

# **ENCOURAGING COMPANY RESCUE**

– a consultation

June 2009



CUSTOMER SERVICE EXCELLENCE



INVESTOR IN PEOPLE

## **CONSULTATION ON PROPOSALS TO ENCOURAGE COMPANY RESCUE**

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## **Foreword**

The global recession has hit businesses hard. BIS, the Department for Business, Innovation and Skills, is completely focussed on getting UK businesses through the global economic downturn to emerge stronger and more successful on the other side.

We want to make the UK the best place in the world to start and grow a business and that includes supporting viable companies when they are struggling. Not only does this help preserve jobs and livelihoods, it gives companies that may be suffering at the moment, more opportunities to improve their financial position and to prosper in the future.

Our corporate insolvency regime is highly regarded by external commentators. It ranks well internationally for the amount that is recovered for creditors and for the speed with which it deals with troubled businesses. But of course improvements can always be made. As part of our continuing review of insolvency matters, we are now proposing some changes. The measures detailed in this consultation are intended to give struggling, but viable, companies a greater chance to work their way through difficult times.

I look forward to hearing your views on these proposed measures.

A handwritten signature in black ink that reads "Pat McFadden". The signature is written in a cursive, flowing style.

Rt Hon. Pat McFadden MP

Minister for Business, Innovation and Skills

## **SECTION A: GENERAL INFORMATION**

### **Executive summary**

1. This consultation document seeks your comments on proposals for measures that will facilitate company rescue where appropriate, and includes at Annex B an outline analysis of some benefits and costs of the proposals, which will be developed upon receipt of consultation responses. Your views will inform any legislative reform.
2. The UK has a long established and well developed insolvency legislative framework, which is highly regarded worldwide, with a reputation for fairness and for striking the right balance between the interests of debtors and creditors. We want to ensure that the insolvency regime remains world class and fit for purpose and this consultation is part of that ongoing process.
3. These proposals look at enhancements to the legislation, to facilitate company rescues in order that the maximum economic value is rescued from companies that get into difficulties, and that the knock-on effects of company insolvencies on their creditors are minimised, thus saving jobs and providing better returns to creditors.
4. In listening to our stakeholders we have heard a variety of views expressed about ways in which our regime could be further enhanced. We feel that consultation on some targeted measures to further improve our rescue culture would be welcomed by many interested parties, and specifically we would wish to see a greater use being made of Company Voluntary Arrangement (CVA) procedures as a route for the restructuring of a company's affairs. We would also like to encourage amongst banks and trade suppliers a willingness to extend credit to potentially viable businesses that have entered some form of insolvency procedure, to give them more chance of making a recovery.
5. In particular, the proposals consider:
  - extending to medium and large-sized companies the option of a moratorium against creditor action - currently only available to small companies - so they too can benefit from a "breathing space" in which they can seek to agree with their creditors a means of securing a company rescue by means of a Company Voluntary Arrangement;
  - the introduction of a new court-sanctioned moratorium available to all companies; and
  - providing greater security to repayment of monies loaned post CVA or administration, to allow firms in difficulties to access the funding they need to get back on track.

6. Section C of this document sets out our proposals in detail. For each proposal, we summarise the proposed changes, by setting out the existing law in the area and outlining our proposals for implementing these changes, together with possible impacts.
7. In taking forward our development of these proposals, we would be very grateful for your views in response to some or all of the questions asked. We appreciate that not everyone will have views on all issues. We would also be grateful for responses to the questions asked in the outline analysis 'Initial Impact Assessment' (see Section C: Annex B), along with any general views on that document you may have, particularly as to whether or not the costs and benefits of the proposals are fully covered.

### **How to respond**

8. When responding please state whether you are responding as an individual or whether you are representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.
9. The consultation was published on 15 June 2009. The consultation period will run for 12 weeks, and the closing date for responses is 7 September 2009. However, we encourage responses as early as possible to assist us in accelerating the process of considering replies.
10. A response can be submitted by letter, fax or email to:

Phillip Nicholls  
Policy Directorate  
The Insolvency Service  
Zone B, 3<sup>rd</sup> Floor  
21 Bloomsbury Street  
London  
WC1B 3QW

Fax: 020 7637 6746

Email: [policy.unit@insolvency.gsi.gov.uk](mailto:policy.unit@insolvency.gsi.gov.uk)

11. This consultation will be of interest to: business; trade organisations and advisers; representative and regulatory bodies; employees and consumers; and academics.

### **Additional copies**

12. This consultation can be found at: [www.insolvency.gov.uk](http://www.insolvency.gov.uk). You may make additional copies without seeking permission.

### **Confidentiality and data protection**

13. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide, to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidentiality.
14. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request

for disclosure of the information we will take account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic disclaimer generated by your IT system, will not, of itself, be binding on The Insolvency Service.

### **Help with queries**

15. Questions about the policy issues raised in the document can be addressed to Phillip Nicholls, The Insolvency Service (contact details as above).
16. If you have any comments or complaints about the way this consultation has been conducted, these should be sent to:

Idowu Babatunde  
Consultation Co-ordinator  
Department for Business, Innovation and Skills  
Better Regulation Team  
1 Victoria Street  
London. SW1H 0ET

Email: Babatunde.Idowu@bis.gsi.gov.uk

Tel: 020 7215 0412

Fax: 020 7215 0235

17. A copy of the Government's Code of Practice on Consultation is attached at Annex A.

### **What happens next?**

18. The Government will consider the responses received and whether it is necessary to legislate on this matter when Parliamentary time allows.
19. Decisions taken in light of the consultation will be published along with a summary of the responses.
20. We intend to actively engage with stakeholders throughout the consultation. Stakeholders will be able to follow developments on these proposals following the consultation on the Insolvency Service website at [www.insolvency.gov.uk](http://www.insolvency.gov.uk).

## **Consultation questions**

### **PROPOSAL A: Extension of small company moratorium provisions to larger companies**

- A1. Do you agree that it would be helpful for medium and large-sized companies to be allowed to benefit from the option of a moratorium from creditor action for up to 28 days?**
- A2. How useful do you think this would be? Do you think it would encourage medium and large-sized companies to utilise the CVA procedure? (If you can give figures, or comment on those in the initial Impact Assessment, that would be helpful.)**
- A3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed? Please provide evidence of the risks or disadvantages, if possible.**

### **PROPOSAL B: Court sanctioned moratorium**

- B1. Do you agree that it would be helpful to have a new Court sanctioned moratorium on creditor action?**
- B2. Do you agree that the proposed moratorium period of 42 days, extendable to 3 months, is appropriate?**
- B3. Do you agree with the proposed tests that the Court would need to consider and the suggested role for the Insolvency Practitioner? If not, what do you suggest?**
- B4. How useful do you think this procedure would be? (Please give figures for numbers of companies or businesses rescued, jobs saved, improved returns to creditors or other benefits, if you can.)**
- B5. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

### **PROPOSAL C: Super-priority of rescue finance in administration expenses**

- C1. Do you agree that finance properly incurred in attempting to rescue a company should rank in front of other administration expenses?**
- C2. How useful do you think this would be? (If you can give figures, that would be helpful.)**

**C3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

**PROPOSAL D: Greater ability to create new secured charges in an administration**

**D1. Do you agree that there should be greater scope to secure post-insolvency financing by an ability to create new fixed charges?**

**D2. How useful do you think this would be? (If you can give figures, that would be helpful.)**

**D3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

**PROPOSAL E: Greater ability to create new secured charges in a CVA**

**E1. Do you agree that access to CVA financing should be facilitated by the ability to offer new security?**

**E2. How useful do you think this measure would be for companies contemplating a CVA? If you can give figures, that would be helpful.**

**E3. Do you think that it is appropriate for the Court to have a role in ensuring protection is provided for existing fixed charge holders?**

**E4. Is it viable to suggest that a company might be able to obtain insurance against the possibility that an existing charge holder is not repaid in full as a consequence of priority being given to a rescue finance provider?**

**E5. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

**PROPOSAL F: Cessation of certain asset based lending (ABL) arrangements on administration or CVA**

**F1. Do you agree that the effect of an asset-based lending (ABL) agreement or floating charge entered into before an insolvency event should be limited to the assets acquired or book debts arising before the insolvency event takes place (with the express exception of long term contracts where future periodic payments have already been assigned in return for an advance made to the company)?**

**F2. How useful do you think this would be? If you can give figures, that would be helpful.**

**F3. Do you think there are any risks or disadvantages to this proposal?  
If so, what are they and how would you suggest that they could be  
addressed?**

## **CONCLUSION**

**G1. We invite views on whether this package is the best way of  
achieving our aim of making company and business rescue easier  
and more successful, and welcome any other comments on these  
proposals.**

## **SECTION B: BACKGROUND TO THE COMPANY RESCUE PROPOSALS**

21. The global recession has created a very difficult environment in which to do business. The Government has been active in offering support. In the Pre-Budget Report 2008, businesses in temporary difficulty were given the opportunity to reschedule their HMRC tax bills to a timetable they can afford through a new HMRC Business Payment Support Service. In January 2009 the Government published 'Real Help for Business', introducing cross-government initiatives designed to help businesses during these tough economic times. Budget 2009 has built on this support extending existing initiatives to support businesses' cash flow while putting in place measures that would support the adjustment towards renewed economic growth and improve the UK's competitiveness.
22. Where possible, the Government wants to provide companies which have a viable future but are facing difficulties, with an opportunity to establish a more stable footing and prosper, helping to preserve jobs and livelihoods. An important part of this is ensuring that the insolvency legislative framework continues to live up to its international reputation for fairness, striking the right balance between the interests of debtors and creditors, both in these current difficult economic times and in the future.
23. The corporate insolvency framework exists to facilitate the orderly and effective handling of the affairs and assets of companies that have become insolvent. The regime has two key distinguishing features:
- it aims to protect, as far as is reasonable, the interests of creditors; and
  - a high priority is given to the rescue of existing companies and businesses, where possible.
24. The framework gives confidence to investors, businesses and other stakeholders by providing a range of appropriate and proportionate procedures.
25. The UK insolvency framework provides routes to rescue and is both highly regarded by external commentators and ranks well internationally. Recent surveys show that the insolvency regime has proved effective in delivering results both for creditors in terms of speed and amounts recovered, and for debtors in reducing stigma and encouraging financial rehabilitation.
26. The World Bank "Doing Business Report 2009" ranks the UK joint 8<sup>th</sup> out of 155 countries for the speed with which it deals with troubled businesses; and 9<sup>th</sup> out of 155 countries for the amount recovered for creditors. This compares with joint 23<sup>rd</sup> and 15<sup>th</sup> for the USA, joint 37<sup>th</sup> and 40<sup>th</sup> for France and 20<sup>th</sup> and 33<sup>rd</sup> for Germany.
27. The routes to rescue are administration and Company Voluntary Arrangements (CVAs). The procedures for administration and CVAs are

set out in the Insolvency Act 1986. A CVA is a mechanism for a company to come to a legally binding agreement with its creditors in satisfaction of their debts and the overall policy objective behind the process is to ensure the continuation of the company as a going concern wherever possible.

28. The Insolvency Service works to maintain and develop its insolvency regime to make sure that it remains world class and fit for purpose. Recent innovations include better targeted advertising requirements. Other changes that, subject to Parliamentary process on a Legislative Reform Order that has been laid before Parliament, are planned to come into force in April 2010 are:

- allowing information and documents to be sent electronically and via websites;
- greater flexibility over how creditor meetings are conducted to facilitate participation;
- liquidators to provide fuller reporting to creditors but no compulsory annual meeting requirements.

29. By reducing the cost of administration in this way, the changes will increase the money available for all creditors, including SMEs, enhancing the effectiveness of the current system.

30. The regime is being tested by the current economic downturn and we believe it is working well. That said, we constantly monitor the effectiveness of the regime and we are now inviting views on whether some additional targeted changes to corporate insolvency law could improve the rescue culture even further, saving more jobs and providing better returns to creditors.

31. In CVAs, small companies facing financial difficulty are currently able to obtain a moratorium on creditor action while seeking agreement with their creditors to deal with their debts. While an agreement is being pursued, the existing management stays in place. The proposals would extend to viable large and medium-sized companies the option of a moratorium while trying to come to an agreement with creditors.

32. Additionally, it is proposed to introduce a new Court-based route for securing a moratorium of up to three months, available to all sizes of companies.

33. The proposals also consider changes that would give companies greater access to additional funds to help them get back on their feet. Under the proposals new money lent to companies in either a CVA or administration would be given greater security, whilst ensuring that existing secured lenders are adequately protected. This could make it more attractive to lend to such companies allowing them to access extra funding when they need it most.

34. The overall aim of these proposed measures is to ensure that company rescues are encouraged to take place whenever they are appropriate and that the knock-on effects of company insolvencies on their creditors are minimised.

## **SECTION C: THE PROPOSALS**

35. Our objective is to promote company and business rescue, by allowing greater opportunity for companies, to generate viable proposals for rescue and restructuring, to be considered by creditors, and by facilitating access to the financing necessary to fund a business rescue. We have made an outline Initial Impact Assessment for each of the proposals identified in this consultation, which is provided at Annex B. We would like to hear your views both on the specific questions below and on the assumptions and calculations in the Initial Impact Assessment.

### **Greater opportunity for companies to generate viable rescue proposals for creditors**

36. A CVA enables a viable company to reach a legally binding agreement with its creditors for repayment, in full and final settlement, of all or a proportion of its debts over a period of time. The existing management can stay in place under these arrangements and the company can continue trading. However, under the 1986 Act, there was no mechanism for a company to obtain a moratorium to stop enforcement action being taken against it whilst an arrangement was being put in place, unless an administrator was simultaneously appointed. That position was altered to some degree by the Insolvency Act 2000, which provided a way for certain small companies to obtain a moratorium to provide a breathing space and give a company's management time to put a rescue plan to creditors.

37. Under the current legislation, larger companies cannot do this, and will often enter administration to secure the moratorium they need while they negotiate a CVA. But administrations are more costly than CVAs and we believe that by providing a CVA with moratorium to larger companies it would discourage the use of the administration procedure for the purpose of securing the protection of a moratorium and consequently save companies money by virtue of lower costs. This is analysed in the Initial Impact Assessment (Annex B). This proposal could lead to significant benefits for creditors, employees and consumers, as well as trade partners.

38. We intend that our proposals for CVAs will also apply to Limited Liability Partnerships (LLPs).

### **PROPOSAL A: Extension of small company moratorium provisions to larger companies**

39. **Proposal A is that, where there is a proposal for a CVA which an Insolvency Practitioner (IP) considers has a reasonable prospect of success, medium-sized and large companies should be able to benefit from the option of a moratorium, as small companies can.**

40. Under Proposal A, Schedule A1 of the Insolvency Act 1986 would be extended so that the moratorium currently available to small companies<sup>1</sup> could be applied to any company (subject to some restrictions) of any size. This would mean that directors of the company could obtain a moratorium by filing documents with the Court preventing creditors from taking action against the company or its property for an initial period of 28 days, where they have submitted to the nominee (an IP) a proposal for a CVA, which the nominee considers has a reasonable prospect of success and of being approved by at least 75% of creditors.
41. The moratorium would give time for the proposed CVA to be put to a meeting of the creditors, and for the meeting to decide whether to approve it. If at least 75% of the creditors agree to the proposal, it is then binding on all creditors that would have been entitled to vote at the meeting. The nominee then becomes the supervisor of the arrangement.
42. Schedule A1 paragraphs 2, 3 and 4 contains various restrictions as to the type of company that is eligible for a moratorium. We propose that these existing restrictions would apply to medium and large-sized companies. This would mean that, in relevant periods defined by filing dates, a company would not be able to obtain a moratorium if:
- it effects or carries out insurance contracts subject to particular exemptions under the Financial Services & Markets Act 2000 (FSMA 2000);
  - under that Act, it accepts deposits;
  - it has a liability for a deposit accepted under the Banking Act 1979;
  - it is party to a market contract or any of its property is subject to a market charge or system charge;
  - it is a participant within the meaning of the settlement finality regulations or any of its property is subject to a collateral security charge;
  - it is party to a capital market arrangement under which there is a debt of at least £10 million and the arrangement involves the issue of a capital market investment or it has any liability under an agreement in that sum, or more; or
  - it is a private public partnership with step in rights.
43. The company would also be excluded from the moratorium process in the following circumstances:
- if it is in administration, is being wound up (or is being treated as wound up when the moratorium started);
  - if an administrative receiver or provisional liquidator is in office;
  - if a voluntary arrangement is in effect;
  - if there has been a moratorium in place in the previous 12 months and no voluntary arrangement had effect when the

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<sup>1</sup> A company which satisfies 2 or more of the following requirements: turnover of not more than £6.5m, balance sheet total of no more than £3.26m and no more than 50 employees.

moratorium ended, or a voluntary arrangement had effect in that time but ended prematurely; or

- if an administrator held office in the period of 12 months ending with the date of filing.

#### QUESTIONS:

**A1. Do you agree that it would be helpful for medium and large-sized companies to be allowed to benefit from the option of a moratorium from creditor action for up to 28 days?**

**A2. How useful do you think this would be? Do you think it would encourage medium and large-sized companies to utilise the CVA procedure? (If you can give figures, or comment on those in the initial Impact Assessment, that would be helpful.)**

**A3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed? Please provide evidence of the risks or disadvantages, if possible.**

#### **PROPOSAL B: Court sanctioned moratorium**

44. We recognise that larger companies are likely to have more complex affairs than smaller ones. They may need additional time to put together proposals and institute protection from the risks of further value destruction by a formal restructuring announcement. Equally, it is important that creditors' interests are adequately protected. We therefore propose **a new procedure, which would allow a Court sanctioned moratorium of up to three months, in circumstances where the Court was satisfied that creditors' interests were adequately protected.**

45. Under proposal B, directors of a company would be able to apply to the Court for an initial private hearing at which the Court could grant a moratorium of 42 days. The directors may subsequently return to Court with an application for an extension of time. Only one extension would be permitted: the moratorium, which would be subject to the supervision of the Court, could not last for a period of more than three months in total.

46. In order to obtain the moratorium, the Court would need to satisfy itself that:

- (a) the company is unable to pay its debts<sup>2</sup>, or is likely to become unable to pay its debts within three months of the hearing date;
- (b) there is a reasonable prospect of a CVA being approved by the creditors; and

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<sup>2</sup> Within the meaning of section 123 of the Insolvency Act 1986

(c) in the circumstances, sanctioning a moratorium would be in the interests of creditors as a whole.

47. The Court application for the initial private hearing should be supported by a statement from an IP that, in the IP's professional view, the tests were satisfied. The IP would also be required to report to the Court, as soon as practicable, in the event that circumstances changed such that these tests were no longer satisfied. The Court would, in those circumstances, have the discretion to:

- remove the moratorium;
- amend the conditions attaching to it;
- move to another insolvency procedure;
- or make such other order as it sees fit (but may not extend the total period of the moratorium beyond three months).

48. The company would need to arrange the members' and creditors' meetings within the time period agreed by the Court for the moratorium, in order to try and obtain support for its CVA proposal.

49. Proposal A and proposal B are mutually exclusive. If a company applied for a moratorium under this proposal B it could then not apply for a moratorium under proposal A, and vice-versa.

## QUESTIONS

**B1. Do you agree that it would be helpful to have a new Court sanctioned moratorium on creditor action?**

**B2. Do you agree that the proposed moratorium period of 42 days, extendable to three months, is appropriate?**

**B3. Do you agree with the proposed tests that the Court would need to consider and the suggested role for the IP? If not, what do you suggest?**

**B4. How useful do you think this procedure would be? (Please give figures for numbers of companies or businesses rescued, jobs saved, improved returns to creditors or other benefits, if you can.)**

**B5. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

## **Facilitating access to rescue finance**

50. Access to finance is a key determinant of business rescue. The following paragraphs:

- provide an overview of the current position regarding the ability of distressed companies to access finance;

- outline why we are making proposals to encourage greater access; and
- consider some of the ways this might be achieved.

### **Sources of lending**

51. A distressed company may seek rescue finance from existing lenders or from lenders with which it has no prior relationship. An existing lender will have information about the company that it has acquired as a result of its past relationship, which should put it in a good position both to work with directors who are looking to involve an existing lender, and to make an expedited, considered decision as to whether it wants to advance the necessary rescue finance. A key factor for the successful negotiation of rescue finance is therefore likely to be the directors securing early involvement of existing lenders.
52. Secured finance from a new lender is currently only likely to be available to support a rescue to the extent that either:
- (a) existing secured creditors agree;
  - (b) the company has assets free of charges, or charged assets with sufficient equity that can be offered as fresh security; or
  - (c) both (a) and (b).
53. Otherwise, any additional finance will either be provided by the directors or by the existing lender - most likely with the benefit of existing or increased security and/or personal guarantees.

### **Why we are suggesting proposals to encourage the provision of rescue finance**

54. Our proposals, aimed at increasing the availability of rescue finance, would offer a range of increasingly enhanced security to the provider of the rescue finance, as an incentive to lend to a company that would otherwise have difficulty attracting finance.
55. Stakeholders tell us that otherwise viable companies are often unable to negotiate new borrowing when they are in financial trouble and that even when they can negotiate, the cost of borrowing is higher than might otherwise be the case.
56. Difficulties arise, for example, when a company's property is (partially or totally) subject to charges or 'negative pledges' held by existing lenders, and those lenders are unwilling to advance the rescue finance themselves which in turn deters new lenders lending. Similarly, a perceived risk of lending to a company in financial trouble drives up the cost of finance.

57. Negative pledge clauses, which are commonplace in lending documentation, limit a company's ability to borrow money using its assets as security, which protects existing secured lenders against any later dilution of their security. Under our proposals, outlined below, negative pledge clauses would be overridden in certain limited circumstances, so making the proposition of providing rescue finance in CVA and administration procedures more attractive.
58. Consequently we propose to give directors more power to secure rescue funding. There is a dual purpose: first, to increase access to rescue funding and, second, to preserve more businesses as going concerns. But there is a balance that needs to be struck as there is a risk, although we believe it to be slight, that this could lead to other creditors being placed in a less favourable position. We recognise that, where a lender has assessed and priced the risk of a secured loan to a company and where that security is now diluted by the fact that new rescue finance acquires a priority, that original lender's interests must be adequately protected. Ultimately, giving companies greater power to secure rescue funding should give viable companies a better chance of a successful rescue or restructuring, thus benefiting all creditors.
59. Additionally, there is a need to ensure that these proposals do not have adverse consequential effects for the cost of borrowing generally. This would be of particular importance for security held subject to negative pledge clauses. Such clauses give lenders – when they agree the initial loans with a company - a degree of certainty as to the extent to which they might rely on that security for repayment. If giving priority to rescue finance overrides negative pledge clauses, without protections, existing lenders could find that the security they hold is worth less to them than they had thought. Consequently such lenders may seek greater security when they agree the initial loans with the company, thereby driving up the cost of borrowing.

### **PROPOSAL C – Super-priority of rescue finance in administration expenses**

60. As a measure to encourage rescue finance, we propose that **finance costs properly incurred in rescue should rank in front of other administration expenses.**
61. Greater priority to repayment of such funding ought to make it more attractive for banks, other financial institutions and trade and services suppliers to supply credit to companies in administration. An increased availability of credit should, in turn, make it easier for administrators to rescue the business rather than having to break up the company and sell assets piecemeal. The provision of post-administration financing should serve to increase the overall pot of money available to creditors, so that even if some creditors are pushed further down the line in terms of priority, creditors in general would be better off.

62. Credit extended to a company in administration is already given an element of priority by being classified as an administration expense. As such, because of the provisions of paragraph 99 of Schedule B1 to the Insolvency Act 1986, it ranks above both floating charge and unsecured creditors. We propose that finance costs properly incurred in attempting to rescue a company should rank in front of other administration expenses.
63. Legislative provision would be made to allow for the rights of negative pledge holders to be overridden in the future, in circumstances where this would stop existing secured creditors from preventing the company from obtaining post-administration rescue financing.
64. This proposal would only apply to administration: it is already open to directors and their nominees under a CVA to propose that post CVA funding be given such super-priority, so there is no need to make special provision for this.

## QUESTIONS

- C1. Do you agree that finance properly incurred in attempting to rescue a company should rank in front of other administration expenses?**
- C2. How useful do you think this would be? (If you can give figures, that would be helpful.)**
- C3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

## **PROPOSAL D: Greater ability to create new secured charges in an administration**

65. We recognise that provision for super priority of expenses might, by itself, be insufficient to attract rescue finance in all cases where a rescue would otherwise be viable. We therefore propose that an IP acting as an administrator should be able to secure new post-insolvency financing:
- **against any property which is not already encumbered by fixed security; or**
  - **as an additional (subordinate) fixed charge on any property; or**
  - **subject to the agreement of the existing fixed charge holder(s) or the Court, and only where there is no scope for new or subordinate fixed charges, as a first charge (ahead of other fixed charges) or an equal first charge on property already subject to a fixed charge,**

**provided that the Insolvency Practitioner is satisfied that:**

- **the granting of such security for this rescue finance is necessary in order to obtain that finance;**
- **the interests of existing fixed charge holders are adequately protected; and**
- **obtaining the rescue finance is in the best interests of creditors as a whole.**

66. New post-administration financing would be defined widely to include, for example, both new loans and trade credit.

67. Such new security would rank ahead of any floating charge created before the insolvency, before any insolvency expenses and ahead of unsecured creditors. In certain circumstances, it would also rank equal, or in priority, to fixed charges. It may be argued that paragraph 99 of Schedule B1 already puts administration expenses, which include the provision of new rescue finance, ahead of any floating charge holders, but this proposal would extend this by providing for express security in respect of any such financing. Legislative provision would be made to allow for the rights of negative pledge holders to be overridden in circumstances where this would allow security to be offered by the company for post-administration rescue financing.

68. This measure would give greater security to post-administration funding and should engender willingness on the part of financial institutions and trade suppliers to extend credit to a company in administration. The IP would need to be satisfied that existing charge holders would not be disadvantaged. Notice would need to be given to existing charge holders to give them a chance to object if they considered that it would adversely affect their position. The burden of proof would be on the administrator to show that existing charge holders are adequately protected. If they disagreed with the administrator's view, it would be open to them to challenge the matter in Court (in the case of new additional subordinate charges) or help inform the Court's decision in the case of a first or equal charge.

69. The decision about whether to create new charges would be at the discretion of the administrator, subject to any Court challenge. The administrator will be a licensed IP, qualified and well regulated, and would be best placed to make such decisions. In coming to a decision the Court will take into account the degree to which any creditors would be adversely affected, and whether on balance the interests of all creditors would be best served by the decision of the administrator.

70. It is recognised that laws of security and the laws of insolvency are closely linked. Any changes introduced that impact, or are perceived to impact, on the ability of secured creditors to recover monies owed could potentially

lead to changes in lending practices, increases in the cost of lending and making funding for solvent companies more difficult to obtain. The safeguards we have proposed are intended to ensure that solvent companies would not be adversely affected in this way.

## QUESTIONS

**D1. Do you agree that there should be greater ability to secure post-insolvency financing by an ability to create new fixed charges?**

**D2. How useful do you think this would be? (If you can give figures, that would be helpful.)**

**D3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

### **Priority for rescue financing in a CVA: the current position**

71. Rescue finance in a CVA is currently classified as a fee, cost, charge or expense incurred for the purposes of the CVA<sup>3</sup>, and can rank ahead of other fees, costs, charges or expenses, unsecured creditors (but not above the interests of secured creditors without their prior consent). The CVA proposal can set out the specific priority to be attached to the rescue finance - again, subject to the requirement not to prejudice the rights of secured creditors without their consent. Where this proposed priority is insufficient to attract any or enough rescue finance, the directors have the option of offering the company's or their own property to a rescue finance provider as security.

72. Secured finance from a new lender to the company is therefore only likely to be available to support a rescue to the extent that existing secured creditors agree and/or the company has assets that are either free of any charges, or that are charged but have sufficient equity to secure new lending. Otherwise, any additional finance is either provided by the directors themselves, or by an existing lender - most likely with the benefit of existing or increased security and/or personal guarantees from the directors.

### **PROPOSAL E: Greater ability to create new secured charges in a CVA**

**We propose that a company which is considering a CVA should be able to secure new finance, conditional upon the CVA proposal being agreed by creditors. The new finance could be secured:**

- **against any property that is not already encumbered by fixed security; or**

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<sup>3</sup> Rule 1.28 The Insolvency Rules 1986 and Rule 1.22 The Insolvency (Scotland) Rules 1986

- **as an additional (subordinate) fixed charge on any property; or**
- **subject to the agreement of the existing fixed charge holder(s) or the Court, and only where there is no scope for new or subordinate fixed charges, as a first charge (ahead of other fixed charges) or an equal first charge on property already subject to a fixed charge,**

**provided that the following three conditions are met:**

- **the granting of such security for this rescue finance is necessary in order to obtain that finance;**
- **the interests of existing fixed charge holders are adequately protected; and**
- **obtaining the rescue finance is in the best interests of creditors as a whole.**

73. This proposal would improve the ability of a company to negotiate with existing secured lenders or new lenders to utilise any of its property that is already subject to a fixed charge as security, where the company did not possess unencumbered property. Where appropriate, a company would be able to apply for a Court order to allow it to use its property in this manner if the consent of existing secured lenders was not forthcoming.

74. A company proposing a CVA would thus be able to offer a rescue finance provider: security over unencumbered property; or a second charge on secured property, or a first charge on any of the company's property ranking either ahead of or equal to an existing first charge<sup>4</sup>. This would give greater security to CVA financing and should encourage financial institutions and trade suppliers to provide CVA financing to a company. In each case, the rescue finance provider would get priority over any existing floating charge holder and ahead of unsecured creditors. Legislative provision would be made to allow for the rights of negative pledge holders to be overridden in circumstances where this would allow security to be offered by the company for post-administration rescue financing.

75. It is recognised that the interests of existing fixed charge holders must be adequately protected. So, in circumstances where the rescue finance is to be secured by a priority or equal first charge, either the existing fixed charge holder(s) should consent to this or, if such consent is not provided, the Court should decide whether the three conditions have been met. The burden of proof would be on the company to show that they are met. The fixed charge holder would receive notice of this Court hearing and would have the opportunity to make representations to the Court to reach its

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<sup>4</sup> Section 4(3) of the Insolvency Act 1986 would need to be amended to accommodate these arrangements.

decision. If the rescue finance is to be secured as the sole fixed charge or a subordinate fixed charge, a statement that in the view of the nominee the conditions are met should be included in the CVA proposal put before the creditors. If the existing fixed charge holder(s) disagrees with the nominee's statement, it would again be open to them to challenge the matter in Court.

76. Notice would need to be given by the nominee of the CVA at the time the nominee submits his/her report to Court<sup>5</sup> (if there is to be no moratorium), or when the nominee submits his/her statement to the directors<sup>6</sup> (if a moratorium is to be obtained), to any existing lender whose interests are secured by a fixed charge over the company's property. That notice would specify the extent to which the company proposes to utilise its assets, under the range of options outlined above, as security for rescue finance.
77. If the existing charge holder(s) are no longer able to rely on the same level of security as they could previously, as a result of the degree to which it is proposed to implement the range of options, then the existing charge holder(s) would have the right to vote on the proposed CVA for the proportion of their interests that would, as a result, become unsecured. This could be one means by which the second condition (that the interests of existing fixed charge holders are adequately protected) is satisfied.
78. The basis for the valuation of the security in question would be set out in the CVA proposal and then determined by the person chairing the meeting that is convened for the purpose of deciding whether or not to approve the CVA. If the existing charge holder has grounds to disagree with the decision reached by the chairperson, that charge holder can apply to Court.
79. Specifying that the chairperson should be the first port of call for determining the valuation should ensure that, where possible, agreement is reached without recourse to the court. But allowing an appeal to the Court against that decision would provide a route of access to an independent arbiter where there are grounds for disagreement.
80. In summary, the company directors would, with the assistance of the nominee, prepare a proposal for a CVA. This would involve negotiations with any existing fixed charge holder. The existing fixed charge holder(s) would either be:
  - willing to provide the rescue finance;

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<sup>5</sup> The nominee is required to submit a report to the Court setting out his/her professional opinion as to whether the proposed arrangement has a reasonable prospect of being approved and implemented; whether meetings should be called; and the date, time and place of those meetings.

<sup>6</sup> Alternatively, the nominee must submit a statement that the proposed arrangement has a reasonable prospect of being approved and implemented; that the company has sufficient funds to carry on trading during the moratorium; that meetings should be called; and the date, time and place of those meetings.

- unaffected by a proposal to introduce another lender for the rescue finance where that lending is secured by a subordinate fixed charge; or
- asked to consent to the rescue finance being secured by a first charge (ahead of other fixed charges) or an equal first charge on property already subject to a fixed charge.

81. If this consent is not forthcoming, the company directors could apply to the Court to confirm that the three requisite conditions would be met if the rescue finance is secured by a priority or equal first charge. The existing fixed charge holder(s) would be able to challenge this statement and make submissions at time of the Court application. Where the Court confirms the appropriateness of the proposals, the existing fixed charge holder(s) would have no further recourse (i.e. their interest are overridden). The CVA proposal (inclusive of the new security proposals) would then be submitted to a meeting of unsecured creditors for approval.

82. It is recognised that, even where a company is able to secure rescue funding, there remains the risk that the rescue finance provider and other creditors might still lose out if the rescue is ultimately unsuccessful. It is, for example, conceivable that the security could be realised for less than the amount of the rescue finance advanced.

83. This risk might be mitigated by a company placing insurance against the possibility that there is insufficient equity in the company's property to provide security for the existing fixed charge holder.

## QUESTIONS

**E1. Do you agree that access to CVA financing should be facilitated by the ability to offer new security?**

**E2. How useful do you think this measure would be for companies contemplating a CVA? If you can give figures, that would be helpful.**

**E3. Do you think that it is appropriate for the Court to have a role in ensuring protection is provided for existing fixed charge holders?**

**E4. Is it viable to suggest that a company might be able to obtain insurance against the possibility that an existing charge holder is not repaid in full as a consequence of priority being given to a rescue finance provider?**

**E5. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

**PROPOSAL F: Cessation of certain asset based lending (ABL) arrangements on administration or CVA**

84. Those assets of a company that change over time, for example, book debts, may, in the normal course of trading, be subject to a floating charge or an ABL agreement such as a factoring agreement or an invoice discounting agreement. Those agreements are likely to extend beyond certain insolvency events (such as agreement to a CVA or the company entering into administration) to, for example, income deriving from new book debts arising post the insolvency event as a result of the company continuing to trade.
85. We wish to invite views on **whether the effect of a floating charge or an ABL agreement entered into before an insolvency event should be limited to assets acquired or book debts arising before that insolvency event takes place.** This would not interfere with any rights over book debts, or other relevant assets, existing at the date of the insolvency event. This would enable the administrator either to negotiate a new ABL agreement or floating charge to secure further rescue financing, or to negotiate an extension of the previous arrangement to cover assets acquired post-insolvency as a result of continued trading. No Court involvement would be required, but the floating charge holder, or the other party to the ABL agreement, would have the right to appeal to Court if they felt they were being unfairly treated.
86. We wish to be clear that this proposal would not extend to an agreement between a company and a lender under which the benefits of a long term contract to which the company is a party (for example for the supply of goods) are assigned to the lender in return for those benefits being advanced immediately to the company. In other words, this proposal would not apply where the company has had the immediate benefit of future periodic payments to aid its cash flow. We recognise that the continuation of such agreements post insolvency event would be necessary to ensure that the lender recovers the money that it has already advanced to the company and which it is therefore rightfully owed.

## QUESTIONS

- F1. Do you agree that the effect of an ABL agreement or floating charge entered into before an insolvency event should be limited to the assets acquired or book debts arising before the insolvency event takes place (with the express exception of long term contracts where future periodic payments have already been assigned in return for an advance made to the company)?**
- F2. How useful do you think this would be? If you can give figures, that would be helpful.**
- F3. Do you think there are any risks or disadvantages to this proposal? If so, what are they and how would you suggest that they could be addressed?**

## Application to Scotland

87. All these proposals are intended to apply throughout Great Britain. The proposals have the purpose of regulating insolvency proceedings and are accordingly reserved matters.

## **Conclusion**

88. We believe that in general the insolvency provisions are working well and that major changes are not needed. Our objective in putting forward these proposals is to refine the law, to make company and business rescue easier and more successful, by allowing a greater opportunity for companies to put together proposals to creditors and by facilitating access to the financing necessary to fund a rescue.

## QUESTION

**G1. We invite views on whether this package is the best way of achieving our aim of making company and business rescue easier and more successful, and welcome any other comments on these proposals.**

## **Annex A – Code of Practice on Consultation**

### **The Consultation Code of Practice Criteria**

1. Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. Consultation should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Consultation exercise should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

## ANNEX B: INITIAL IMPACT ASSESSMENT