insolvency

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insolvency newsletter

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1. TECHNICAL NEWS

1. THE INSOLVENCY (AMENDMENT) RULES 2010

As most members will be aware, the Insolvency Service's Rules Modernisation Project has resulted in extensive changes being introduced and these become effective, in relation to new insolvencies, with effect from 6 April 2010. The changes are set out in the Insolvency (Amendment) Rules 2010 (SI 2010/686), which can be found on the OPSI website (www.opsi.gov.uk).

There are two principal drivers of the new changes. First, the project has sought literally to modernise the rules governing ways of communicating with stakeholders so as to bring them into the 21st century and to speed up insolvency procedures. This replicates steps in this direction which have recently been taken in company law. Second, and following on from the first point, the project aims in a number of ways to save money: a target of £25 million pa has been identified. Practitioners should note that the Insolvency Service expects any cost savings achieved as a result of adopting the new rules to be passed on to creditors in the form of better returns. (The stress laid on achieving cost reductions in insolvency procedures happens to coincide with the OFT's current project to investigate whether UK corporate insolvency procedures are giving value for money).

The major changes being made are summarised below.

Electronic communications

The assumption that all communications between IP and stakeholders will be in writing, and delivered through the post, is ended, and IPs have new options to use e-mail as a standard means of delivery. A new Rule 12A.10 provides that, unless in any particular case some other form of delivery is specified, any notice or document may be sent by electronic means *as long as* each recipient has *consented* to delivery in that form and has provided an e-address for delivery of the document concerned. Consent may be sought and given in respect of specific documents or generally. Thus, whenever an IP wishes to take advantage of this new facility in an insolvency case, the first step will be for him to approach all stakeholders in the case concerned and to establish whether they wish to receive communications in hard or soft copy. However, even where stakeholders have responded in favour of receiving soft copies, the IP must still offer them the possibility of receiving a hard copy: any document made available electronically must state that the recipient is entitled to request a hard copy and provide a telephone number, email address and postal address for this purpose. And where any such request is made, it must be complied with within five business days.

Another delivery option for practitioners is provided via changes to the Insolvency Act. In accordance with new sections 246B and 379B of the insolvency Act, IPs may also post most statutory documents on their firm's web site provided that they separately inform recipients, each time that a new document is posted on the site, of the fact of its posting and giving the address of the site, complete with any applicable password. Again, any notice of this kind must add that the recipient is entitled to request a hard copy of any document posted on the site.

The default rule as regards web posting is that this sort of notice to individual stakeholders must be sent in respect of each and every document that the OH places on a web site. But an IP will also be able to apply to the court, in accordance with new Rule 12A.13, for permission to place ALL relevant documents on the web and send just the one direct notice to creditors advising them in advance that all such material will be accessible on the specified site. For the court to agree to any such application it must be satisfied that the costs of sending out individual notices each time there is a new document posted would be disproportionate, hence this option is clearly intended to be used primarily in larger cases.

Reporting to creditors

In the interests of empowering creditors in insolvency procedures, especially with regard to the office holder's remuneration, there are new requirements for IPs to prepare and send out annual progress reports in liquidations, administrations, CVAs/IVAs and bankruptcies. The new progress reports, in the case of liquidations, must include, *inter alia*:

- details of the basis set for the IP's remuneration (or of any steps taken to set it)
- details of progress in the winding up, including a receipts and payments account which should include details of remuneration charged and expenses incurred during the period
- details of any assets that remain to be realised (new IR 4.49C).

Circulation of these reports will take the place of current requirements to hold annual meetings – annual meetings will only remain compulsory in Scottish procedures. The reports will need to be sent out to members/creditors within two months of the end of each 12-month period and a copy sent to Companies House.

When it comes to the final report in a winding up or bankruptcy, there is a new requirement for the office holder to send out a draft of the final report that he proposes to lay before creditors at the final meeting. This will have to be sent out at least eight weeks before the holding of the final meeting.

Remuneration

Significant changes are made to the rules governing remuneration. These changes fall into three categories – firstly the basis on which remuneration may be approved, secondly the requirements regarding reporting to creditors, and thirdly procedures for resolving disputes.

Currently, of course, there are generally two options open to members and creditors as regards the basis of the office holder's fees – they can be set either as a percentage of realisations or by reference to time properly incurred in the exercise of the office holder's functions. The revised rules provide a third option, namely setting the remuneration as a fixed amount from the start.

Not only that but the changes also say that the remuneration may be fixed by reference to any one or more of the three bases, and different bases may be assigned to different tasks carried out. So, for example, creditors could in future agree to pay a liquidator a fixed fee for investigation work, on a percentage of realisations basis for recoveries over a specified amount and the rest in time costs. That decision will be for the creditors to take. These changes apply to liquidations, bankruptcies and administrations alike.

Changes are also made to the situation where the creditors do not make a decision. At present if the basis of the liquidator's remuneration is not fixed by the creditors, then under IR 4.127A he can rely on the default basis set out in schedule 6 of the Rules. In future this route will only be available in MVLs and then if more than 18 months have passed since his appointment. In CVLs, the liquidator in a case where creditors fail to fix his remuneration within 18 months will have to apply to the court – and in fixing remuneration the court will have the same options as will in future be available to creditors.

And there is a new provision specifically dealing with the situation where a new liquidator is appointed. This says that any agreement regarding remuneration which bound the previous liquidator will remain in force with respect to the new liquidator unless and until any new agreement is reached or a court order is made.

With respect to reporting, the main element of the new progress reports (referred to above) will be information on remuneration. The reports will have to include details of all remuneration charged and expenses incurred by the office holder during the reporting period. And the draft of the final report, which has to be sent out prior to the final meeting, will need to give a very wide range of information on fees and expenses.

If creditors consider that they have not been given all the information they need in these reports they can take action. In respect of both the progress reports and the draft final reports, 5% in value of the creditors, or in the case of MVLs, 5% of the members carrying voting rights, will be able to go back to the office holder and ask for further information about the remuneration or expenses detailed in the report.

And the office holder will be expected to respond to any such request within 14 days, although he will be able to stop short of providing all the information asked for if he thinks that the time or cost of preparing the information would be excessive, or that disclosure would be prejudicial to the conduct of the liquidation. But if creditors or members are not satisfied with the explanation they are given, any creditor or member can go to court to force the liquidator to comply.

New powers are going to be made available to both creditors and office holders to dispute matters regarding remuneration.

Creditors will still be able to make challenges under IR 4.131 provided they can speak for 25% in value of all the creditor body. But amendments made to that Rule mean that they will also be able to argue to the court that the basis of remuneration, already agreed, is excessive and also that expenses incurred or to be incurred by the liquidator are so excessive as to be unreasonable. If the court finds that any application made by creditors is well founded it will be able to make any one or more of these new orders:

- an order to change the basis of remuneration
- an order that some or all of the liquidator's expenses not be treated as expenses of the liquidation and
- an order that the liquidator account for any identified excess of remuneration or expenses.

Bear in mind that any application under the revised IR 4.131 must be made within eight weeks of receipt of either the progress report or the draft final report.

Similarly, a trustee, liquidator or administrator will also have a new power to go back to the body which originally approved the basis of his remuneration to challenge it if there has been a 'material and substantial change in the circumstances that were taken into account in fixing it'. So this may entitle a liquidator whose remuneration was limited to a fixed amount to seek an increase if he finds subsequently that the time he has had to put in on the case will not be covered by the fixed fee.

Pe-appointment administration costs

There are going to be new provisions regarding the vexed issue of pre-administration costs.

In the first instance the administrator will have a new obligation to include within his statement of proposals details of any pre-administration costs that have been incurred, and these will include any fees charged and expenses incurred by him or by any other IP involved in preparing for the administration.

The information disclosed will have to include all amounts already paid and the identity of any person who pays any such pre-administration costs. The full contents of the new disclosures are set out in the amended IR 2.33.

And it will then be for the creditors committee (if there is one) to decide whether or not to approve these fees and expenses under a new IR 2.67A. If for any reason the committee doesn't approve them, or if they don't approve the full amount incurred, the administrator will have to go to a full meeting of the creditors. And if there is still no agreement, then the administrator will have to apply to the court for a determination.

Meetings

The standard period for notices of all statutory meetings is reduced from 21 days to 14 days (save for final meetings where minimum notice will be 28 days).

And in keeping with recent changes in company law, IPs will be able to pass resolutions in windings up and bankruptcy by correspondence rather than in formal meetings. Under new IR 4.63A and IR 6.88A, the office holder in a liquidation or bankruptcy will be able to send out a notice to those stakeholders who would be eligible to attend a meeting setting out the terms of a proposed resolution and inviting them to respond by midday on a specified date which must be at least 14 days from the date of the notice. But there will also be safeguards here – 10% in value of creditors, and contributories representing 10% of the voting rights, may insist to the liquidator or trustee that he actually convene a meeting instead.

Virtual meetings

Meetings in future will not necessarily need to be physical ones. This again is a development which mirrors changes that have already been made in company law.

In future, an office holder will be able to hold any meeting of creditors, members or contributories – except a meeting of members in a MVL - on a virtual or electronic basis if he considers it appropriate.

But for the office holder to be in a position to do this, he will need to make arrangements to ensure that every person attending on a virtual basis is able to exercise his rights to speak and vote at the meeting (and by implication everyone else attending should be able to hear what everyone else has to say as well).

Not only this, but the Act as revised will stress that it remains the responsibility of the convenor of any virtual meeting to ensure that those attending are properly identified and that the medium used is sufficient secure to ensure that no persons are able to take part in the meeting unless they are eligible to do so. Thus, the practicalities of ensuring that the technology works, and that only invited people take part, are going to be key factors in the use of this option in practice, especially where large meetings are concerned.

Also, if an office holder proposes to hold a virtual meeting, but creditors or contributories don't agree, then 10% of them can insist that the meeting be a physical one rather then a virtual one. In the case of creditors committees or liquidation committees, any single member will be able to require a physical meeting.

The big area of uncertainty surrounding the holding of virtual meeting is probably what happens if the technology breaks down, and what is the IP expected to do about it if that happens? The revised Rules give some guidance as to what is to happen in that case.

Firstly, if the chairman becomes aware during the course of a meeting that there has been an IT breakdown and some people are unable to participate, even for a short time, he will have a number of options, for example:

- he can continue the meeting
- he can declare the meeting void and re-convene it
- he can declare the meeting valid up to the point where the breakdown occurred and adjourn it
- or he can suspend the meeting for up to one hour.

Where he decides to continue the meeting, the Rules say that those proceedings will be valid unless he decides to declare the meeting void or the court directs otherwise.

That being said, any victim of an IT breakdown will be able to make a formal complaint to the chairman of the meeting, or to the office holder if he has been appointed as such, regarding his exclusion from the meeting. And on receipt of any such complaint, the chairman/office holder will have to take such action as he sees fit to remedy any prejudice he thinks has been caused to the complainant's interests.

So in terms of the validity of the proceedings, the Rules state clearly that any meeting which is continued despite an identified IT breakdown will still be valid. Where the breakdown is not discovered during the meeting, then the excluded person will still be able to complain to the chairman/office holder and if he is not satisfied with the response he receives he will be able to complain to the court. And the court will have the power to render the proceedings invalid.

Reduction in court filings

The revised Rules cut back on the amount of court filings that office holders are required to make, in the interests of saving costs and reducing administrative burdens. For example, there will no longer be any requirement for the administrator to file a copy of the statement of affairs under IR 2.29 and no longer any need to file with the court a notice of disclaimer of onerous property – that notice will in future be filed with Companies House (and where appropriate with the Land Registry). And in an IVA, where there is no application for an interim order, the nominee will make his report not to the court but to the debtor's creditors.

Affidavits

Those documents that either the Act or the Rules currently require to be sworn by affidavit will in future be required only to be verified by a statement of truth the form of which is set out in the revised Rules. The protection for creditors is that, under the Civil Procedure Rules that regulate statements of truth, anyone making a false statement in a statement of truth can be prosecuted for contempt of court.

Gazette notices

There are new standard contents for Gazette notices – these are set out in new IR 12A.31-12A.33. These standard contents will be over and above any other specific information that might be required in individual cases.

Forms

One consequence of the move towards allowing e-communications is that there is going to be less emphasis in the Rules on the use of prescribed forms. The emphasis going forward is going to be more on prescribing the information that needs to be included in a particular notice or document, rather than on the format of the document itself. That way, the Rules lend themselves to a medium-neutral approach to delivery.

Implementation

For the most part the revised Rules will apply to all cases where an individual or a corporate body enters into an insolvency procedure on or after 6 April 2010. The main exceptions relate to liquidations which follow administrations which commenced before 6 April 2010 and compulsory liquidations which follow voluntary liquidations which commenced before 6 April 2010.

So for some time we will have a situation where IPs have to deal with two parallel regimes, one for existing insolvencies and the other for new insolvencies. And looking slightly further ahead, the idea is to produce a fully consolidated version of the Rules, incorporating the changes referred to above as well as the advertising changes that came in last year, and that consolidated version will be published in April 2011.

2. REVIEW OF INSOLVENCY PRACTITI0NER REGULATION

The second 'Annual Review of Insolvency Practitioner Regulation' has been published by the Insolvency Service and is available to view on the IS web site (www.insolvency.gov.uk).

The report states that:

- the number of authorised insolvency practitioners who are active and taking insolvency appointments increased from 1303 to 1331 during 2009
- the Recognised Professional Bodies and the Insolvency Service between them carried out a total of 410 (293 in 2008) monitoring visits to ensure that performance and conduct by IPs continues to be fit and proper
- 80 IPs were subject to sanctions following monitoring visits in 2009 ranging from having their licences withdrawn to financial penalties, for failing to follow the agreed common standards.

3. PRE-PACK ADMINISTRATIONS

The Government announced on 19 March that it will consult on ways to increase transparency and confidence in pre-pack administrations. The announcement coincides with the publication of the second report prepared by the Insolvency Service on practitioner compliance with SIP 16. That report, which has been posted on the Insolvency service's web site, suggests that rate of compliance has fallen from 65% (as at the time of the first report in 2009) to 62%.

The consultation will explore issues such as the following:

- Giving statutory force to the SIP 16 disclosure requirements
- Following a pre-pack administration, provide for automatic scrutiny of the directors' and administrators' actions by the Official Receiver, or
- Require different insolvency practitioners to undertake pre and post appointment work, or
- Require court or creditor approval for all business sales to connected parties.

4. DEBT RELIEF ORDERS

This article has been prepared for the newsletter by Jon McGurk of the Official Receiver's Office in Plymouth.

Research carried out by the Department of Constitutional Affairs in 2004 showed a significant number of people who were insolvent and unable to pay their debts but for whom the existing debt management and insolvency regime was inaccessible, because they either lacked have the assets and income to set up an IVA or a debt management plan, or because they did not have the necessary fees and access to the Court system to enter bankruptcy. Further research on existing bankruptcy cases revealed many with no assets or income which could be used to pay creditors, together with relatively low levels of liabilities, indicating that for those debtors bankruptcy was not the necessarily the right solution.

After consulting the creditor community and debt advice sector, the Insolvency Service formulated Debt Relief Orders (DROs) as a new debt solution including them in the Tribunal Courts and Enforcement Act 2007.

The principal features of DROs are as follows.

- An online application is submitted to the Insolvency Service by an authorised intermediary (usually a skilled debt advisor).
- There is a one-off, non-refundable fee of £90, payable through post offices or payzone outlets.
- Making the DRO commences a moratorium period of 12 months, preventing creditors from pursuing the debtor and on conclusion all the debts covered by the DRO are discharged.
- Creditors are notified and an entry is made on the electronic individual insolvency register.
- During the moratorium debtors are subject to restrictions similar to those for undischarged bankrupts.

The intermediaries who submit applications are given approved status by Competent Authorities, who are in turn designated by the Secretary of State. No intermediary can charge a debtor for completing or submitting a DRO application.

There are strict eligibility criteria which balance the needs of debtors with the interests of the creditors. These include:

- debtors must have total assets of no more than £300 (excluding usual exempt assets and vehicles worth up to £1,000 but including any mortgaged property even if in negative equity)
- monthly disposable income not exceeding £50
- total liabilities not exceeding £15,000 (including debts excluded from the DRO such as fines or student loans)
- no previous DRO application within the preceding six years.

The web-only portal access to make the application is a radical departure for the Insolvency Service and takes forward the transformational government agenda being rolled out across Whitehall. To keep fees low the processing of DRO applications, currently done at the Official Receiver's office in Plymouth, is also highly automated, and involves credit reference agency checks against the information supplied by debtors, and e-mail notification to creditors where possible.

Creditors have a 28-day period in which to object to the DRO which can invoke the Official Receiver's powers of enquiry, compliance is compulsory for debtors. Valid complaints or objections can lead to: the revocation of the DRO (which lifts the moratorium leaving creditors free to pursue the debtor); civil restriction (equivalent to Bankruptcy Restriction Orders) or prosecution. As with all statutory insolvency procedures DROs are under the ultimate control of the Courts.

Since going live in April 2006 the DRO regime has proved successful with over 1,300 Approved Intermediaries working to nine Competent Authorities, submitting up to 100 DRO applications a day, well on the way to meeting the first year target of 14,000 cases. Competent Authorities include commercial companies and not-for-profit organisations from across the debt advice sector. Largest take-up has been in the Midlands, North West and Wales.

Further information on DROs can be found on the Insolvency Service website at: www.insolvency.gov.uk and following the links under 'alternatives to bankruptcy'.

2. REGULATORY NEWS

1. REALISATIONS OF PENSIONS IN OLD BANKRUPTCY CASES

The RPBs have agreed that it is important that old bankruptcy cases that are receiving pension payments, or will be in the future, are not kept open indefinitely and there should be some benefit to the creditors.

The Insolvency Service has confirmed that they do not want IPs to hand back bankruptcy cases to the Official Receiver to deal with as ex-officio and have suggested that IPs use a similar system as that used by official receivers. An article on this issue in Dear IP is expected shortly.

2. PRE-APPOINTMENT EXPENSES

Practitioners are asked to note the view of the ACCA's Monitoring Unit that the purchaser of a business ought not pay the pre-appointment expenses incurred in relation to an insolvent company as this is considered to be against the Ethical Code.

3. APPLICATION FOR RELEASE OF LIQUIDATOR OR TRUSTEE FOLLOWING REMOVAL BY COURT ORDER

Increasingly IPs are moving between firms, resulting in the transfer of large numbers of cases by court order. IPs are reminded of the following.

- Sections 174(4) and 299(3) of the Insolvency Act 1986 provide that where a liquidator or trustee is removed by court order he must apply to the Secretary of State for release.
- The terms of the court order of transfer will include a provision that the creditors in each case are given notice of the transfer together with a notice period in which to object.
- When applying to the Secretary of State for release, IPs are required to confirm that a period of notice has been given to creditors and that no objections have been received from them.

4. CLOSED CASE FILES

When an IP leaves a firm or that firm enters into an insolvency procedure, the IP will still have responsibility for his closed case files. It is therefore important for the IP to have a succession policy in place as he would have for his open cases. Where the succession policy does not include this, the IP must take responsibility for the storage of the closed cases. Another matter that needs to be addressed is where the outgoing IP does not remain an IP, possibly owing to retirement or withdrawal of a licence, as the ex-IP would not be permitted to deal with any issue arising on his closed cases.

5. REMUNERATION UPLIFTS AND COMPLIANCE WITH SIP 9

The Insolvency Rules allow for uplifts on fees in certain cases, primarily where the matters being dealt with are complex. However, IPs are reminded that such uplifts should never be taken as a matter of course and each case should be dealt with on its merits. Additionally, there should be full transparency to the creditors so that they can take a considered view on whether to approve the remuneration proposed.

6. STATEMENTS OF TRUTH

Statements of truth are being utilised by some creditors to support their claims in IVAs where the creditors have acquired the debts and do not have any substantive paperwork to support the debts. It is for the IP to consider whether or not to admit the claims and this will depend primarily on the difference between the level of the debts admitted by the debtors in their proposals and the level of the debts claimed by the successor creditors.

7. TERMINATION CHARGES BY FACTORING COMPANIES

Some factoring companies are known to levy high termination charges, sometimes equal to the amount of monies being held. The IP should examine the contract to ascertain whether the termination charges are in accordance with the contract in place. Where the IP considers the termination charges are so high as to be unfair, the IP could consider whether the matter should be passed to the OFT for consideration.

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