets?

It is also not clear why liquidators and trustees are entitled to remuneration on the distribution scale only in relation to floating charge distributions and not also to fixed charge ones.

17.23 Voting on remuneration

It is suggested that this Rule might be extended also to administrations, in relation to pre- and post-appointment remuneration. Given that many practitioners now work in limited companies, it may be appropriate to extend the prohibition to employees of the company in which the office holder is a director or employee.