Department for
Business, Energy
& Industrial Strategy

Insolvency and Corporate Governance

20 March 2018

Insolvency and Corporate Governance

The consultation can be found on the BEIS section of GOV.UK:
https://www.gov.uk/government/consultations/insolvency-and-corporate-governance

Any enquiries regarding this publication should be sent to us at
insolvencyandcorporategovernance@beis.gov.uk

Contents

General information

Purpose of this Consultation

This consultation is about delivering a strong business environment - a key foundation of the Industrial Strategy - by seeking views on new proposals to improve the governance of companies when they are in or approaching insolvency. The views of the following people and organisations would be particularly useful:

- Directors of companies
- Institutional shareholders and the investment community
- Insolvency professionals – legal and practitioner
- Business representative bodies
- Professional bodies
- Company secretaries
- Credit managers
- Wider civil society groups
- Academics and think tanks
- Landlords
- Employees
- Members of the public

Issued: 20 March 2018

Respond by: 11 June 2018

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Business Frameworks Directorate

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Territorial Extent:

The territorial extent of this consultation is England, Wales and Scotland, with the exception of:

- parts of both the sale of distressed businesses and the value extraction schemes sections relating to companies in liquidation which would be devolved in Scotland; and
- the group structures, professional advisers, dividends and shareholder stewardship sections which also apply to Northern Ireland.

The UK Government is responsible for the operation and regulation of business entities in England and Wales, and in Scotland. Previously, the Northern Ireland administration has agreed that, while the operation and regulation of business entities remains a transferred matter within the legislative competence of the Northern Ireland Assembly, amendments to the Companies Act 2006 and legislation regulating business entities should be made in the same terms for the whole of the United Kingdom.

How to Respond

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. Your responses can be made in three ways:

1) Direct responses to the questions posed can be made on this portal: beisgovuk.citizenspace.com/business-frameworks/insolvency-and-corporate-governance
2) Electronic responses should be sent to insolvencyandcorporategovernance@beis.gov.uk
3) Hard copy responses should be sent to:

   Business Frameworks Directorate

   Department for Business, Energy and Industrial Strategy

   1st Floor, 1 Victoria Street,

   London, SW1P 0ET

Additional Copies:

You may make copies of this document without seeking permission. An electronic version can be found at https://www.gov.uk/government/consultations/insolvency-and-corporate-governance

Confidentiality and Data Protection

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. 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 full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on the GOV.UK website. This summary will include a list of names of organisations that responded but not people's personal names, addresses or other contact details.

Quality Assurance

This consultation has been carried out in accordance with the Government's Consultation Principles.

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

Email: beis.bru@beis.gov.uk

Executive Summary

The UK has a leading international reputation for being a dependable place in which to do business One of the reasons why we have maintained such a reputation is that we have kept our corporate governance framework up to date with reviews and improvements from time to time.

We are already working to implement reforms to improve the corporate governance regime in relation to executive pay, strengthening the employee and wider stakeholder voice in the boardroom, and corporate governance in large privately held businesses. Our insolvency regime is another important part of the UK's business environment and is well regarded internationally. The Government recognises however, that the regime must be continually improved to ensure it delivers the best possible outcomes now and in the future.

The Government wants to take this work further to reduce the risk of major company failures occurring through shortcomings of governance or stewardship, and to strengthen the responsibilities of directors of firms when they are in or approaching insolvency. The purpose of this consultation is to seek views on proposals to achieve that aim as well as ensuring we maintain a fair balance of interests for all stakeholders. It also explores options to improve the Government's investigatory powers when things go wrong, and it invites views on a number of areas where our existing processes and rules may need updating.

In pursuing these improvements, we intend to ensure that the business environment in Britain remains open, fair and attractive and that the actions of a few businesses do not undermine the reputation of British business generally. Specifically, we want to ensure that it facilitates creditors' continued operations beyond periods of financial difficulty or insolvency experienced by debtors. By creating optimal conditions for dealing with the processes and impacts of insolvency, we can help to ensure that creditor stakeholders can continue their operations, pursue new contracts, or make new investments and, in doing so, continue to contribute to the UK economy by creating jobs and paying taxes.

In particular, this consultation considers:

Sales of businesses in distress: This section proposes potential changes to ensure that directors responsible for the sale of an insolvent subsidiary of a corporate group take proper account of the interests of the subsidiary's stakeholders. This proposal seeks to deter reckless sales, which could potentially harm stakeholder interests, in those limited circumstances. Where a large company or business cannot support itself then the directors involved in any sale, including directors of a holding company controlling the sale of shares in a subsidiary, should satisfy themselves that the sale would lead to a better outcome for creditors than putting the company into formal insolvency.

The proposals seek to ensure fair outcomes when major companies get into difficulties, whilst avoiding putting barriers in the way of credible business rescue efforts.

Reversal of value extraction schemes: This section proposes where a company in financial difficulties has been 'rescued' by investors who then strip it of its assets to lessen their loss, or protect their profits, should the company eventually become insolvent. These arrangements are often complicated and designed to avoid existing protections for creditors.

Government wants all creditors to be treated fairly in an insolvency situation and is seeking views on potential changes to how certain transactions, or a series of transactions entered into before insolvency can be challenged.

Investigation into the actions of directors of dissolved companies: This section explores proposals to extend existing investigative powers into the conduct of directors to cover directors of dissolved companies. Difficulties are caused when companies are dissolved with outstanding debts or allegations of director misconduct, because the Insolvency Service does not currently have the necessary powers to investigate.

Strengthening corporate governance in pre-insolvency situations: This section explores a number of wider corporate governance issues that can be particularly relevant when companies get into financial difficulties and seeks views on whether further action by Government is needed.

- **Group structures:** This section considers whether steps should be taken to improve governance, accountability and internal controls within complex company group structures;
- **Shareholder responsibilities:** This section seeks views on whether there may be further opportunities, such as through the Financial Reporting Council's review of the Stewardship Code, to strengthen the role of shareholders in stewarding the companies in which they have investments;
- **Payment of dividends:** This section seeks views on whether the legal and technical framework within which dividend decisions are made could be improved and made more transparent whilst ensuring that dividend payments should remain for directors to decide, having regard to their legal obligations and guidance;
- **Directors' duties and the role of professional advisers:** This section asks if directors are commissioning and using professional advice with a proper awareness of their duties as directors and the requirement to apply an independent mind;
- **Protection for company supply chains in the event of insolvency:** This section explores whether supply chain and other creditors should be better protected and, if so, how this could be achieved while preserving the primacy of the interests of shareholders.

Sales of Businesses in Distress

This section explores potential changes to encourage the directors responsible for a sale of an insolvent subsidiary of a corporate group to take account of the interests of the subsidiary's stakeholders.

Summary of the Issues:

- *Directors of an insolvent company must act in the best interests of its creditors.*
- *But the directors of a holding/parent company cannot be held liable for the sale of an insolvent subsidiary, even if is damaging to the subsidiaries' creditors and stakeholders.*
- *We propose to change this by enabling directors of a parent company to be held to account - and penalised - where the sale of an insolvent subsidiary causes harm to creditors and this was foreseeable at the time of the sale*

Sales of Insolvent Subsidiaries

Many large businesses in the UK are made up of groups of companies under common control, usually through a parent company. One of the advantages this offers is that it makes it possible to ring-fence higher risk business ventures from those that are more stable and profitable by placing them into separate companies. Providing a group company continues to receive sufficient financial support from its parent or other companies in its group, it can continue to trade even if it is making losses and would otherwise have to cease. This enables new start-ups within a group, or loss-making subsidiaries, to receive the time they need to grow or to be turned around. If these attempts are unsuccessful, the rest of the group remains protected from any losses made from a failed company in a group.

The controlling directors and managers of a corporate group may conclude that a loss-making subsidiary should be disposed of. Even where a company is in financial difficulty, there may be some value to a third party in its business as a going concern, although it

may need new investment or restructuring to return to profitability. One option for such a company is for it to be sold to new owners (by selling the company's shares). This may provide a cash return to the group, removes the need for it to continue funding the distressed company and transfers responsibility for the future operation of the company to its new owners.

In many of cases, a sale may be in the best interests of all parties, including stakeholders such as creditors, employees and the subsidiary's pension fund. A responsible owner, recognising that there is value in a distressed subsidiary but where they are unable or unwilling to continue to fund its trading can sell it to a new investor. This may return it to profitability and, prevent its collapse - saving jobs , paying its suppliers and maintaining payments into any pension fund.

***Example** – Alpha Limited is loss-making and has only been able to continue to trade through the support of its parent company Beta Limited. Beta's support has enabled it to meet its obligations towards its pension scheme, which is in deficit. The directors of Beta are keen to dispose of the loss making subsidiary: on finding a buyer, Gamma Limited, they do not investigate Gamma's background but proceed with a sale as quickly as possible.*

Gamma has limited financial means and no viable plan for Alpha. As a result Gamma has no reasonable prospect of being able to address Alpha's pension deficit or maintaining the level of financial support that Beta had previously provided.

Following the sale Gamma extracts cash from Alpha through the levy of management charges and introduces no new capital into the business. Within 12 months Alpha is placed into administration and its pension scheme turns to the Pension Protection Fund.

However, there is currently no requirement in law for a seller to consider the future viability of a business after its sale. There is no formal requirement, for example, to review a purchaser's credentials and proposals, and no duty of care on the part of a seller towards the company's employees or future creditors. If a company that was sold subsequently fails, even if the sale contributed to that failure, or if the purchaser is found to have had no viable way to return the business to profitability, the seller cannot be held accountable for the consequences of the decision to sell the business. Existing company and insolvency law can address the conduct of the failed company's directors and can attack certain transactions which have unfairly harmed creditors, but it does not readily allow for the conduct or actions of directors of another company (for example a parent company) to be addressed.

The success or failure of a company can impact not only on its owners but on its employees, suppliers and customers, as well as the wider business community and economy. In line with the aims of our Industrial Strategy to generate growth and earning power for businesses and individuals, we want to ensure that creditors, their business operations and investments are not unfairly affected. By minimising this risk, we can help to ensure creditors' continued contribution to the UK economy, creating new sources of

investment for businesses, contributing to their expansion of employment, capital and productivity gains.

A large[1] subsidiary company within a group may have thousands of employees and smaller businesses may depend upon it for survival. The Government considers that when such a company is in financial difficulty, any decision to sell it outside of formal insolvency proceedings should take into account the interests of its stakeholders. For example, this would include the impact of the withdrawal of the group's financial support from the company being sold and the ability of the purchasing party to provide such support in the future.

The Proposal – Director Accountability

The management of UK companies is largely undertaken by its directors, appointed by their shareholders (the "owners") to run them on a day to day basis.

Directors of UK companies must comply with the legal duties placed upon them; including key duties set out in the Companies Act 2006, and ensure that their companies comply with the law. If an individual director falls short of the standards required they can be disqualified for up to fifteen years, and the law makes a variety of provisions for them to be made personally liable for losses they have caused. By contrast, no similar duties are imposed upon shareholders provided they do not take part in the day to day management of their company (and by doing so act as a director). This reflects the relative responsibilities of the director and shareholder roles, and what can reasonably be expected of a director who manages a business compared with a shareholder who simply holds a stake in its success.

In many cases, a company's shares will be owned by another company (a 'holding company') and the decision to sell will be made by the holding company's directors. The Government considers that holding company directors should be held to account if they conduct a sale which harms the interests of the subsidiary's stakeholders, such as its employees or creditors, where that harm could have been reasonably foreseen at the time of the sale.

In line with the existing law, appropriate penalties for a director who causes loss or harm might include disqualification and personal liability.

[1] Section 465 of the Companies Act 2006 provides a threshold definition for medium sized companies, above which it could be considered that a firm is large.

Limits on Accountability for the Consequences of Selling an Insolvent Company

Any new restrictions or penalties, if introduced, should be proportionate. This could be achieved by limiting director liability or disqualification to those cases where the holding company director acted unreasonably and the harm caused to stakeholders from the sale could have been reasonably foreseen.

If introduced, the new requirement and, potentially, accompanying penalties will fall on the directors[2] of holding companies that have a controlling interest in another large private or unlisted public company, a "group subsidiary". The directors may be held liable for losses following a sale of the group subsidiary, as we describe below, subject to the following criteria:

- At the time of the sale, the group subsidiary must either be insolvent, or insolvent but for guarantees provided by other companies or directors in its group;
- The subsidiary enters into administration or liquidation within two years of the completion of the sale;
- The interests of its creditors must have been adversely affected between the date of the sale and the liquidation or administration; and
- At the time that they made the decision to sell the company, the director could not have reasonably believed that the sale would lead to a better outcome for those creditors than placing it into administration or liquidation.

The Government considers that, if all of the above requirements are met, an administrator or liquidator of the former group subsidiary should be able to apply to court for an order that the director contribute a sum that the court thinks fit towards the subsidiary's creditors. The director should also be liable to be disqualified where appropriate.

The proposed requirements ensure that directors would only suffer penalties in exceptional situations where the group subsidiary was in financial difficulty; the directors could not reasonably have believed that the sale was in the interests of creditors; the group subsidiary has subsequently entered administration or liquidation; and the harm that should have been foreseen has occurred, with creditors suffering losses. Where a director reasonably believes that the sale is in the best interests of creditors; where creditors have not been adversely affected following the sale; or where the business does not fail within two years, no penalties will apply.

[2] Including, for these purposes, any shadow director, any person controlling a director and any person connected with a director.

In reviewing the director's reasonable belief, a balance should be struck between expecting them to have taken into account all available information about the future in assessing the purchaser's credentials and plans, and obtain assurances or guarantees where that is appropriate; and allowing them to accept statements that the purchaser might make. Beyond a certain point, which we suggest is two years from the date of the sale, it will not be appropriate to expect the selling company's directors to be able to predict the longer term impact on the subsidiary's creditors.

The proposal does not require there to be any causal link between the sale and the failure. The Government considers that it is enough that the director could not reasonably have believed that the sale was in the interests of creditors, and this has been borne out by a worsening position followed by formal insolvency.

The Government is keen to hear views on whether new penalties should be introduced for directors who sell an insolvent subsidiary without any reasonable expectation that the sale is in the interests of the subsidiary's stakeholders and the company then fails.

Consultation Question

1.	Do you think there is a need to introduce new measures to deal with the situation outlined?

Consultation Question

2.	Should the new measures be limited to the sale of a subsidiary or should a new measure extend to any act procured by the parent (through its directors), which operates to the prejudice of the creditors of the subsidiary once that subsidiary is insolvent? Might such measures create material conflicts for directors? If so, how might they be resolved?

Consultation Question

3.	Should the target be the parent company directors responsible for the sale? If not, who else should be targeted; or who in addition?

Consultation Question

4.	How can we ensure that there is no impact on sales which genuinely seek to rescue distressed businesses, or bring new investment into distressed businesses?

Value Extraction Schemes

This section considers whether new powers should be introduced in addition to those that currently exist to undo a transaction, or a series of transactions, which unfairly strips value from a company, in order that insolvency law keeps pace with modern business practices.

For over 400 years, English law has recognised that certain transactions entered into by a debtor in the run up to insolvency are unfair to creditors and should be reversible. This concept has developed over time, with the most recent provisions being introduced over thirty years ago, in the Insolvency Act 1986. It is crucially important that these provisions remain fit for purpose as business practice evolves.

The tools that allow insolvency office-holders to reverse transactions that are unfair to creditors are known collectively as antecedent recovery powers. Some of these powers apply differently depending whether or not the transaction is entered into with people who are connected with the debtor company (for example, a company's director). This is an important distinction as antecedent recovery powers have a lookback period – a period prior to formal insolvency in which a transaction must have taken place to be subject to potential recovery. For certain antecedent recovery powers, where the parties are connected to the company a longer lookback period applies than where there is no connection.[3] This difference reflects the fact that a connected party will have a greater degree of knowledge about the debtor company when entering into the transaction. An example of a connected transaction would be a director being repaid a loan in the period before the company goes into insolvency. In such cases, the lookback period is usually two years.

[3] Under Insolvency Act 1986 provisions, liquidators/administrators can take action to -

- reverse an action (including a payment) made prior to a liquidation/administration that favours a particular creditor in advance of others in the run up to insolvency (known as a preference in England and Wales and an unfair preference in Scotland);
- pursue assets that have been sold for less than their value prior to the insolvency (known as a transaction at an undervalue in England and Wales and a gratuitous alienation in Scotland);
- reverse extortionate credit transactions; and
- avoid certain floating charges (a floating charge is a type of security taken over a debtor company's assets by a creditor).

In England and Wales only, there are also provisions in the Insolvency Act against debt avoidance more generally (and that do not rely on a debtor's insolvency to pursue).

For some antecedent recovery powers, where there is no connection with the debtor company – a trade supplier with no common directors/owners with the debtor company, for example – the lookback period is only six or twelve months (depending on the type of antecedent recovery). This ensures that normal trading activity is not unnecessarily harmed.

Some recent insolvency cases have highlighted that value can now be extracted from ailing companies via complex investment schemes or transactions. These do not readily fall within the scope of the existing powers of recovery. The Government is concerned that the tools available to insolvency office-holders, while appropriate for more simple transactions, may not be adequate to counter all types of transactions which unfairly strip value from an ailing company in the modern world. This may particularly be the case where the company has been previously sold or new investment introduced in a way which unfairly immunises the investor to the extent that in a subsequent insolvency they suffer little or no loss, while others lose out.

The existing antecedent recovery provisions recognise that value may be unfairly extracted from a company prior to insolvency and so give office-holders the right to apply to court to reverse such transactions to bring about a fairer distribution of a company's assets to all creditors.

There has been concern that the present law does not adequately deal with the scenario where an ailing (though not yet in administration or liquidation) company has been 'rescued' by investors who then extract value to return at least part of their investment quickly and to lessen their potential loss should the company subsequently fail. These arrangements could take the form of management fees; excessive interest on loans; charges over company property being granted; excessive director pay or other payments; or sale and leaseback of assets. These types of transactions may unfairly benefit certain parties whilst putting creditors in a worse position than they would otherwise have been in should that company subsequently become insolvent.

Such business rescues will not always fail – many will succeed and thrive and the Government welcomes and supports the turnaround of such businesses. However, where they do fail, the Government is concerned that some complex financial structures put in place by investors at the time of or after a 'rescue' attempt, are unfair to the wider body of creditors. Supporting the Industrial Strategy's ambition to create a fair business environment shaped by competition and contestability, the Government wants all creditors to be treated fairly upon insolvency and wants to ensure that there are adequate tools for office-holders to reverse complex transactions that remove value prior to a company's insolvency in order to reach a fairer outcome for creditors. In doing so, the risks to creditors' operations or future investments would be mitigated, supporting their continued operation and economic participation.

The Proposal

The Government is seeking views on how new powers could be introduced to allow an insolvency office-holder to apply to a court to reverse a transaction (or series of transactions) considered to have unfairly removed value from a company in the approach to insolvency in cases where the company had previously been rescued in the way described above. This will sit alongside rather than replace the existing antecedent recovery powers previously outlined, which remain beneficial for more straightforward transactions.

A new power to challenge value extraction schemes would better enable insolvency office-holders to tackle complex transactions that strip companies of their value prior to an insolvency, or place certain parties in an unfairly advantageous position when assets are distributed after a company has become insolvent. The office-holder could determine whether the transactions, however structured, were undertaken to unfairly put a particular party in a better position on insolvency than other creditors and apply to the court to take legal action against the party or parties in order to claw back money for other creditors.

As the Government appreciates that value extraction schemes could take a number of forms, any legislation introduced may need to be broadly formulated to prevent easy avoidance and allow the insolvency office-holder to address such schemes in whatever form they take.

The Government considers that such powers, if introduced, should apply only where the company:

- had received new investment;
- had value extracted in a transaction or series of transactions designed to the benefit of that investor or those connected to it, without adding value to the company; and
- subsequently enters liquidation/administration.

The Government considers that all three elements should be present for a claim to be brought by an insolvency office-holder.

Example *- A company in financial trouble is bought by a new investor. The new investor injects £20m as a loan into the company, to support its working capital.*

The company pays interest on the loan at considerably more than a commercial rate and the loan is secured over the company's property. In addition, the company pays a 'management fee' to the investor.

The company subsequently enters formal insolvency.

The investor has benefited from interest payments and management fees prior to the insolvency and, at insolvency, benefits from its charge over the assets (after insolvency expenses and preferential creditors are paid).

As outlined above, in certain cases the length of the lookback period for existing antecedent recovery provisions depends on whether the party that entered into the transaction is connected with the debtor company. The Government believes that the value extraction schemes explained above can only realistically be undertaken by connected parties, for example a director or shareholder of the company, given the degree of control necessary to construct them. The Government considers that any proposal for new antecedent recovery tools should therefore only cover connected party transactions. In line with existing antecedent provisions, there should be a lookback period attached to any new proposals. For most existing antecedent recovery provisions that can be taken against connected parties the lookback period is 2 years and the Government considers that any new proposals should mirror this.

There is another important factor that is usually considered in existing antecedent recovery provisions. The debtor company must be technically insolvent (i.e. having liabilities more than its assets or being unable to pay its debts as and when they fall due) at the date of the transaction or have become insolvent as a result of entering into the transaction in order for the insolvency office-holder to be able to challenge the transaction.

The Government considers that this insolvency test may not be appropriate in relation to a challenge to the value extraction schemes outlined. The Government considers that value extraction schemes are a ‘hedge’ against a turnaround failing to ensure that the investor does not lose all or most of its investment on a failure – in effect, shifting some of the risk of the initial investment onto unconnected creditors. Instead of a direct insolvency test, the Government believes the test should be that the value extraction scheme must have unfairly put the beneficiary in a better position than other creditors in a subsequent formal insolvency (liquidation/administration) than would otherwise have been the case.

The UK has a mature and sophisticated market for turnaround finance and new investment into distressed businesses should not be discouraged. Government does not wish to deter lenders in this sector as it appreciates that if new finance was not available, companies that are presently able to be saved might fail in the future and enter formal insolvency unnecessarily.

The Government believes that any new proposals to address unfair value extraction schemes must adequately balance the interests of all creditors in receiving a fair distribution with the interests of investors in receiving a fair return on their investment. The Government is keen to receive the views of stakeholders on the potential impact of this proposal on the availability of turnaround finance.

The Government wants to ensure that all creditors are treated fairly in a formal insolvency. It believes that, in the vast majority of cases, this happens. However, in a small minority of cases, complex investment structures allow sophisticated parties to unfairly insulate themselves from risk to the detriment of other creditors. Existing legal protections are

insufficient to allow insolvency office-holders to unpick these value extraction schemes. The proposed power will allow such schemes to be tackled by office-holders and so enable a fairer distribution of a company's assets when it fails. The Government also recognises that terms such as "unfairly" and "excessive" may be subjective terms. It is commercially reasonable that the party providing the rescue package will stand to benefit, otherwise there is no incentive to provide the finance. What Government is seeking to address is a transaction, or a series of transactions, that have been set up in such a way that value is being extracted from the company being rescued while at the same time:

a) value is not being added to the company, and

b) other creditors are being disadvantaged more than is commercially reasonable.

Government is seeking views on what the balance should be between these competing interests.

Consultation Question

5.	Are new tools needed to enable insolvency office-holders to better tackle this behaviour? Or could existing antecedent recovery powers be expanded to ensure this behaviour is tackled?

Consultation Question

6.	Do you agree the Government should introduce a value extraction scheme reversal power as outlined above? Do you agree that the insolvency test in the current powers is not appropriate in the circumstances outlined above?

Consultation Question

7.	Could the proposal adversely affect the availability of finance for distressed companies? Could it have other adverse effects? If so, how might the proposal be modified to mitigate these effects? Are there any protections that should be given to investors?

Consultation Question

8.	How could the proposal be developed to ensure that only those schemes which unfairly extract value and harm the interests of other creditors can be challenged by the insolvency office holder? Should concepts such as “unfair” and “excessive” be defined or left to the courts to develop through case law?

Dissolved Companies

The Insolvency Service's investigation and enforcement activity is fundamental to giving individuals and businesses the confidence to conduct business, and that those who break the rules and damage others' interests may be identified and held to account. This section explores Government's proposal to extend existing investigative powers into the conduct of directors to cover directors of dissolved companies.

Closing a limited company

A limited company can cease to exist in a variety of ways. The method chosen to close the company may depend on whether it can pay its bills or not.

If the company is actively trading and can pay its bills ('solvent'), directors can either:

- *apply to get the company struck off the Register of Companies – this is known as " voluntary dissolution"; or*
- *start a members' voluntary liquidation.*

Striking off the company is usually the cheapest way to close it.

Companies House also has the power to compulsorily strike off a dormant company (this is known as "compulsory dissolution".

If the company can't pay its bills, it is insolvent and the interests of the people the company owes money to (its creditors) legally come before those of the directors or shareholders. There are a range of formal insolvency procedures by which a company can be closed down.
When a company is dissolved, it effectively no longer exists. If a complaint is received about the actions of the director of a dissolved company, the current statutory requirements mean it is time consuming and costly for the Secretary of State to investigate the complaint.

Alternatively, if a company is no longer trading, but does not owe any money, it can be left to become dormant. It will remain registered on the register of companies and annual accounts and confirmation statements must continue to be submitted.

Background

Complaints are regularly received from the public about alleged wrongdoing by directors of companies after they have been dissolved and often in relation to successive company failures. Evidence also points to a low-level but recurring theme of directors using dissolution to avoid debts. These debts include, but are not limited to, tax, civil penalties, employment tribunal awards and other liabilities.

The example sets out a typical complaint where, dissolution is used to shed existing liabilities. The director in many cases continues running the same business using a new company which can often have a very similar name to a previous company.

The Secretary of State currently has two investigative powers: the power to investigate live companies under the Companies Act 1985 and the power to investigate the conduct of directors of insolvent companies under the Company Director Disqualification Act 1986 (CDDA 1986). On average, 1,200 directors are disqualified each year following investigation using these powers. The net benefit to the market (in terms of creditor damage prevented) for each director disqualified is estimated at over £100,000[4]. Disqualification plays an important part in making the UK a safe business environment and maintaining confidence in the market and the limited liability framework.

Where the conduct of directors falls below expectations, the current regime enables appropriate investigations to be conducted into both live and insolvent companies. The current legislative framework does not, however, allow for the investigation of the conduct of directors whose companies have been dissolved and removed from the company register unless the company entered an insolvency procedure prior to dissolution or the company has been restored to the register. There is a concern that some company directors are able to avoid being held accountable for misconduct by allowing, or actively causing, their companies to be dissolved instead of putting the company into a formal insolvency process.

While it is not impossible for the Secretary of State to take action against a director of a dissolved company, to do so requires an application to court for restoration of the company, which is impractical where the Secretary of State does not already have strong evidence of misconduct and could undermine the integrity of the register if firms which have ceased operations are routinely resurrected to the register.

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627605/annual_report_2016-2017_-_final-web.pdf

Powers to Investigate Directors' Conduct

Government proposes that the scope of the current investigation and enforcement regime be extended to include former directors of dissolved companies.

This may be achieved by introducing a new power to allow for investigation into the conduct of individuals who were directors of companies which have been dissolved, and to take action against former directors who are found to have acted in breach of their legal obligations. In particular, Government is considering whether the Secretary of State should have the power to:

> ***Example*** *– A creditor was owed £1000 from Company Y Limited. The director of that company applied for dissolution of Company Y Ltd without first settling the debt owed. Although the creditor objected to striking the company off the register, they could not take further action due a lack of funds.*
>
> *The director of Company Y Limited had been the director of 6 companies dissolved between 27 September 2011 and 27 October 2015, owing various creditors money. None of the companies entered formal insolvency proceedings before being dissolved.*
>
> *All the dissolved companies were registered at the same address. Although Company Y Ltd was dissolved in 2013, another company was incorporated by the same director in 2014 and then dissolved in August 2016.*

a. Require any person to provide such information as may be reasonably requested to allow the Insolvency Service to investigate the conduct and actions of former directors of a dissolved company;
b. Seek an order disqualifying a former director from being a director of any other company;
c. Seek an order that the former director financially compensates creditor(s), where the director's actions caused identifiable losses; and
d. Seek a prosecution where there is evidence of criminal conduct.

This will complement the existing powers to investigate director conduct and strengthen our ability to take rogue directors out of the marketplace.

There are approximately 400,000 company dissolutions annually. This proposal will allow the Insolvency Service to target appropriate cases for investigation without imposing any additional burden on the majority of directors who wish to legitimately dissolve their companies and have not committed any misconduct.

Since there is no office-holder's report in the case of a dissolved company, the trigger for investigation will likely be a complaint received from a member of the public, a creditor or other government department, or a connection to an existing investigation into a live or

insolvent company. The new provision is intended to be exercised at the Secretary of State's discretion where there is sufficient evidence of wrong-doing and it is in the public interest to do so. Evidence of wrong doing (or "unfit conduct") generally derives from:

a) Behaviour which is to the detriment of creditors when a company is insolvent,

b) Failure to comply with company law obligations; or

c) Failure to ensure that a company is properly run.

Consultation Question

9.	Do you agree that there is a problem in this area and that action should be taken to prevent directors from avoiding liabilities and scrutiny by dissolving their companies?

Consultation Question

10.	Do you agree that director conduct in a dissolved company should be brought within the scope of the Secretary of State's investigatory powers? Do you have any other comments on the proposal?

Strengthening Corporate Governance in Pre-Insolvency Situations

This section explores a number of further areas of corporate governance law, and practice that have been highlighted following recent company failures which may need attention to keep our corporate frameworks up to date.

Group structures

The UK has an enviable reputation as a great place to start and grow a business, further supported by the Government's Industrial Strategy published last year. As businesses grow, particularly where they do so through acquisitions, their corporate structures are likely to become more complex. It is important that these structures remain effectively managed and governed and that corporate governance arrangements and internal controls are robust.

Example – Company "A" became insolvent. Prior to its insolvency there were a number of features about the way it operated and was governed that may have contributed to its failure and made consequences for creditors more severe.

- The company had expanded rapidly, primarily through acquisitions. The resulting group structure was complex with more than 300 subsidiary companies leading to record keeping issues and challenges for the group board in exercising effective control of the group as a whole.
- Many major shareholders did not challenge the board's long term strategy, its corporate governance and risk management nor its executive remuneration policies. Resolutions at AGMs were typically passed by majorities of 95% or more. Critics of the board's approach made no headway - withdrew their investment.
- The company continued to make large dividend payments to shareholders out of distributable profit, despite having a significant defined benefit pension fund deficit and big liabilities to banks and others.
- Its directors used external professional advisers, including accountants and consultants to help take key decisions but there were questions about whether they had considered this advice through the prism of their wider directors' duties and the requirement to apply an independent mind.

The company had an extensive supply chain, As its cash position deteriorated, it extended standard payment terms for suppliers from 60 to 120 days building up big debts to creditors and creating cash flow difficulties in the supply chain.

Groups should have clear records on the entirety of their structure, including the identity of all directors of subsidiary companies. It should also be clear to third parties which company within the group structure they are entering into contracts with, and which company within the group owns particular assets. This is particularly important in the event of insolvency, where clarity over corporate structures and ownership of group assets helps to establish complex intra-group balances, minimise the costs and expenses of the insolvency process and maximise returns to creditors.

A clear governance structure and good record keeping also makes it easier to hold the right people to account. Whenever a corporate insolvency occurs, the conduct of the directors of the company is considered. Directors may be disqualified from acting as a director for up to 15 years if they are considered to have been guilty of misconduct. Transparency, particularly in relation to responsibilities and the line of accountability should protect those directors whose actions were lawful and reasonable and facilitate investigations into any directors who were reckless or dishonest leading up to the company's failure.

The UK Corporate Governance Code[5] which is overseen by the Financial Reporting Council and which applies to premium listed companies already has strong "comply or explain" provisions for directors to assess and report on their internal control systems and at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review is expected to cover all material controls, including financial, operational and compliance controls.

In addition, new reporting requirements being introduced as part of the package of corporate governance reforms announced by the Government last August will require larger companies, including large subsidiaries within groups of companies to disclose their corporate governance arrangements. When implemented, this will ensure more transparency about the relationship between parent companies and their large subsidiaries.

Consultation Question

11.	Are stronger corporate governance and transparency measures required in relation to the oversight and control of complex group structures? If so what do you recommend?

[5] [5] UK Corporate Governance Code, provision C.2.3. https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf

Shareholder Responsibilities

Large corporate failures amongst listed companies are rare, but when they occur can give rise to questions about whether shareholders, particularly large institutional shareholders, should have been more alert to warning signs, been more engaged with long term company strategies and done more to challenge boards to take timely remedial action.

Under the Companies Act 2006 and the Financial Reporting Council's UK Corporate Governance Code, it is the responsibility of the board of directors to run a listed company's affairs, ensuring it has strong corporate governance and manages risks and opportunities in a way that supports the company's long term success. But shareholders also have an important role to play in promoting the long-term success of the company and should be pro-active in ensuring that it is being run responsibly.

Institutional shareholders, who manage large long-term investments on behalf of pension schemes and other asset owners can, by virtue of their size and expertise, have a particularly important role in engaging effectively with investee companies. Indeed, in the case of the managers of large tracker funds who do not have a choice over the shares they hold, active stewardship is the key way in which the manager can seek to add value for the underlying investor.

As a matter of good practice, engagement should extend beyond voting at a company's Annual General Meeting or choosing to buy or sell stock in a company. It should also include pro-active stewardship activities to ensure that investee companies have strong corporate governance arrangements in place, a robust approach to risk management and a strategy and executive remuneration policies which support sustainable, long-term success.

Table: Principles from the FRC's Stewardship Code

Institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities.
- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
- monitor their investee companies.
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
- be willing to act collectively with other investors where appropriate.
- have a clear policy on voting and disclosure of voting activity.
- report periodically on their stewardship and voting activities.

Many institutional investors take these responsibilities seriously, including through their compliance with the Financial Reporting Council's Stewardship Code. That Code has been in place since 2010. It asks investors to base their stewardship approach on a consistent set of principles (see table), including regular and effective monitoring of company performance, and to set out publicly how they achieve this. Investors' ability to hold companies to account has also been strengthened by requirements on listed companies since 2014 to produce risk and viability statements under the FRC's Corporate Governance Code. This is a relatively recent development, and best practice in the preparation and use of these statements to maximise their value to investors is still developing.

Additionally, the UK investment community has taken recent steps to improve the way in which it discharges its shareholder responsibilities. Last year, for example, the Investment Association (which represents the UK asset management industry) published "Long Term Reporting Guidance"[6] which sets out investors' expectations of how listed companies should report each year on how their investment decisions are promoting the long-term value of the company. Investor pressure of this kind for more transparent reporting by listed companies on how their capital allocation decisions affect their productivity, and how this aligns with their long-term strategies, can make an important contribution to our Industrial Strategy's ambition to improve productivity across the UK.

UK institutional investors have also established an "Investor Forum"[7] which aims to represent the views and concerns of major shareholders collectively to individual companies on a case-by-case basis. In 2017, members identified 14 companies as candidates for collective engagement, of which 10 proceeded to full engagement.

This progress is welcome, but recent corporate failures make it right to ask whether a larger proportion of institutional investors could be more active and engaged stewards, and whether more could be done to ensure that company directors and their investors engage constructively. Business collapses are often the product of poor long term strategies and months and even years of deteriorating performance or poor company direction and management. Engaged and committed shareholders have a clear interest in understanding and acting upon the warning signs. They should, for example, challenge directors on the steps they are taking to manage and mitigate risks as well as ensuring that executive remuneration policies align the interests of directors with the interests of the company. Directors in turn, should to take investor concerns seriously and to engage with them.

[6] https://www.theinvestmentassociation.org/media-centre/press-releases/2017/new-guidance-urges-ftse-companies-to-demonstrate-how-they-act-long-term-to-get-better-returns-for-savers-and-investors.html
[7] https://www.investorforum.org.uk/

Several of these issues are being addressed at Eiropean Union level through the Shareholder Rights Directive (2017/828/6). This introduces a number of minimum level requirements across the EU, with the objective of strengthening engagement and increasing transparency to achieve effective and sustainable stewardship amongst institutional investment, asset management and proxy advisers.

A significant opportunity to help strengthen the quality of investor engagement with UK companies will arise later this year when the FRC consults on a revised UK Stewardship Code[8] . The FRC has recently sought stakeholder comments on how this review can be best framed[9]. Options for reform include:

- More explicitly addressing in the Code how investors should consider the long-term sustainability of the companies they invest in, including assessments of a company's strategy, its capital allocation decisions and its culture;

- Promoting better reporting of stewardship outcomes by investors, as opposed to just reporting on processes and inputs;

- Setting out a new responsibility in the Code on asset managers to monitor and engage on how the directors of companies in which they have invested fulfil their requirement to have regard to employee interests, good relations with suppliers and customers and other matters when carrying out their duty under section 172 of the Companies Act 2006 (see table on page 30).

On the third option, the Government is already committed to introducing a new statutory requirement on all large companies to report each year how directors are fulfilling their section 172 duty. This will provide important new information for shareholders enabling them to be more effective in holding directors to account for how they are having regard to the other stakeholder interests on which a company's long term success often depends.

Further ideas for strengthening stewardship include the possibility of establishing an expert "stewardship oversight group" which could review significant corporate failings and scandals, make recommendations, and ensure that lessons are applied throughout the investment chain. Members could include the Investor Forum, company chairmen, company secretaries, asset owners and the FRC.

More might could also be done to encourage effective stewardship through a commitment by FTSE companies to hosting periodic strategy and stewardship forum meetings focussing on the company's long term strategic plans.

[8] https://frc.org.uk/investors/uk-stewardship-code
[9] https://www.frc.org.uk/consultation-list/2017/consulting-on-a-revised-uk-corporate-governance-co

Consultation Question

12.	What more could be done through a revised Stewardship Code or other means to promote more engaged stewardship of UK companies by their investors, including the active monitoring of risk? Could existing investor initiatives to hold companies to account be strengthened (e.g. through developing the role of the Investor Forum)? Could better arrangements be made to ensure that lessons are learned from large company failings and controversies?

Payment of Dividends

Shareholders investing in a company put their capital at risk and can lose it all in the event of insolvency. Conversely, if the company is profitable, investors expect an equitable return on their capital in the form of dividends and share price appreciation. This trade-off underpins well-functioning capital markets and is generally understood and accepted.

Concerns arise where it emerges that a company in financial difficulties and approaching insolvency nevertheless paid dividends to its shareholders, particularly in circumstances where net debt was high or there was a large pension fund deficit.

The law on the payment of dividends in the Companies Act 2006 sets out that dividends can only be paid out of a company's profits, which are available for distribution as shown in the relevant accounts (normally the profit and loss account) drawn up in accordance with UK law and accounting standards which in turn are drawn from international accounting standards. A dividend cannot be paid in the absence of accumulated profits, regardless of the existence of surplus cash balances or unused borrowing facilities. In addition, only realised profits may be distributed.

The link between the profit in a company's financial statements and any reserves available for distributions is elaborated in guidance issued by the Institute of Chartered Accountants of England & Wales in TECH/02/2017[10]. The directors of a company are responsible for making the assessment about what profits are technically available for distribution and how much should, in fact be distributed, having considered the requirements of the Companies Act and any relevant guidance.

[10] https://www.icaew.com/-/media/corporate/files/technical/technical-releases/legal-and-regulatory/tech-02-17-bl-guidance-on-realised-and-distributable-profits-under-the-companies-act-2006.ashx?la=en

Any surplus or deficit in respect of a company's defined benefit pension plan will appear on its balance sheet as a "net defined benefit asset" or "net defined benefit liability". Increases in any deficit will reduce the accumulated profits of the company, reducing the likelihood that a distribution can be made. Where a company adds funds to the pension fund to reduce or eliminate a deficit, there is an impact on the company's solvency as this will reduce the cash available to meet other liabilities as they arise.

The law and accounting principles which underpin decisions about dividend payments are well established. However, examples of large companies continuing to pay out large dividends in the period immediately before their insolvency raise questions about whether reform is needed. One of these is whether the definition of "distributable profits" remains fit for purpose. A further question is whether there is sufficient transparency and accountability to shareholders and other stakeholders for decisions taken by companies on how to allocate capital as between, for example, the competing demands of investment in R&D, returns to shareholders, pay and benefits for employees, making the business more sustainable and contributions to pension funds.

The Government has no plans to interfere with decisions about dividend payments. These are matters for directors and shareholders and interference could have a chilling effect on future investment. It is however, interested in views on whether the legal and technical framework within which distributable profits are determined and within which directors exercise their judgements about what distributions to make could be improved.

Consultation Question

13.	Do you consider reforms are required to the legal, governance and technical framework within which companies determine dividend payments? If so what reforms should be considered? How should they be targeted so as not to discourage investment?

Directors' Duties and the Roles of Professional Advisers

Section 172 of the Companies Act 2006 requires directors to act in the way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members and in doing so have regard to the interests of employees, the consequences of any decision in the long term and other specified matters. This duty is owed by the director to the company and cannot be delegated.

Table: Text of Section 172(1) the Companies Act 2006

Duty to promote the success of the company
(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to — (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.

Many companies, particularly larger and more complex ones, will often seek professional advice, for example on financial, legal or competition matters, so that directors have access to the expertise needed to help them make important decisions for the company. Indeed, in some cases they will be required to do so.

It is important to recognise, however that the duties and responsibilities of directors to the company are different from those of professional advisers. Directors are subject to the duty under section 172 of the Companies Act, as well as duties to exercise independent judgement and to exercise reasonable care, skill and diligence. Professional advisers, on the other hand are subject to whatever legislation, standards or supervision applies to their particular profession and contractual obligations to their client.

An accountant, for example, might be asked to advise on the amount of "distributable profits" that a company is legally allowed to distribute in dividends. The adviser would be expected to provide accurate advice on the amount, but that might be higher than the

amount that directors in exercising their duties think is prudent given their wider knowledge of the company and the business risks. It is ultimately for the directors rather than advisers to take the final decision.

Other examples could involve actuarial advice on how to address a company pension scheme deficit or advice on tax matters. A tax adviser might be asked to provide advice on tax planning and avoidance schemes. The adviser would need to ensure that they were legal schemes, but the director on receipt of the advice would need to comply with the directors' duty to promote the success of the company having regard to the matters in section 172 such as the desirability of maintaining a reputation for high standards of business conduct, and the likely consequences of the decision in the longer term.

The Government is interested in views on whether some directors are commissioning and using professional advice without a proper awareness of their duties as directors, and in particular the requirement to apply an independent mind.

Consultation Question

14.	There are perceptions that some directors may not be fully aware of their duties with regard to commissioning and using professional advice. Do you agree, and if so, how could these be addressed?

Protection of Companies in the Supply Chain

When an insolvency event occurs, the likelihood of those in the supply chain recovering all they are owed diminishes. This is particularly true of small and medium sized enterprises who tend to be lower down the payment chain and have less ability to "persuade" payment from a major company. The risks are particularly acute in sectors such as construction where there are often delays in payment and certain contractual provisions can mean firms in the supply chain do not receive final contractual payments for up to a year after work has been completed.

The Industrial Strategy recognises that small and medium-sized businesses throughout Britain make a significant contribution to our country through the value of goods and services they sell, the jobs they provide, and the taxes they pay. By doing more to encourage prompt payment to SMEs within supply chains, we can help to meet our commitment to ensure a fair framework for business, facilitate their continued operations and ensure that they have more money to invest to improve productivity.

The excessive length of some payment terms and the unacceptable practice of not paying bills when they are due both cause concern for a well-functioning economy. Each practice adds financial risk to the supply chain. The longer the payment terms, or the later the invoice is paid, the more is owed to suppliers when a company becomes insolvent and therefore the more expected income suppliers risk losing with all that this entails for jobs, investment and possibly their own company's survival.

The Payment Practices and Performance Reporting requirement (PPR), introduced last year, will shed light on the length of payment terms, and the extent of late payment of invoices. Reports submitted by large companies will show the average time a company takes to pay invoices, the percentage paid within 30 days, within 60 days and longer than 60 days. They will also provide information about companies' dispute resolution processes, charges for remaining on supplier lists and supply chain finance options.

As our public database of reports grows we expect suppliers to take an increasingly active interest in checking both the standard payment terms of their potential customers and also their real-world performance against those standards and against the 30 and 60-day breakpoints. We also expect media interest as the performance of individual companies and particular sectors come under the spotlight. Institutional investors may also take a closer interest as engaged company stewards because good business relationships with suppliers are an indicator of successful, sustainable businesses. This extra scrutiny will help make payment terms and payment practices a more important boardroom issue as companies reflect on their corporate reputation and on their ability to compete for the best suppliers. In addition, all reports must be approved by a named company director or, for Limited Liability Partnerships, a designated member. It is a criminal offence by the business, and every director of the company, if the business fails to publish a report within the specified filing period, or if they publish a false or misleading statement.

PPR will take time to bed in as different financial year-ends mean many companies' first reports are not due until later in 2018, and as interested parties find ways to make effective use of the data. In the meantime we recognise that transparency alone, does not fully correct any imbalance of market power between big companies and small. Government will therefore continue to look at what more could be done to deliver a fairer payment culture for small businesses and ensure they can trade on fair terms. Later this year, for example, BEIS will launch a call for evidence on how to eliminate unfair payment practices to small businesses and the Cabinet Office will consult on making a supplier's approach to payments to its own suppliers part of the selection process for larger government contracts.

Success in encouraging better payment practices will reduce levels of outstanding debt but there will inevitably be losers in an insolvency situation. The Government is therefore seeking views as part of this consultation on whether more should be done to help protect payments to suppliers, particularly smaller firms, in the specific event of the insolvency of a customer. In seeking views it also wants to understand whether there would be any wider, perhaps unintended consequences, from taking such steps and how they might be managed.

There are a number of possible approaches which could be considered. They include:

- Increasing the use of specific mechanisms such as Project Bank Accounts (PBAs). A PBA is a ring-fenced bank account from which payments are made directly and simultaneously by a client to members of its supply chain down to second tier suppliers. PBAs have trust status, which secures the funds in them which can only be paid to the beneficiaries – the supply chain members named in the account. The advantage of trust status is that in the case of insolvency of the main contractor, monies in the account due for payment to the supply chain are secure and can only be paid to supply chain members; and

- Preventing the misuse of certain payment provisions typically included in construction contracts, for example, the withholding of retention payments, or a proportion of the value of the contract used as surety against defects. The Government concluded a consultation on this issue on 19 January[11], and is due to respond to the consultation later this year.

In addition, under current corporate insolvency law, there are circumstances in which a set proportion of funds is ring-fenced and paid over to unsecured creditors (which would include supply chain businesses) ahead of the usual order of priority. This provision was introduced in 2003 and the level of funds ring-fenced has not been reviewed since then. The level of this ring-fenced money (known as the “prescribed part”) is set out in The Insolvency Act 1986 (Prescribed Part) Order 2003 and is capped at a maximum of £600,000 being available through this provision.

Consultation Question

15.	Should Government consider new options to protect payments to SMEs in a supply chain in the event of the insolvency of a large customer? Please detail suggestions you would like to see considered.

[11] https://www.gov.uk/government/consultations/retention-payments-in-the-construction-industry

Consultation Question

16.	Should Government consider removing or increasing the current £600,000 cap on the proportion of funds that can be ring-fenced and paid over to unsecured creditors (the "prescribed part") or enabling a higher cap in larger insolvencies? What would be the impact of increasing the prescribed part?

Other Issues

The UK has a robust and respected framework of corporate governance and regulation, but there may be further ways to reduce the risk of major company failures occurring through short comings in governance or stewardship which do not deter investment. This section of the consultation document has already highlighted a number of specific areas which may merit further investigation. However, a final question has been included to provide an opportunity for respondents to suggest other themes, ideas or proposals that could be explored to strengthen this vital area of our corporate framework.

Consultation Question

17.	Is the current corporate governance framework in the UK, particularly in relation to companies approaching insolvency, providing the right combination of high standards and low burdens? Apart from the issues raised specifically in this consultation document, can you suggest any other areas where improvements might be considered?

Catalogue of Questions

Sales of Businesses in Distress

Q1. Do you think there is a need to introduce new measures to deal with the situation outlined?

Q2. Should the new measures be limited to the sale of a subsidiary or should a new measure extend to any act procured by the parent (through its directors), which operates to the prejudice of the creditors of the subsidiary once that subsidiary is insolvent? Might such measures create material conflicts for directors? If so, how might they be resolved?

Q3. Should the target be the parent company directors responsible for the sale? If not, who else should be targeted; or who in addition?

Q4. How can we ensure that there is no impact on sales which genuinely seek to rescue distressed businesses, or bring new investment into distressed businesses?

Value Extraction Schemes

Q5. Are new tools needed to enable insolvency office-holders to better tackle this behaviour? Or could existing antecedent recovery powers be expanded to ensure this behaviour is tackled?

Q6. Do you agree the Government should introduce a value extraction scheme reversal power as outlined above? Do you agree that the insolvency test in the current powers is not appropriate in the circumstances outlined above?

Q7. Could the proposal adversely affect the availability of finance for distressed companies? Could it have other adverse effects? If so, how might the proposal be modified to mitigate these effects? Are there any protections that should be given to investors?

Q8. How could the proposal be developed to ensure that only those schemes which unfairly extract value and harm the interests of other creditors can be challenged by the insolvency office holder? Should concepts such as “unfair” and “excessive” be defined or left to the courts to develop through case law?

Dissolved Companies

Q9. Do you agree that there is a problem in this area and that action should be taken to prevent directors from avoiding liabilities and scrutiny by dissolving their companies?

Q10. Do you agree that director conduct in a dissolved company should be brought within the scope of the Secretary of State's investigatory powers? Do you have any other comments on the proposal?

Strengthening Corporate Governance in Pre-Insolvency Situations

Q11. Are stronger corporate governance and transparency measures required in relation to the oversight and control of complex group structures? If so what do you recommend?

Q12. What more could be done through a revised Stewardship Code or other means to promote more engaged stewardship of UK companies by their investors, including the active monitoring of risk? Could existing investor initiatives to hold companies to account be strengthened (e.g. through developing the role of the Investor Forum)? Could better arrangements be made to ensure that lessons are learned from large company failings and controversies?

Q13. Do you consider reforms are required to the legal, governance and technical framework within which companies determine dividend payments? If so what reforms should be considered? How should they be targeted so as not to discourage investment?

Q14. There are perceptions that some directors may not be fully aware of their duties with regard to commissioning and using professional advice. Do you agree, and if so, how could these be addressed?

Q15. Should Government consider new options to protect payments to SMEs in a supply chain in the event of the insolvency of a large customer? Please detail suggestions you would like to see considered.

Q16. Should Government consider removing or increasing the current £600,000 cap on the proportion of funds that can be ring-fenced and paid over to unsecured creditors (the "prescribed part") or enabling a higher cap in larger insolvencies? What would be the impact of increasing the prescribed part?

Q17. Is the current corporate governance framework in the UK, particularly in relation to companies approaching insolvency, providing the right combination of high standards and low burdens? Apart from the issues raised specifically in this consultation document, can you suggest any other areas where improvements might be considered?