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Dear Ms Strub,

Re: EHYA Submission on Insolvency Law Reform

Thank you for your letter of the 22nd February 2008, addressed to Eleanor Mack, of the Enterprise Team at HM Treasury, concerning your proposals for the reform of English insolvency law. This has been forwarded to me for reply as The Insolvency Service has policy responsibility for insolvency law.

The Insolvency Service is committed to maintaining a world-class insolvency and enforcement regime that creates the conditions for business success and helps the UK respond to the challenge of globalisation. To this end, we will continue to engage with all stakeholders, including the EHYA, to consider the corporate insolvency regime against the backdrop of new challenges as they arise.

We recognise that in the commercial world as it is now, there are many different stakeholders who have, often diverse, interests in a distressed company. When considering whether the insolvency regime remains fit for purpose we must adopt a balanced approach, taking into account the views of all stakeholders, and not just the views of a single group.

As part of our ongoing engagement with stakeholders, The Insolvency Service recently hosted a seminar on the future of corporate insolvency. From the views expressed at the seminar, it is clear that there is no consensus amongst stakeholders as to how any future regime should look, or indeed whether wholesale change is necessary at all.

It would be for BERR Ministers to propose any changes to insolvency law, and in doing so would work with colleagues across Government, this would, of course include HM Treasury.



Notwithstanding the comments above, I have some specific comments relating to the detail contained in the EHYA proposals.

You have stated that your proposals could be implemented by making relatively 'minor amendments' to existing law. We do not believe this to be the case, as any change would require a substantive change to primary legislation, which is currently not possible. This would essentially be a new procedure, with potentially a major impact on the rights of a variety of stakeholders, which would need extensive consultation. We are yet to receive detailed evidence that something new is required, and if such evidence were to be provided, we would need to evaluate it and assess its likely impact.

1. Outline of New Procedure

You have briefly outlined your proposed procedure, but it is still couched in broadly theoretical terms. Would you be able to provide evidence/examples of how it would work in practice, perhaps with detailed scenarios?

In the first paragraph of the outline procedure, you have mentioned 'distressed companies that are worth rescuing'. On whose judgement would this be based, would it be on creditors/shareholders/directors, etc?

You have also stated that the 'existing management would stay in place'. Would this be all the existing management? What would be the situation if there had been any mismanagement/fraud committed by the existing management? If the company were insolvent, who would pay the management fees?

You have mentioned that it would be possible to 'cancel or vary the rights of existing shareholders'. This could result in challenges from shareholders, with possible human rights consequences. This could result in delays in any restructuring, with a limbo situation during any legal wrangles. How would you address these situations?

Have you considered the rights of employees?

You have stated that it would be possible for the court to 'override any negative pledge'. Again this could result in a challenge by existing charge holders, with possible human rights consequences. In addition, where you have any legislation that affects a contractual relationship, this will be factored in when contracts are devised/drawn up. If the EHYA proposals are adopted, the associated risks will be factored into contracts, and could therefore skew commercial relationships in general, not just in an insolvency scenario. There could be a move to more fixed charges and/or higher interest rates with possible shorter call periods. This could all affect UK investment generally with the threat that investors could look elsewhere to do business.

It is also mentioned that the company could 'borrow funds and grant security'. However if the company is struggling or insolvent, over what assets could the security be granted? A number of the concerns mentioned in the previous paragraph are also applicable in this situation.

You mentioned that a number of these proposals could also apply to schemes of arrangement or CVAs proposed by an administrator or liquidator. However you have not explained how this would work in practice and/or which parts of the proposals would be applicable.

Have you also considered set off both in terms of an insolvency and non-insolvency situation?

Finally, the proposals make no mention of how frequently this procedure will be available to companies? Could there be an abuse of process if there is no limit or timescale on how many times a company could make use of this proposed procedure?

2. Stay of Enforcement

In your proposals, you have stated that the automatic stay would be 'commenced by a company'. Who would this be? Would it be the directors or shareholders? Would shareholders vote for a procedure where their rights could be over-ridden?

The proposal is based on an existing insolvency trigger (unable to pay debts) – How is this different to administration?

Having an automatic stay in a non-insolvency situation is not something we would welcome. It would more than likely give an unfair advantage to a company in temporary but not terminal difficulty (and perhaps not insolvent) when compared to a rival competitor trading normally with debts to pay and liable to charges that can be enforced.

It is stated that the company would 'pay its non-financial creditors' as they fall due – How would the company do this if it is insolvent and who would decide who a 'non-financial' creditor is. Are you proposing a specific test?

The proposed stay would last for a 'maximum of three months initially'. Is this long enough? The idea of three months for administration was rejected in the Enterprise Act 2002.

The effect on financial creditors will also have to be considered. Similar concerns to those raised in over-riding charge holder and security rights would also be applicable here. Any increased risks will be factored into contracts, with possible consequence for commercial relationships in general and UK investment.

At the recent Insolvency Service seminar, the issue of contract termination was widely discussed, with strong opinions expressed as to whether one should obligate suppliers and/or customers to continue their relationship with a company in an insolvency scenario. The majority opinion was that third parties should be left to make decisions upon whether to continue in their relationship with a company based upon the commercial reality of the situation, even if this includes an insolvency scenario. However, there were opinions expressed that in certain situations, there should be stays of enforcement action on contractual termination provisions. Clearly, there are differing opinions within the insolvency profession on this and other issues raised by the EHYA.

3. Funding

The earlier comments about negative pledges are applicable here, with possible consequences for UK investment.

Again, would 'company' be the directors or shareholders?

With it being a court-based system, how will all the court hearings be funded? After all the fees are paid and challenges dealt with, will there be any significant value left in a company that was insolvent in the first place?

There is already provision within the legislation that would effectively afford a super priority status to post administration lending, where it is an expense of the administration. Is there any reason why you think this provision is not adequate?

4. Use of the Stay in CVAs

Within a CVA, a nominee (Insolvency Practitioner) will work up proposals with the directors. What do you envisage the role of the nominee to be in this new procedure? What has happened to the 'monitor'?

No mention is made of how this new procedure would interact with the current Schedule A1, which already allows a moratorium for 'small' companies. You could have a situation where there are small companies within a group.

5. The Monitor

Your proposals have recommended a role for a monitor, reporting to the court on any events that might adversely affect the likelihood of a successful restructuring. However the monitor would not have the power to control the board of directors or to manage the company's affairs in any way, with a duty only to the court and not to the creditors or the company.

However, would this be akin to having responsibility but no power? You would have the formality of a court order, and have a position where you had to account to the court, but not having any power to really influence proceedings.

The relationship between the monitor and existing management will need careful consideration. What would happen if there were fundamental disagreements between the two parties? The monitor should not be simply a figurehead.

What safeguards are there against any abuse and how will we deal with it? Will there be any scrutiny of the directors? What about any fraud/mismanagement conducted by the directors? How do you envisage this procedure interacting with the CDDA and the other criminal and civil provisions contained within the IA1986, such as wrongful trading? What about the rights of creditors under provisions such as s423IA1986 and other 'claw back' provisions?

In addition, who would be eligible to be a monitor? What are the criteria? Would it be restricted to Insolvency Practitioners/turnaround professionals or others? Who would accredit them and how would the regulation of monitors work?

If a company were insolvent, how would a monitor get paid? What ranking would the monitor have in any priority of payments?

6. Use of the Stay in Administration

Are your proposals significantly different to what is already currently available under administration?

Would there be any scrutiny of the directors or their actions? There would be a need to be protection against any abuse.

We appreciate the work that the EHYA has done to come up with its proposals and welcome the contribution it makes to any discussion on the future of English insolvency law. However, we do not believe that what you have proposed is a simple scheme, and which raises the many questions that I have detailed above.

We do not believe that there is sufficient evidence to show that the UK needs this procedure or that it is desirable. It overrides many basic principles of UK insolvency law and practice, and any new proposal would require a strong evidence base, evaluation and parliamentary time, which is currently not possible.

However, we are considering hosting another seminar in the Autumn to discuss some of these issues further and we will let you have further details once these have been finalised.

I am happy for you to circulate this letter to your members.

Yours faithfully



Nick Howard
Director of Policy