

EVALUATION PLANNING PAPER – CORPORATE PROVISIONS OF THE ENTERPRISE ACT 2002

Purpose of the paper

1) To recommend an evaluation plan for the corporate provisions of the Enterprise Act 2002 ('EA') that encompasses the capture of benchmark information.

Background

2) The main aims of the corporate provisions of the EA are to promote company rescue and to increase returns to creditors. To achieve this the Act introduced a new streamlined system of administration, prohibited the appointment of administrative receivers, abolished Crown preference and introduced the prescribed part. The main changes introduced by the Act, including details of the prescribed part, are summarised at Appendix A.

New administration provisions

3) Administration was introduced by the Insolvency Act 1986 ('IA') to provide a company facing financial difficulties with a breathing space during which time a rescue package or a scheme for the more advantageous realisation of assets could be put in place. The procedure was changed by the EA with the aim of increasing its flexibility and making it quicker, cheaper and less bureaucratic.

4) Administration proceedings are intended primarily to facilitate the rescue and rehabilitation of insolvent but potentially viable companies. To promote the use of administration as a rescue vehicle, the EA streamlined the procedure by creating without court order entry routes and introducing simpler means of exit. In addition, the Act requires administrators to perform their functions as quickly and efficiently as possible, time limits within the procedure have been reduced generally and an overall time limit of 1 year has been introduced.

Prohibition of the right to appoint an administrative receiver

5) An administrative receiver has a duty of care only to the party making the appointment and not to the body of creditors as a whole, the right to appoint an administrative receiver was therefore prohibited, subject to certain exceptions, in all cases where the floating charge was created after the commencement of the provisions on 15 September 2003. Administration is a collective procedure which takes into account the interests of all parties and, as a result of the changes outlined above, it is hoped that administration will be the procedure of choice in cases where the charge-holder is still entitled to appoint an administrative receiver.

Abolition of Crown preference and the prescribed part

6) The EA abolished the Crown's preferential status as a creditor within insolvencies. One of the policy intentions behind the abolition was that the benefit would go to unsecured creditors. In cases where there is no floating charge the funds will flow directly to the unsecured creditors. For cases where there is a floating charge a new section 176A was inserted into the IA which requires that a prescribed part of the funds available to the holders of floating charges is set aside for the benefit of unsecured creditors. The requirement to set aside the prescribed part does not apply in cases where the floating charge was created prior to the commencement of the provisions on 15 September 2003.

Timing

7) The Insolvency Service made a commitment to undertake an evaluation of all the measures of the EA within 3 years of commencement of the provisions. The corporate provisions of the Act commenced on 15 September 2003 and the evaluation process is due to be completed by

14 September 2006 with the option of further reporting where more information is required or there are inconclusive results.

Aims and key features of the evaluation

8) The principal aim of the evaluation is to provide a comprehensive assessment as to whether, to what extent and how the corporate provisions of the EA meet the policy objectives. The evaluation will also provide information and data that can be used to inform future policy decisions.

9) The evaluation also seeks to capture benchmark information regarding the effect of the legislation that was in place before the implementation of the Act.

Main evaluation issues

10) The main issues to be considered in determining whether, to what extent and how the corporate provisions contained within the EA meet the policy objectives are outlined below and explained in more detail in the rest of this paper.

New administration procedures

11) The main objectives of the administration provisions are: -

- to promote the rescue of viable companies, and
- to achieve a better return to creditors.

Prohibition of the right to appoint an administrative receiver

12) The main objectives of the prohibition of the right to appoint an administrative receiver are: -

- to protect the interests of unsecured creditors, and
- to encourage the use of administration.

Given the clear policy overlaps between the introduction of new procedures for administration and the prohibition of administrative receivership these are considered together in the following paragraphs.

Abolition of Crown preference and introduction of the prescribed part

13) The main objectives of the abolition of Crown preference and the introduction of the prescribed part are: -

- to improve returns to unsecured creditors, and
- to set the prescribed part at an appropriate level.

Methodology and Sources of Information

14) The general approach to the evaluation and the proposed sources of information to be used are as follows: -

a) Prescribed part evaluation return ('PPER')

Insolvency practitioners have been asked to complete a return (a copy is included at appendix "B") for all cases from 1 April 2003 where there is a floating charge. The form was drawn up in conjunction with R3 who indicated their willingness to support this process.

b) Partnership with Nottingham University School of Law ('Frisby/Nottingham')

A research project by Dr Sandra Frisby, University of Nottingham School of Law, into the conduct of administrations and administrative receiverships with a view to evaluating whether changes introduced by the EA are likely to facilitate the achievement of the objectives of the Act. As part of this project, a database of company information will be created from information collected at Companies House and this will provide a valuable source of data for our evaluation. We expect a final report on this project in January 2006.

c) John Armour and Adrian Walters research – Impact of the EA ('Armour/Walters')

A consideration of how the corporate insolvency provisions of the Act are impacting on practice, in particular how the new administration provisions, compared with administrative receivership, are affecting IP's decisions and costs, and how the practices of banks, insolvency practitioners and legal advisers are changing. The final report is due in December 2006.

d) Alan Katz and Michael Mumford research – Analysis of Trends in Liquidation and Administration ('Katz/Mumford')

This study aims to measure and evaluate whether there has been a substitution of administration for liquidation since the implementation of the EA and to ascertain and measure whether a significant number of companies that now go into administration "ought to be" liquidation cases. The final report is due in December 2006.

e) Additional research

We will need to consider and collate the results of the prescribed part returns and the aforementioned research projects and carry out further "in-house" work where necessary to fill any lacuna or explore particular areas further. This may be achieved through a consideration of a small number of case studies, internal databases and statistics, DTI statistics, an analysis of data filed at Companies House and additional survey work (if required).

NEW ADMINISTRATION PROVISIONS AND PROHIBITION OF THE RIGHT TO APPOINT AN ADMINISTRATIVE RECEIVER

Objective 1: To promote company rescue through the increased use of administration

15) This policy objective aims to encourage companies that get into financial difficulty to seek assistance at an appropriate time and to promote the rescue of viable companies. If companies and/or their businesses can be rescued rather than being wound up, the outcome should be better for the company, its creditors and the economy as a whole.

16) The EA modified administration to make company rescue a priority and we will look at the number of company/business rescues and other outcomes to assess the use, and success or otherwise, of administration as a rescue procedure. In general terms, a company rescue occurs when the whole of a company is sold on, whereas a business rescue occurs when the main business activity of a company is sold on to another entity, in such cases the company itself may not survive but its main business activity does.

17) To promote the use of administration as a rescue mechanism, the EA sought to make the procedure faster, simpler and less expensive. Furthermore, streamlining the administration procedure was seen as a way to encourage its use by a more diverse type and size of company. We will therefore consider the total number of insolvencies in the 2 years before, and the period since, the EA, numbers by type of procedure (administrations, administrative receiverships, liquidations, CVAs) and the relationships/ratios between them. To establish whether “new” administration has resulted in savings and whether it is being used by a wider range of companies we will also carry out case study research into pre- and post-EA entry procedures looking at costs, speed and ease of entry as well as whether there has been any change in the nature of the companies using administration, e.g. the type/profile of companies going into administration and breakdowns by business sector/geographical location.

18) The burden and expense of a mandatory application to court for an administration order was considered to be a barrier to entry into the procedure and the EA therefore also allows for without court order appointments subject to certain conditions and procedural steps being met, for example in order to protect the interests of floating charge-holders. We will therefore look at levels of without court order appointments to establish to what extent these procedures are being used. The costs of administration are considered in more detail under objective 2 (returns to creditors).

19) The EA also set out to introduce more certainty into the administration procedure in order to make it more attractive to all interested parties. Whereas administration was previously open-ended, the EA introduced an overall time limit and specific, finite, endings. We will therefore look at how the new procedures and various exit routes are being used. In addition, under objective 2 (returns to creditors), we will also consider whether these new measures result in savings by considering the average length of administrations and whether the new timescales are being adhered to (and if not, the reasons why).

20) To reinforce the emphasis on administration, a prohibition, subject to certain exceptions, has been introduced on the right to appoint an administrative receiver. The prohibition prevents floating charge-holders from appointing an administrative receiver but only in cases where the charge was created following commencement of the provisions. Given the spirit of the EA and the modifications made to administration it is hoped that pre-commencement charge-holders will choose to use the new administration provisions rather than put

Enterprise Act Evaluation [Planning Paper]

companies into receivership and we will examine the levels of administrative receivership compared with administration.

21) Exceptions to the prohibition were created in order to allow the financial markets to function without being unduly hindered and to ensure the continued supply of public services. We will seek the views of those parties that use the exceptions to establish how effectively they have been able to work within them, e.g. when drafting charges.

22) Furthermore, to strike a balance between the interests of floating charge-holders and unsecured creditors, the holders of all qualifying floating charges must be given notice of the company's or directors' intention to appoint an administrator and they will still be able to step in and appoint their own choice of administrator. Similarly, when a floating charge-holder wishes to appoint an administrator, he is obliged to give notice to the holders of any prior floating charges, who must consent to the appointment or make alternative arrangements to appoint their own choice of administrator. This enables the holder of the most senior charge to determine who is appointed. However, once appointed, the administrator will have to act in the interests of the company's creditors as a whole. We will consider how often this "trump" card is played and consider the actions of floating charge-holders to see if they trump the applicant's choice of administrator and the reasons why.

23) In analysing patterns, trends, results and outcomes we will need to consider the impact of any external factors that may be producing changes from the benchmark position. For example, an increase in the use of administration could simply be part of a rising trend of corporate insolvencies caused by prevailing economic conditions.

24) Furthermore, we will need to consider the impact of case law, such as Leyland Daf, Spectrum and others (e.g. Huddersfield Fine Worsteds Ltd), on relative case numbers and how they might affect insolvency practice, for example the practices of lenders and decisions made by insolvency practitioners. We will continue to monitor future developments in case law ahead of publishing the final report.

25) We will also seek the general opinions of interested parties on the changes introduced in relation to administration, i.e. the views of financial institutions, creditors, representative bodies etc.

26) The suggested evaluation criteria are:

Measure	Definition	Benchmark information	Rationale	Methodology
a) The number of company rescues and business rescues	The number of company and business rescues as a percentage of all administrations	The level of company and business rescues in administration as a percentage of all administrations in the 2 years ended 15 September 2003	To assess the extent to which the new administration provisions are being used as a rescue procedure	Frisby/Nottingham
b) The total number and type of insolvencies	The total number of administrations relative to the total number of	The number of insolvencies and a breakdown by procedure in the 2	To assess whether the use of administration has increased and	Frisby/Nottingham Katz/Mumford

Enterprise Act Evaluation [Planning Paper]

	insolvencies and in comparison to other types of procedure	years ended 15 September 2003	whether its use has risen in relation to other types of procedure	
c) Profile of companies entering administration, e.g. geographic location, business sector	The profile of companies entering administration by: - business sector - geographical location	The profile of companies entering administration in the 2 years ended 15 September 2003	To measure if administration is being used by more diverse companies	Frisby/Nottingham
d) Pre- and post-EA entry methods to administration	Case study analysis and views on entry methods to administration	Speak to IPs and solicitors about how they find the new procedures compared to pre-EA	To assess the extent to which the new administration provisions make the procedure faster, simpler and less expensive to enter	Armour/Walters Additional research - e.g. case studies, survey and interviews
e) Number of without court order administration appointments	The total number of without court order administrations relative to the total number of administrations	N/A – without court order appointments were not available under the old administration procedure	To measure if the new procedures are being used	Frisby/Nottingham
f) Use of administrative receivership	The levels of administrative receiverships in comparison to administrations	Levels of administration and administrative receivership in the 2 years up to 15 September 2003	To assess whether the holders of floating charges prefer to use the new administration provisions even in cases where they are still entitled to appoint an administrative receiver	Additional research – DTI statistics
g) Use of the exceptions to the prohibition of appointment of administrative receiver	The exceptions to the prohibition were created to enable the continuation of public services and financial markets. We need to ensure that those parties for whom the exceptions were targeted have been able to work within them without difficulty	N/A - exceptions not in place prior to commencement	To examine whether the exceptions cover all the areas for which they were intended and that relevant stakeholders are able to work within them without problems	Additional research – interview/survey
h) Actions of floating charge-holders	Whether qualifying floating charge-holders are opting to use administrative receivership or instead trumping the applicant's choice of administrator with	N/A – charge-holder could not trump applicant's choice of administrator under previous provisions, the alternative was to	To assess whether floating charge-holders have opted to use their right under the EA to choose an administrator of their preference and	Frisby/Nottingham Armour/Walters Additional research - e.g. case studies, survey and interviews

Enterprise Act Evaluation [Planning Paper]

	their own preference	appoint an administrative receiver instead	trump the applicant's choice of administrator	
i) Are there any other external factors affecting the use of insolvency procedures	To what extent have factors beyond the EA affected the use of insolvency procedures, in particular administration and administrative receivership	N/A - relates to events after commencement of the provisions	Case law (for example) can have a dramatic affect on insolvency practice and this should be examined to ensure that the results of the evaluation are not unduly distorted	Frisby/Nottingham Katz/Mumford Armour/Walters Additional research – e.g. survey, interview, analysis of databases
j) General views associated with administration	<p>i) Is there a change in the nature of lending, do banks lend against security and do they favour administrative receivership over administration?</p> <p>ii) Will creditors and suppliers support the company, post administration?</p> <p>iii) How do competitors feel if they see a company write off significant liabilities from their balance sheet while they are trading and paying all their creditors?</p>	Speak to banks, creditors and supplier and also competitors about their views of administration	To assess whether the changes to administration introduced by the EA have resulted in a change in culture/mindset with regard to different stakeholders views of administration	Armour/Walters Additional research – e.g. survey and interview

Objective 2: To achieve a better return to creditors

27) We need to establish whether the new administration procedures are creating better returns to all classes of creditors, i.e. secured, preferential and unsecured, compared to “old administration” and administrative receivership.

28) As outlined above, the EA introduced a streamlined system of administration by providing without court order entry routes for floating charge-holders, companies and their directors and introducing simpler means of exiting from the procedure. The Act also imposes a new duty on the administrator to perform his or her functions as quickly and efficiently as reasonably possible, as well as introducing an overall time limit for the procedure and reducing time limits generally. The aim of the changes is to make administration faster and fairer to all with the whole procedure a lot less expensive, thereby enabling greater returns to creditors.

29) Returns to creditors in an administration will depend on many factors including the level of assets, liabilities and costs/complexity of the procedure. We will need to bear this in mind when analysing whether “new administration” is providing a better return to creditors and will need to use appropriate measures, considering returns in the pound alone may produce misleading results and so we will also look at returns in relation to a company's worth, i.e. its net assets.

Enterprise Act Evaluation [Planning Paper]

30) The EA sought to simplify the administration procedure, for example by dispensing with the requirement for a 2.2 report and creating without court order entry routes. We would expect this to be reflected in cost-savings in relation to applications and we will need to consider whether this is the case.

31) We will also look generally at the proposals of administrators and the reasons why administration was considered the most beneficial option. In addition, if rescue was not considered viable, why was this the case and what was the impact on creditors. We will also consider proposals to explore sources of funding, e.g. are costs being met by 3rd parties or from working capital etc. To achieve this we will carry out a case study type analysis of administrators' proposals and outcomes.

32) In considering costs, we will need to consider all costs, i.e. court fees, IP costs, solicitors' costs, etc. We will also look at IP products, such as pre-packaged administrations to see how these vary with other administrations (including pre-EA) and why. The cost of administration was previously considered to be a barrier to entry and we will evaluate whether this is still the case or if costs have decreased with resultant increases in funds available to creditors.

33) As outlined above, we will also look at the number of administrations dealt with within the statutory timescales compared to previous administrations and the length of the procedure, both pre- and post-EA, as in principle this has an impact on the cost of the procedure and hence returns to creditors.

34) Finally, we will also examine exit routes and the extent to which administration is being used as a one-stop procedure. To do this we will consider the numbers/percentages of companies exiting via a CVA, voluntary liquidation or dissolution and the percentage of cases in which distributions to creditors are made.

35) The suggested evaluation criteria are:

Measure	Definition	Benchmark information	Rationale	Methodology
a) Returns to all classes of creditors	Returns to secured, preferential and unsecured creditors	A breakdown of returns to these categories of in the 2 years ending 15 September 2003	To assess whether the changes introduced in the EA result in increased returns to creditors	Frisby/Nottingham
b) The costs of administration	Examination of proposals and average cost. (breakdown of costs)	Average cost of the procedure for administration applications in the 2 years ending 15 September 2003	To assess whether the EA provisions have led to an overall decrease in the average cost of an administration application, with resultant increases in returns to creditors	Frisby/Nottingham Armour/Walters Additional research

Enterprise Act Evaluation [Planning Paper]

c) The average length of an administration	Average length of an administration and whether statutory timescales have been adhered to	Average length of an administration in the 2 years ending 15 September 2003	To assess whether the EA provisions have led to a reduction in the length of administrations	Frisby/Nottingham Additional research
d) Choice of exit routes and distributions to creditors	The number and percentage of companies using the various exit routes and the average distribution made when administration is used as a one-stop procedure	N/A – no distributions made under the old administration procedure	To assess whether the EA provisions have resulted in the use of administration as a distribution mechanism	Frisby/Nottingham

ABOLITION OF CROWN PREFERENCE AND THE INTRODUCTION OF THE PRESCRIBED PART

Objective 1: To show funds given up by the Crown preferentially are flowing to unsecured creditors in cases where there is no floating charge

36) When the Crown gave up its preferential status within insolvencies it was intended that the financial benefit should go to unsecured creditors. In cases where there is no floating charge the funds should flow directly to unsecured creditors without any associated increase in costs.

37) In order to establish whether this is the case, a number of insolvencies will be examined on a case study basis to see whether the funds given up by the Crown are indeed going to unsecured creditors. Each case will be analysed to show what each class of creditor would have received with and without the abolition of Crown preference.

38) The suggested evaluation criterion is:

Measure	Definition	Benchmark Information	Rationale	Methodology
Funds flowing to unsecured creditors	Increase in money available to unsecured creditors as a result of the abolition of Crown preference	The amount the Crown would have received preferentially in these cases but for the abolition.	To demonstrate whether monies given up by the Crown are flowing directly to unsecured creditors	Case study

Objective 2: To ensure that the prescribed part has been set at an appropriate level

39) In cases of insolvency where there is a floating charge, to enable the benefit of the abolition of Crown preference to flow to unsecured creditors we will need to establish whether the prescribed part has been set at the right level. We will therefore consider whether the prescribed part delivers an amount for unsecured creditors that is broadly equivalent to that which the Crown departments have given up through the abolition of preferential status and also whether the introduction of the prescribed part has a neutral impact on the holders of floating charges.

40) This will be achieved by calculating whether the level at which the prescribed part has been set by the Insolvency Act 1986 (Prescribed Part) Order 2003 is delivering an appropriate amount to unsecured creditors.

41) The major difficulty in assessing this at present is that the prescribed part only applies in cases where the floating charge was created on or after 15 September 2003, it will therefore not yet apply in a large number of insolvencies.

42) The Service, in conjunction with representatives of R3 (the trade association of insolvency practitioners), has drafted a return to be submitted in all cases where there is a floating charge. The returns require insolvency practitioners to provide details as to the funds available to the holders of floating charges and to provide an estimate of what they consider would have been preferential Crown debt but for the abolition. From the requested information we can calculate what the prescribed part would be (if it applied) and compare this with the amount given up by the Crown in each case.

43) The suggested evaluation criterion is:

Measure	Definition	Benchmark Information	Rationale	Methodology
Amounts delivered by the prescribed part	Measured by analysing the level of funds made available to unsecured creditors through the operation of the prescribed part against what the Crown would have received had their preferential status not been abolished	The amount of money paid to the Crown in respect of their preferential claims	To verify that across the board an equivalent amount is being made available to unsecured creditors as was previously paid to the Crown in respect of their preferential claims	PPER

Enterprise Act Evaluation [Planning Paper]

Timing

44) The estimated timetable for completion of the evaluation is as follows:

September 2005	Project Plan and 2 nd Interim Evaluation Report
September 2005 – September 2006	Liaison with authors of research projects, gathering and analysing data
April-September 2006	Draft evaluation report
September 2006	Final evaluation report

As outlined above, if there are any areas that require further exploration or analysis then an additional report(s) may be issued after September 2006.

**Corporate Policy Development Team
September 2005**

APPENDIX A: A summary of the legislative changes

Administration – Schedule B1 was inserted into the IA with effect from 15 September 2003. It is beyond the scope of this paper to detail those provisions in full but the main provisions of that schedule are outlined below:-

- Rather than the 4 distinct purposes for administration set out in the IA, the EA introduced one overarching purpose for all administrations, which is broken down into 3 objectives. The primary purpose of administration is to rescue the company as a going concern although other objectives may be pursued (i.e. achieving a better result for creditors than under an immediate winding up or realising property to make a distribution to one or more secured or preferential creditors) if they would be in the best interests, or at least not unnecessarily harm the interests, of creditors.
- In addition to court appointed administrators, the Act allows for without court order entry appointments by the holders of floating charges, companies and their directors.
- The Act permits an administrator to make a distribution to creditors, although a distribution to unsecured creditors is only allowed with the permission of the court.
- Administration terminates automatically after 1 year unless it is extended by the consent of creditors and/or order of the court.
- Specific endings were introduced to allow a company to move directly from administration to creditors' voluntary liquidation or to dissolution.

Prohibition of appointment of administrative receiver - Section 72A of the IA provides that the holder of a qualifying floating charge in respect of a company's property may not appoint an administrative receiver. This only applies to floating charges created on or after 15 September 2003 and various exceptions to this provision are set out in sections 72B-72H of the Act.

Abolition of Crown preference - Section 251 of the EA removed debts due to the Inland Revenue, Customs and Excise and Social Security Contributions from the categories of preferential debts in schedule 6 to the Insolvency Act 1986. The transitional provisions are set out in article 4 of the Enterprise Act 2002 (Commencement No 4 and Transitional Provisions and Savings) Order 2003 (SI 2003/2093).

Prescribed part - Section 176A of the IA provides that a liquidator, administrator or receiver must make a prescribed part of the company's net property available for the satisfaction of unsecured debts. This only applies in relation to floating charges created on or after 15 September 2003. In addition, an office-holder is not obliged to set aside the prescribed part where the company's net property is less than £10,000 ("the prescribed minimum" SI 2003/97 – see below) and the costs of making a distribution to unsecured creditors would be disproportionate to the benefits; in cases where the net property exceeds £10,000, an office-holder may seek relief from the court on those same grounds.

The calculation of the prescribed part is set out in article 3 of the Insolvency Act 1986 (Prescribed Part) Order 2003 (SI 2003/2097):-

- (1) The prescribed part of the company's net property to be made available for the satisfaction of unsecured debts of the company pursuant to section 176A of the 1986 Act shall be calculated as follows –

Enterprise Act Evaluation [Planning Paper]

(a) where the company's net property does not exceed £10,000 in value, 50% of that property;

(b) subject to paragraph (2), where the company's net property exceeds £10,000 in value the sum of—

(i) 50% of the first £10,000 in value; and

(ii) 20% of that part of the company's net property which exceeds £10,000 in value.

(2) The value of the prescribed part of the company's net property to be made available for the satisfaction of unsecured debts of the company pursuant to section 176A shall not exceed £600,000.

Appendix B - Evaluation of the Enterprise Act – Prescribed Part

EVALUATION FORM

Name of company	
Type of proceedings	
Date proceedings commenced	
Date of creation of floating charge	
Assets available to preferential creditors (1)	£ (£)
Payments to preferential creditors (2)	£ (£)
Total claim of Inland Revenue and HM Customs and Excise (3)	£ (£)

(1) In brackets please add the level of books debts that would be covered by the floating charge should the decision in Brumark apply.

(2) In brackets please indicate the level of the payment to Inland Revenue or HM Customs and Excise if this case predates commencement of the Enterprise Act

(3) If the proceedings commenced after the date that the Crown's preferential status as a creditor was abolished, please indicate in the brackets the level of the Crown claim that you estimate would have been preferential but for the abolition