RESPONSE TO CONSULTATION

CONSUMER PREPAYMENTS ON RETAILER INSOLVENCY

LAW COMMISSION
Introduction
1. The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents around 20,000 members who advise and lead business across the UK and in almost 100 countries across the world. ICAS is a Recognised Professional Body (RPB) which regulates insolvency practitioners (IPs) who can take appointments throughout the UK and we have an in-depth knowledge and expertise of insolvency law and procedure.

2. ICAS’s Charter requires it to primarily act in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and protect their interests. In the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

3. ICAS is interested in securing that any changes to legislation and procedure are made based on a comprehensive review of all of the implications and that alleged failings within the process are supported by evidence.

4. ICAS is pleased to have the opportunity to submit its views in response to the Law Commission (the Commission) consultation paper on consumer prepayments on retailer insolvency.

Key Messages

5. We understand the concern and need to offer protection to consumers, particularly those who may be ‘vulnerable consumers’, however any need for change must be balanced against the increased burden and cost for business in doing so.

6. A number of the suggested proposals may pose practical difficulties in implementation. Retailer insolvencies will often involve national retailers operating throughout the UK. The UK has multiple legal jurisdictions and certain elements of insolvency legislation are devolved. Proposed solutions must be capable of implementation throughout the UK in a harmonised manner.

7. We support the view that insolvency practitioners should play a part in ensuring consumers have relevant information when a retailer becomes insolvent. Indeed in virtually every retailer insolvency, large or small, insolvency practitioners will already support consumer creditors through the provision of information and assistance with their claims. However, the provision of information to consumer creditors is not solely an issue for the insolvency profession. Retailers and card issuers also have a greater role to play in providing information and general awareness of schemes such as chargeback.

8. We would encourage any remedial action in relation to information and the chargeback scheme to be carried out via non-regulatory provisions.

9. We do not support the use of trusts as a method of protection for consumer creditors. Due to the multiple legal jurisdictions within the UK we consider that there would be significant difficulties associated with the use of trusts in addition to the additional administrative and cost burden this would place on businesses.

10. We do not support the proposal for the creation of a new “consumer charge” security. We would envisage that developing such a proposal would involve a number of significant difficulties as a result of the different legal jurisdictions, the effect on availability and cost of finance for retailers and practical issues around creation, crystallisation and identification of those entitled to benefit from the charge.

11. We support the view that mandatory protection should be required for any scheme marketed as a savings vehicle. Such schemes are particularly used by the most vulnerable in society and therefore mandatory intervention is warranted.
12. Whilst we appreciate the intention behind the proposal to offer preferential status to consumer creditors in retailer insolvencies, we do not believe that the case has been made out in this regard. The granting of preferential status is no guarantee that consumer creditors would receive their money back in an insolvency situation. In addition such a move is likely to impact on the availability and cost of funding available to the retail sector.

13. Should it be decided that preferential status should be afforded to consumer creditors we make a number of comments and suggestions to the detailed proposals on the parameters surrounding preferential consumer creditor claims.

Detailed Response

14. Our detailed responses to the questions contained within the consultation paper issued by the Commission are provided in Appendix 1.

17 September 2015

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Appendix 1 – Response to specific consultation questions

Q1 Do consultees agree that the protection given to some types of consumer prepayments on retailer insolvency should be reformed?

Yes No Other

ICAS does not express a particular view on this question.

The policy position in respect of consumer protection is one for Government to decide on. It is however important for consumers and the insolvency profession that there is a clear and well understood position relating to consumer prepayments on retailer insolvency.

The policy position should be considered based on evidence and after consideration of any consequences that may arise from any proposed reform.

For example, by creating additional protection involving increased regulation or administration smaller retailers may stop providing a service that is of benefit to their customers. Similarly, by amending insolvency ranking of consumer prepayments this may impact upon the availability or cost of finance available to retailers.

Q2 In this paper, we identify two particular sectors where consumers risk losses on retailer insolvency: gift vouchers and deposits in the furniture and home improvement sectors. Are there other sectors in which consumer prepayments are particularly problematic in the event of retailer insolvency?

Insolvency practitioners will come across consumer prepayments in a number of sectors in addition to the two particular sectors mentioned. Pre-payment/deposits may be taken in almost every consumer transaction situation where the product/service is not delivered to the consumer at the time of purchase. Any insolvency event where an individual is put at risk of loss will be potentially problematic. Other sectors may include (but not restricted to):

- Storage services
- Online retail
- Holiday accommodation (non travel agency bookings)
- Bridal wear
- Functions (wedding receptions, birthday events, other anniversaries, funeral wakes)
- Local retailer “Christmas savings” schemes
Proposal 1  Insolvency practitioners should give information to consumer creditors about chargeback claims and make available on the retailer’s website a confirmation that the company is in administration or liquidation.

Q3a  Do consultees agree with this proposal?

Yes  No  Other

ICAS would agree that information should be available about chargeback claims. In our experience most insolvency practitioners will provide advice to consumer creditors where there is a prospect of the chargeback schemes being available to them.

We however do not see this as purely a matter for the insolvency practitioner. There is a wider need for the availability of such protection to be publicised by card issuers generally and for them to facilitate access to chargebacks.

There are often practical difficulties with websites once a company is in insolvency. Gaining access to the website is often problematic (passwords not being provided) or gaining the co-operation of website hosts or designers to make the necessary changes. In addition, not all consumers will have internet access and therefore information provided via the web should not be the only method of communication.

Proposal 2  All card issuers should give consumers a brief explanation of how to raise a chargeback. This should include:

1. Contact details (including a phone number and website address);
2. Details of situations in which consumers may raise a chargeback, including when a retailer enters administration, and what documentation needs to be provided to the bank;
3. A statement that consumers who think they have met with an unreasonable refusal may complain to the Financial Ombudsman Service.

Q3b  Do consultees agree with this proposal?

Yes  No  Other

As stated in Q3a we believe that card issuers have a responsibility to raise awareness of chargeback schemes and assist consumers with accessing these.

Proposal 3  Card schemes such as Visa and MasterCard should provide a publicly available authoritative guide on how chargeback works.

Q3c  Do consultees agree with this proposal?

Yes  No  Other

See comments to Q3a and Q3b.
Q4  Do you have any comments on how Proposals 1 to 3 should be implemented?

In respect of Proposal 1, any requirements on IPs as a result of any changes would be best achieved through the introduction of a Statement of Insolvency Practice (SIP) setting out industry best practice in a retail or prepayment scenario. We are not aware of any evidence that would suggest a statutory solution would be required to achieve the outcome. A statutory solution would be complicated and time consuming to achieve given the possibility of involving legal jurisdictions in England and Wales, Scotland and Northern Ireland and devolved responsibility for some aspects of insolvency law to the Scottish Parliament.

In respect of proposals 2 & 3 we would only highlight that it is unlikely that short term awareness activities will be effective and that a continuous response would be required to generate the desired outcomes.

Q5  Our provisional view is that chargeback should not be required by legislation. We seek views for and against legislating for new legal duties to be imposed on card issuers to refund payments in circumstances currently covered by chargeback.

Within insolvency situations the chargeback system is effective for consumer creditors and that we are not aware of any evidence to suggest that legislative backing is required. As stated in response to previous questions the effectiveness can be increased through greater awareness and provision of information on how to access the scheme.

Q6  Would trusts designed to protect some rather than all prepayments (either where funds could be draw-down, or where only some prepayments were put into trust), be an acceptable compromise in situations where ring-fencing all prepayments is not practical or affordable for the business?

Yes  No  Other

We consider that trusts would be difficult to reliably create, enforce and monitor. The legal requirements for trusts vary across the different legal jurisdictions of the UK which will make it difficult for those who operate in different jurisdictions to deal with.

Any requirement to hold funds in trust is an additional burden on business and would run contrary to the current desire to remove burdens from business.

The requirement to hold funds in trust would also impact on the cost of doing business due to compliance and monitoring costs as well as possible increased finance costs as a result of these funds no longer being available as working capital. There may also be potential VAT and tax consequences.
Q7 Would it be useful to develop a series of standard trust deeds which businesses could use to protect consumer prepayments?

Yes No Other

As highlighted in Q6, trust law is different in the various UK legal jurisdictions and as a result the number of standard trust deeds required to cover all legal jurisdictions and situations would not be insignificant.

If standard trust deeds were to be made available then a number of matters would require further consideration. For example, how would working capital finance be affected, what is the cost and implications of businesses requiring to re-write terms and conditions, would this impact on decisions of multi-national retailers to do business in the UK, etc.

Q8 Do consultees have any experience of prepayment insurance? If so, we would be interested to learn more about:

(1) Cost of insurance and who bears this;

(2) Extent of insurance coverage and any limitations or exclusions which may apply;

(3) Claims procedure for consumers including documentation to be supplied;

(4) Interaction between insurance and section 75 claims (for example, whether consumers must first pursue a section 75 claim where available before making a claim under the insurance policy).

If applicable, we would also be grateful for sample policy documents.

We have no direct knowledge of prepayment insurance.

Q9 What can be done to overcome barriers to consumer prepayment insurance?

No comments.
Q10 Is there merit in developing a new statutory “consumer charge” to be registered at Companies House, which businesses could use on a voluntary basis to give priority to some specified classes of consumer claims?

Yes  No  Other

We do not consider that there is merit in developing a new “consumer charge”. There are a number of significant difficulties which would arise in developing the proposal as outlined including:

- No protection would be available to consumers of sole traders or partnerships
- Changes would be required to legislation to cover all UK jurisdictions, this would involve aspects of devolved legislative responsibility
- The proposed ranking of the charge may adversely affect availability and pricing of working capital finance
- How would the creation of the charge be viewed within an established business? Would its creation be interpreted as a signal to customers that it was in financial difficulty with director’s taking steps to protect consumers?
- Administrative difficulties in identifying consumers who are protected by the charge
- Identification issues of those capable of benefiting from the charge, particularly around charge registration and crystallisation times.

It is likely that such a charge would also result in significantly increased complexity and time involvement of insolvency staff in retailer insolvencies. As a result costs would increase and impact on returns to creditors generally.

Proposal 4 Rather than introducing mandatory prepayment protection for all gift vouchers, retailers should be encouraged to take more voluntary steps to protect consumers.

Q11 Do consultees agree?

Yes  No  Other

We believe that mandatory steps should only be introduced where there is evidence of a significant risk or potential for harm and which cannot be mitigated through voluntary measures.
Proposal 5  Providers of vouchers should state in the terms and conditions of the voucher whether or not the value of the voucher is subject to any protection in the event of insolvency.

Q12 Do consultees agree? Could this be introduced voluntarily, or would it require regulation?

Yes  No  Other

We do not believe that inclusion of this information within terms and conditions of itself will provide sufficient transparency to consumers. The majority of consumers will not read “small print” as evidenced from the lack of knowledge about the chargeback scheme for instance. For consumer creditors to be aware of protection (or lack of) then this would require a much higher profile and explicit statements to be made at the point of payment.

We do not consider that there is significant risk associated with non-disclosure as disclosure or otherwise will not affect any eventual the outcome in the event of an insolvency. The decision to make a prepayment is likely to be driven by a number of factors of which the possible protection in event of insolvency is unlikely to be significant in the majority of cases. For these reasons we consider that a voluntary requirement, supported through retailer codes, would be preferable over regulation.

Proposal 6  It should be unlawful to market a scheme in a way which suggests that it can be used as a savings vehicle without putting some form of protection in place to protect the funds.

Q13 Do consultees agree?

We welcome additional comments on this proposal. In particular:

(1) Is our definition correctly targeted?

What additional costs would our proposal impose?

Yes  No  Other

Saving schemes are often used by the most vulnerable in society and therefore additional measures of mandatory protection should be afforded to such schemes.

We agree that any scheme which implies or is explicit about a savings element should be captured within the definition to be used.

Additional costs should be proportionate to the size of business and level of funds within the savings scheme.
Proposal 7  Legislation should provide the Government with reserve powers to regulate high-risk voucher intermediaries which hold significant funds over a long period and which may use those funds for other purposes without providing consumers with alternative protection.

Q14  Do consultees agree?

Yes  No  Other

We do not believe that Government should be provided with reserve powers. The case for any legislative change should be made out by Government and legislation introduced if necessary at the appropriate time.

If reserve powers were to be taken, a clear understanding of the conditions under which the powers would be invoked should be set out during the time when the legislation is passing through parliament.

Q15  What would the risks and potential costs be for any voucher intermediary (whether “high-risk” or not) if they were required to introduce protection mechanisms such as trusts, insurance or bonding?

See Q6 and Q7

Q16  Do consultees agree that sector-specific regulation is not a suitable means of protecting consumer prepayments in the furniture and home improvement sectors?

Yes  No  Other

Historical information presented within the consultation paper supports the view that these sectors present a significant risk and history of retailer insolvencies with significant consumer prepayment harm. Section 11.60 of the consultation paper however recognises that in introducing sector specific regulation there would be cost and administrative burdens placed on the sector. It is for Government and sector regulators to consider whether the risk to consumers is sufficient to warrant intervention in these sectors specifically over and above any general measures being considered to offer consumer prepayment protection.
Proposal 8 A limited category of consumer claims should be given preferential status, to rank behind employees but in front of floating charge holders. The preferential status would apply where the consumer provided a significant sum of new money to the business in the run-up to the insolvency, using a payment method which did not offer a chargeback remedy.

Q17 Do consultees agree with the policy behind this proposal?

Yes  No  Other

Whilst we can appreciate the thinking behind the proposed policy position we consider that there is insufficient evidence to suggest that the policy would achieve the desired objectives or that other methods could not be used to achieve the objectives. We do not consider that a sufficiently strong case has been made out to warrant special protection for certain categories of consumer creditors.

The policy, if implemented, would also significantly alter the insolvency principle of *pari passu* by granting a subordinate ranking to employees preferential claims.

Consumer creditors are voluntary creditors in that they are capable of making a choice of whether to make a prepayment or not. We do not think it likely that anyone in that situation does not recognise that there is a risk in making a payment that they will not receive value. The policy would result in a higher ranking than involuntary creditors which would seem a strange situation.

The granting of preferential status is also no guarantee that consumer creditors would receive their money back in an insolvency situation. This will be a factor of fixed charge assets with equity, floating charge realisations, costs of realisation and the insolvency process and prior ranking preferential claims. The creation of preferential status for consumer creditors may result in other creditors seeking to improve their ranking through fixed charges.

The introduction of a consumer creditor preference may also impact on the availability of funding to businesses operating in the sector. The increased cost to business as a result of a consumer creditor category may outweigh the benefits to consumers.

The examples provided in paragraph 12.20 are not wholly to do with the inability to assess risk but also demonstrate issues with director/company behaviour prior to insolvency. The introduction of consumer creditor preference is unlikely to address behavioural issues.

Consideration could be given to extending protection to ‘cash’ prepayers via other methods, for example by debit card providers becoming jointly liable for certain transactions in a similar way to credit card providers. All card services are provided through card merchant service providers who could reasonably be required to assess the credit worthiness of retailers before supplying card machines. This would therefore eliminate the risk identified of consumers being unsophisticated and unable to assess the risk of providing prepayment to a retailer.
Q18  Do consultees agree that the preferential status should apply to money paid within a set period before the date of entering administration/liquidation? We seek views on whether that set period should be three months.

Yes  No  Other

See Q17 above.

Should preferential status be pursued then we would agree that a set period would be an appropriate way of assessing the 'cut-off'. This is consistent with other areas of insolvency legislation (for example unfair preferences). With the exception of gift vouchers, we feel that it is likely that the majority of consumer prepayments would normally expect to be fulfilled within a 3 month period and therefore that period appears appropriate.

We note at para 12.50 of the consultation paper it states “If the aim is to encourage administrators to deliver the goods which have been ordered….”. We would highlight that the creation of a preferential status for consumer creditors is unlikely to achieve that aim. The remaining issues that an administrator (or liquidator or receiver) will consider before being able to fulfil an order would include factors such as whether the retailer has the stock, whether the retailer has title to the stock, whether payments still require to be made to the supplier which may affect retention of title issues, and funding to continue trading more generally.

Q19  Do consultees agree that preferential status should be limited to claims where the consumer has paid more than a certain amount, either in a single transaction or in a series of linked transactions? We seek views on whether that amount should be £100.

Yes  No  Other

See Q17 above

Should preferential status be proceeded with then the proposal to create a deminimus limit for claims would result in a different treatment not only to other preferential creditors’ claims but to the basis of all claims in an insolvency. For example, employee preferential claims would be processed as a preferential claim irrespective of whether it amounted to a small value. Similarly claims within any other category are processed irrespective of value.

If it were proposed that a restriction on the level of preferential consumer creditor claims should be pursued then we would suggest the rather than a value of claim being the determining factor other more appropriate factors may be considered. This is because it not guaranteed that any preferential creditor will receive 100p in £. We consider that if there is a case for a preferential deminimus level (on the grounds that the claims must be sufficiently large enough to justify the cost of distribution) then the deminimus level should be linked to actual distribution value rather than claim value alone. It may therefore be more appropriate to set an upper limit for the value of claims (as is the case for preferential employee claims for unpaid wages) and a deminimus value of actual dividend payment. For example, preferential consumer creditor claims may be limited to £1,000 subject to a minimum actual dividend payment to the consumer creditor of £100. Further consideration would require to be given to the upper limit of claims and the deminimus distribution value.

An alternative to the deminimus distribution value would be to provide in legislation for the insolvency office holder to disapply preferential consumer creditor claims in a similar manner to the disapplication provisions for the prescribed part.
Q20 We seek views on the impact of this proposal generally. We are also interested in the following issues:

(1) Are retailers able to keep records of prepayments of (say) £100 or more made by cash or cheque, so as to present a running total of such sums to their floating charge holders?

(2) Would floating charge holders be able to monitor these sums?

(3) Do many businesses rely on these prepayments to a significant degree?

The ability of a business to keep and access such records depends entirely on its systems and how they have decided to structure and run their finances and banking relationships. We anticipate that there would be an administrative cost and burden in administering these records.

Floating charge holders would only be able to monitor these sums if the information was available and provided by the company. In our view it would be for the floating charge holders to ascertain whether they wished to monitor this information and arrange with the company for reports to be provided in the same way as they would monitor any other financial information requested under the banking covenants.

Q21 We are interested in hearing about examples of businesses:

(1) which rely on these prepayments but do not have secured creditors; and/or

(2) which successfully traded their way out of financial difficulties by relying on consumer deposits by cash or cheque.

No comments.
Proposal 9  For specific goods, which are identified at the time of the contract, ownership should be transferred at the time the contract is made. This should apply even if the retailer has agreed to alter the goods in some way before the consumer takes possession.

Proposal 10  For unascertained or future goods, which are not identified at the time of the contract, ownership should be transferred when goods are identified for fulfilment of the contract.

Q22  Do consultees agree with these proposals? In particular:

(1) Would they assist administrators in determining whether to fulfil consumer orders?

(2) What impact would they have on other creditors?

Yes  No  Other

We consider that proposals 9 and 10 would further complicate contract law in the UK. Further complicating the competing claims between retention of title, holders of liens and customers is unlikely to be helpful. Any additional complexity is likely to result in additional time and costs being incurred in an insolvency process resulting in lower returns to creditors generally.

Any decision to continue trading and fulfilment of orders will be undertaken by an office holder based on a number of specific factors but fundamentally whether this will increase or protect the potential return to creditors generally.

Q23  Should these rules be mandatory, so that they apply by law to all contracts?

Alternatively, should the parties be able to agree alternative provisions?

Mandatory  Parties can agree alternative provisions  Other

See response to Q22

Q24  Are there any arguments for ownership of goods to be transferred immediately to consumers upon conclusion of the contract?

Such a proposal ignores how competing claims (e.g. retention of title, liens) are to be resolved, adding complexity, delay and possible cost to insolvency cases. Transfer of ownership in something that does not yet exist is particularly problematic. The position would further be complicated by factors such as insurance and risk in an item still on a retailer’s premises, or in the possession of a third party, where title has passed to the customer.