insolvency

ACCA

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insolvency newsletter

ISSUE 21 – JUNE 2011

1. TECHNICAL NEWS

THE FUTURE OF PRE-PACKS

Following extensive discussions on this subject from late 2008, it is now being formally proposed to make certain changes to the Insolvency Rules in respect of pre-pack administrations. The changes would have the following effect.

- Where a pre-pack has been or is being negotiated, the IP will be required to record in Form 2.2B (the consent to act form), that the prospective sale price represents, in his view, a better result for creditors than any other outcome.

- Where the office holder intends to sell a significant proportion of the assets of a company, or assets which are necessary to the continuance of the business (or a significant part of the business) to a connected party where there has been no open marketing of the assets, he will be required to give three days notice to all known creditors of the proposed terms of the sale.

- Where a significant proportion of the assets of a company, or assets which are necessary for the continuance of the business, are sold by the office holder to any party before his proposals have been issued, he will be required to give a detailed explanation and justification of the sale in his proposals to creditors or first progress report. [This would accordingly put the disclosure requirements of SIP 16 on a statutory footing].

Not only this but, with a view to stopping any migration of pre-packs to liquidations, the additional controls would be extended to liquidations.

It is currently being proposed that the changes outlined above will be commenced in October 2011.

As members may be aware, the third report by the Insolvency Service on compliance by IPs with the guidance set out in SIP 16 and the subsequent guidance by itself in Dear IP 42 was published earlier this year. It found that compliance had risen to 75% during 2010, and had reached 84% towards the end of that year.

REGULATION OF INSOLVENCY PRACTITIONERS

The report published by the OFT in 2010 – The Market for Corporate Insolvency Practitioners – has been followed up this Spring by proposals from the Insolvency Service to take the OFT's recommendations forward. The document can be found at http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/IPConsult.pdf

The OFT's report had concluded that there was a significant difference in the comparative ability to influence insolvency proceedings as between secured and unsecured creditors. The former group, argued the OFT, tended to remain influential in proceedings, including with regard to the level of IPs' fees, until such time as their claims were satisfied: once that happened, the remaining creditors were not able to exert material influence on the case and this had implications for the cost of proceedings. The OFT made a number of recommendations designed to improve the confidence of unsecured creditors in the ability of the system to satisfy their interests. The consultation from the Insolvency Service addressed whether specific regulatory reforms were needed to take forward the recommendations made by the OFT.

The first, and most far-reaching issue dealt with in the consultation paper concerns the basis of dealing with complaints against IPs. As members will know, licensing and monitoring activities have since 1986 been carried out by the seven RPBs and the Insolvency Service; each of the RPBs consider complaints against their own members and licence holders. While efforts have been made to standardise regulatory standards across the profession, there remains a body of opinion that the present multi-regulator structure does not deliver consistency of approach and decision-making, especially in respect of disciplinary cases: in coming to its conclusion the OFT cited a study which suggested that a substantial number of IPs were not convinced that the status quo achieved true rigour and consistency. The OFT report considered that the establishment of some form of independent complaints handling machinery would increase confidence in the integrity of the regulatory framework, especially among unsecured creditors, and would thereby increase their willingness to participate actively in insolvency cases.

The Insolvency Service accepts that there is an issue here and comes up with four possible models for a revised complaints handling machinery.

The first, and most radical idea, would see the creation of a brand new body which would consider all complaints, against all IPs, and rule on them. The individual RPBs would therefore not be involved at any stage of the process, and appeals would be to the courts.

The second idea is to allow the RPBs to continue to investigate and determine complaints against their members but to set up a new body to consider appeals.

The third model is to set up a new body to decide on complaints, with investigative work remaining with the RPBs, and the fourth would see the adding to this model of an additional investigative function.

ACCA's view is that, of the four models, the only one which appears to be capable of achieving the public policy objective as identified by the OFT would be the first, ie to establish a dedicated independent complaints handling body. The other models would involve significant responsibility for handling complaints remaining with the RPBs. While that first model would be the most expensive of the four, if the aim is to increase stakeholder confidence in the system by making complaints handling visibly independent of the professional bodies, it is the only option which should be considered.

The second main theme of the Service's consultation concerned wider regulatory issues. It proposed, again following up a recommendation from the OFT, setting down a number of objectives for the framework of regulation: this idea appears to have been met with general support. Less popular has been the Service's proposal to abolish the Joint Insolvency Committee (JIC) and replace it with a new Standards Board. ACCA has called for the retention of JIC albeit with some changes to its modus operandi. It has accepted the argument for some lay representation at the strategic and planning levels (although the drafting of SIPs should remain the preserve of specialists) and has recommended that its procedures be streamlined by giving JIC the authority to agree new standards.

The third theme of the consultation sees the Service make a number of technical amendments to primary and secondary legislation, again with a view to improving the position of unsecured creditors. These include raising the amount of the company's net property which should form 'the prescribed part' under section 176A of the Insolvency Act 1986, requiring the IP's hourly rates to be fixed at the start of the proceedings (with limited opportunity to revise them later on) and – controversially – requiring the IP to give creditors an estimate of the duration and cost of the process at the initial creditors' meeting.

The Service's conclusions are expected to be announced by the Summer.

PROPOSED AMENDMENTS TO PRIMARY LEGISLATION

The Insolvency Service has conducted a limited consultation on possible amendments to primary legislation.

It is suggesting extending the scope of fraudulent and wrongful trading to encompass administrations and administrative receiverships, where in both cases the company does not exit as a going concern. The restrictions on the use of a liquidated company's name, in s 216 IA 86, would also be extended to the continuing use of the company's website name. Section 192, concerning the submission of annual information to the Registrar of Companies, would be revoked (this has been superseded by the requirement introduced in April 2010 for the liquidator to produce an annual progress report).

These amendments would only be taken forward should a suitable legislative opportunity arise.

MONEY LAUNDERING REGULATIONS 2007

The Government has issued an interim report following its review of the operation of the above. The report summarises the feedback received from stakeholders and sets out its provisional response to it. For the most part, the Government position remains committed to the strict set of rules contained in the 2007 Regulations: there is no suggestion that the CDD requirements, or the current SAR regime, will be amended in any way. On a few matters though, it appears willing to consider some softening of the regime. For example it raises the possibility of introducing an exclusion from the registration requirements for very small traders with very low levels of turnover (it suggests £15,000 pa). It also reports the critical comments received on the efficiency of the rules regarding determination of beneficial ownership and politically exposed persons and suggests it will consider further its position on those matters. Comments on the report are invited by 30 August; it can be accessed via www.hm-treasury.gov.uk

STATISTICS

Company insolvencies – England and Wales

There were 4,121 compulsory liquidations and creditors' voluntary liquidations in total in the first quarter of 2011 (on a seasonally adjusted basis). This was an increase of 3.7% on the previous quarter and an increase of 2.1% on the same period a year ago. This was made up of 1,074 compulsory liquidations (which are down 10.2% on the previous quarter and down 17.2% on the corresponding quarter of the previous year), and 3,047 creditors' voluntary liquidations (which are up 9.7% on the previous quarter and up 11.2% on the corresponding quarter of the previous year).

Additionally, there were 1,314 other corporate insolvencies in the first quarter of 2011 (not seasonally adjusted) comprising 349 receiverships, 782 administrations and 183 company voluntary arrangements. In total these represented a decrease of 2.2% on the same period a year ago.

Individual insolvencies – England and Wales

There were 30,162 individual insolvencies in the first quarter of 2011. This was a decrease of 15.5% on the same period a year ago.

This was made up of 12,539 bankruptcies (which were down 31.3% on the corresponding quarter of the previous year), 10,835 Individual Voluntary Arrangements (IVAs), (which were down 8.0% on the corresponding quarter of the previous year) and 6,788 Debt Relief Orders (DROs), (which were up 20.3% on the corresponding quarter of the previous year)

In the first quarter of 2011, 84.2% of bankruptcies were made on the petition of the debtor, broadly comparable to the levels for recent quarters. The percentage of bankruptcy orders involving trading debts (self-employed bankruptcies) was 18.9% in the fourth quarter of 2010 (first quarter 2011 figures for trading-related bankruptcies are not yet available), notably higher than levels seen in recent quarters.

Insolvencies in Scotland and Northern Ireland

In Scotland, company liquidations increased by 1.5% over the first quarter of 2010, while individual insolvencies were down by 18% over the same period.

In Northern Ireland, the number of company liquidations was down 8% on the same quarter in 2010 while bankruptcies increased by 42% over the same period.

ESC C16

Members will recall the proposal made by HMRC towards the end of 2010 in respect of ESC C16. This concession allows, at the discretion of HMRC, distribution of capital by companies that are to be dissolved under what is now s1003 CA 2006 to be treated as a capital gain on the part of the recipient rather than a distribution. HMRC was proposing to limit the application of what is currently C16 to the first £4,000 of assets. Contrary to initial expectations this change did not come into effect via the Finance Act of 2011 and so C16 is still active. It is likely however that HMRC will raise the issue again in 2012.

LEGISLATION

The Bribery Act 2010 finally comes into effect on 1 July 2011, following widespread concerns about the clarity and meaning of the legislation. The new Act has two main implications for firms of insolvency practitioners – firstly, they need to ensure that they establish internal controls designed to ensure that they do not fall foul of the new offence of 'corporate bribery' and secondly, they need to be aware of the new range of offences in the Act for the purposes of making SARs under the Proceeds of Crime Act.

Particular concern had been expressed about the draft version of the statutory guidance which the Ministry of Justice had issued last Autumn to explain the implications for businesses of the new corporate offence of bribery. The draft was considered to be impractical and inadequate: it has now been comprehensively re-drafted and re-issued: it can be found at http://www.justice.gov.uk/guidance/making-and-reviewing-the-law/bribery.htm

The corporate offence (which applies to all UK-based companies and partnerships carrying on a business in the UK, and foreign companies and partnerships which are carrying on business here) means that a business can be prosecuted under s7 of the Act if any 'associated person' (such as an employee, agent or subsidiary entity) bribes another person with the intention of obtaining or retaining business or some form of advantage for the entity. Thus, in the case of a UK company, it may commit the offence if an associated person anywhere in the world commits an individual bribery offence with the intention of securing a business advantage for the entity.

There is, however a statutory defence against any prosecution and that is that the business has put in place 'adequate' controls to prevent acts of bribery occurring: the new statutory guidance referred to above focuses on advising businesses as to what the courts may regard as being 'adequate'.

The guidance includes the following points.

- The controls which businesses should put in place in the light of s7 should be proportionate to the risk of bribery which the individual business faces. Accordingly, each business should carry out a risk assessment to identify the nature and extent of the bribery risks it is likely to incur, and then plan controls which are commensurate with those risks. Specifically, the guidance says that the risks run by a business trading only in the UK are likely to be lower than if it is trading on a global basis.

- It is not the intention of the Act to criminalise bona fide expenditure on corporate hospitality, which it expressly acknowledges to be an established and important part of doing business. Expenditure will only become bribery if there is an intention on the part of the payer to induce the recipient to engage in conduct that he should not engage in bearing in mind his responsibilities to act impartially or in the best interests of his employer. The guidance does however acknowledge that this is likely to remain something of a grey area and the scale of the hospitality provided may well be taken into account in deciding on which side of the line it falls.

- There is no specific exemption in the legislation for 'facilitation payments' (low-level bribes paid to get officials to speed up their actions or to get them to do what they should be doing anyway). Thus, a facilitation payment paid by an associated person will technically expose the business to liability. However, the guidance stresses that demands for such payments are a common and deeply-rooted practice in many parts of then world and eradication of the practice will require joined-up action over many years to achieve: this is a signal to the courts to take a lenient approach to the making of such payments. It adds that where people feel compelled to make such payments, the common law defence of duress is likely to be available.

- On enforcement, the guidance tries to reassure businesses that prosecutions will only be brought where there is sufficient evidence and where the authorities consider that a prosecution would be in the public interest.

Finally, there is a clear statement in the guidance that no bribery prevention regime will be capable of preventing bribery at all times.

Once an anti-bribery regime has been agreed and procedures established, it is of course essential that the policies and practices inherent in it are communicated clearly to all employees, agents and subsidiary entities who need to be aware of it.

2. REGULATORY NEWS

Members are asked to note the following advice from ACCA's Monitoring Unit.

BONDS FOR CASES MOVING FROM ADMINISTRATION TO CVL OR CVA TO CVL ETC

Although bond providers may not require insolvency practitioners to inform them when an appointment moves from administration or CVA to CVL, ACCA does require this information to be included on the bordereaux cover schedule. The release from the administration or CVA appointment is to be shown (Insolvency Practitioner Regulations 2005) and the new CVL appointment to be shown separately.

FINAL REPORTS

Members are asked to note that Companies House are rejecting final returns for a CVL under S106 unless they are accompanied by a copy of the final progress report in respect of cases commenced after April 2010. They are also requiring the reports to be made up to the date of the final meeting and not be the draft copy that was provided to creditors.

RULE 4.49D(2)(B)

Under Rule 4.49D(2)(b) the draft final report must be accompanied by a statement of the creditors' right to request information under Rule 4.49E and their right to challenge the liquidator's remuneration and expenses under Rule 4.131. It is not sufficient for the statement to refer to where the information can be obtained.

2009 RULES ON DISCRETIONARY ADVERTISING

Where the IP exercises his discretion not to advertise he does not need to document this. Where the IP decides not to exercise his discretion in this respect – in other words he decides to advertise – he should document this decision why he felt it to be appropriate.

DATA PROTECTION ACT

Members are reminded that personal registration is required of an IP under the Data Protection Act even if the firm is registered.

APPROVAL OF CATEGORY 2 DISBURSEMENTS WHEN MOVING FROM ADM TO CVL

Under Rule 4.127(5A) a liquidator need not get separate authority for remuneration when the company has moved from administration to liquidation. However, there is no mechanism for approval of category 2 disbursements. As it stands at present a separate resolution would need to be obtained by the liquidator if he wished to claim category 2 disbursements and he would not be able to rely on the administrator's resolution.

3. CASES

WINDING UP ON THE JUST AND EQUITABLE GROUND

Secretary of State for BIS v PGMRS and another [2011] 1 BCLC 443

The court heard an application from the Secretary of State to wind up two companies. The grounds included a lack of commercial probity (specifically a tendency to not to pay their tax debts until they became insolvent); the involvement in company management of one of the shareholders despite a disqualification she had given two years previously; and a failure to maintain or preserve accounting records. One of the companies involved was also trading whilst insolvent.

It was held that the court's responsibility was to carry out a balancing exercise between those maters which constituted reasons for why the company should be wound up compulsorily and those reasons why it should not, giving such weight to the various relevant factors. The court had to evaluate the public interest reasons to form a view as to whether they gave rise to sufficient reasons for making an order.

In the case in question, all the serious allegations against the company had been proved. A pattern had emerged that the companies were traded at the expense of HMRC until they became insolvent. That represented a lack of commercial probity on the part of the companies' sole director and his wife who had incorporated the companies.

On the evidence it was considered to be appropriate in the public interest for the companies to be wound up.

THE STATUS OF CORPORATE DIRECTORS

Holland v HMRC [2010] UKSC 51

The Supreme Court ruled in this case concerning the circumstances in which an individual who was a director of a corporate director should be deemed to be a dev facto director of the end company.

Under s212 IA 86, a creditor may request the court to compel an officer of a company being wound up to repay monies in respect of misuse of power or breach of fiduciary duty.

Mr and Mrs Holland set up a group structure which aimed to administer the business and tax affairs of contractors, especially those working in the IT sector. Under this structure, 42 trading companies were created in respect of clients' affairs. Two further companies were created to act respectively as the sole director and secretary of each of these client companies. Mr and Mrs Holland were the directors of both those companies and owned each of the 42 'client' companies via another company. The individual contractors were both employees and non-voting shareholders of the client companies.

The aim of the structure was to ensure that the annual taxable profits of each client company did not exceed £300,000, in order to get the benefit of the small companies' rate of corporation tax. From the income the companies received from the contractors' clients, they paid a salary to each employee/shareholder and also declared dividends to each shareholder/employee (after making provision for the payment of corporation tax at the small companies rate). HMRC challenged the structure on the basis that Mr Holland was the settlopr of the sole voting share in each of the client companies, and the result was that the companies were held to be associated for tax purposes, thus exceeding the 300k threshold. As a result the companies were insolvent.

HMRC argued that Mr and Mrs Holland were de facto directors and were responsible for paying out some £13m in illegal dividends.

The Supreme Court ruled, by majority decision, in favour of Mr Holland and against HMRC. It held that the mere fact of acting as a director of a corporate director is not enough for an individual to become a de facto director of the end company. On the facts of the case, Mr Holland was deemed to have acted as the director of the corporate director and had not assumed any more personal involvement in the end companies. Further, it did not follow from the fact that Mr Holland took all the relevant decisions that he was a de facto director – the basis of liability of a de facto director is an assumption of responsibility and being part of the governing structure.

It should be noted that two of the five judges disagreed with this position: the dissenting view argued that if a person takes all the important decisions affecting a company and sees that they are carried out, then he is acting as a director of the company, and that it was 'artificial' to argue that Mr Holland was doing no more than merely discharging his duties as a de jure director.

CORPORATE MANSLAUGHTER

Cotswold Geotechnical Holdings (unreported)

The first conviction has been made under the Corporate Manslaughter Act 2007. Under that statute a company (or a partnership) commits an offence if it causes the death of a person to whom it owes a duty of care, and if the way in which the company's activities are managed or organised amounts to a gross breach of that duty of care.

The company that was prosecuted and convicted in this case was a very small, one-man building company. A 27-year old geologist was working for the company investigating soil conditions in a trench on a building site. The employee was left on his own in the trench at the end of the day when the structure collapsed on him and he unfortunately died.

The CPS argued that the employee was put at excessive risk because the employer's systems had failed to take all reasonably practicable steps to protect him from working in that way. It also argued that the company had ignored industry guidance on the precautions that employers should take when carrying out excavation work.

Apart from the conviction itself the interesting thing about this case was that the sentence was a fine of £385k, to be paid over ten years. That figure falls substantially below the recommended minimum fine of 500k, as suggested by the Sentencing Guidelines Council. Part of the reason for that may well have been the poor health of the sole director who was suffering from cancer.

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TECH-INS-021

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