WRITTEN RESPONSE TO CALL FOR EVIDENCE:
COLLECTIVE REDUNDANCY CONSULTATION FOR EMPLOYERS
FACING INSOLVENCY

THE INSOLVENCY SERVICE
Executive Summary

Introduction

1 The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants and represents over 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. 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. On 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 Call for Evidence issued by The Insolvency Service in respect of collective redundancy consultation for employers facing insolvency. We shall be pleased to discuss in further detail with the Insolvency Service any of the matters raised within this response.

Executive summary

5 ICAS fully supports the need to provide legislative protection for employees and to ensure that their voice is heard in avoiding unnecessary redundancies or ensuring that where redundancies are necessary that these are mitigated.

6 Legislation makes no distinction between redundancies in solvent and insolvent situations. We believe that it is necessary for legislation to recognise the different landscapes and factors at play in each of these situations. In doing so, the inherent tension that exists at present in insolvent situations between employment law and insolvency/company law which are the cause of much conflict at this present time shall be resolved. Legislation should therefore be amended to give clarity and remove conflict rather than leaving resolution to the courts or employment tribunals.

7 The detailed process of consultation and the consequences of failing to consult are such that when consultation can be carried out, the focus is on getting the process right rather than on the quality of the consultation. We call upon the Government to simplify the consultation requirements when a company is facing insolvency or is in a formal insolvency process to allow greater focus on quality of the consultation. This would include:

- Simplified notification process, including ability to submit electronically and using one notification for multiple sites
- Removing insolvent companies from the current statutory consultation requirements
- Working with the insolvency profession to introduce a principals based standard for the insolvency profession to work to which would better reflect the wide spectrum of situations which can be faced
- Providing additional support to employee representatives who will not necessarily have the skill or knowledge to effectively contribute to collective consultations

8 We would also recommend that in order to provide support to employees facing redundancies, Data Protection legislation is clarified so that it is clear that insolvency practitioners can be clear about their ability to share personal data with appropriate agencies where the purpose is to support and guide employees through redundancy and finding alternative employment.
9 Transfer of Undertakings and Protection of Employment Regulations (TUPER) can act as a barrier to the preservation of employment in insolvency situations. Any redundancies made prior to a going concern sale of the business could result in a challenge being made for unfair dismissal unless the redundancies were for economic, technical or organisational (ETO) reasons. The risk of an unfair dismissal challenge being raised and any subsequent liability passed to the new employer under TUPE poses a significant barrier to such sales and may ultimately lead to greater job losses than would otherwise be required. There may be significant advantages to the wider economy in creating within legislation a presumption that redundancies when a company is within an insolvency procedure are for ETO reasons unless shown otherwise thereby removing a barrier to going concern sales and leading to a wider protection of employment.

10 Insolvency practitioners should not be faced with criminal penalties for failing to consult on redundancies in situations where they have no real alternative but to make redundancies immediately on appointment. We would suggest that insolvency practitioners who fail to carry out an adequate level of consultation in all of the circumstances of the case are best dealt with through the insolvency practitioner regulatory regime which can offer tougher penalties than the current legislative provisions. Legislation should therefore be amended to that effect and the Government work with the insolvency profession to introduce appropriate self-regulated standards of practice which would set out on a principal based approach requirements in relation to employee consultations.

Detailed Comments

11 We fully support the policy that there should be clear levels of protection for employees in order to avoid situations where unnecessary redundancies may be made or to mitigate the effects of redundancies where they cannot be avoided. We recognise that there are significant benefits to the economy and the wider society by ensuring the effects of redundancy are minimised where possible.

12 The effect of redundancies is felt most severely when a business is facing insolvency or has already moved into an insolvency process. At such times, the directors and insolvency practitioners often face complex and conflicting legislative requirements. These are enshrined in a landscape involving employment legislation, insolvency legislation, company law and case law.

13 Employment legislation makes little distinction between the requirements where redundancies are being undertaken where a company is insolvent and where redundancies may be envisaged as part of a solvent entity. It is this lack of distinction which in our view leads to many of the current tensions between employees and their representatives or trade unions and management and insolvency practitioners. Legislation creates an expectation gap which in many instances simply cannot be reconciled.

14 We believe that in the main, directors and insolvency practitioners act in the best interests of all stakeholders involved in an insolvent company situation. Constraints are applied through a mix of legislative and commercial considerations. It is a matter of policy for the Government to consider whether there is a need and desire to promote the interests of one stakeholder group over others and to then ensure that there is effective legislation to achieve that policy objective.

15 In an insolvent situation, the outcome of collective consultation is rarely about whether options exist to rescue the business. These will in most circumstances already have been investigated by management and insolvency professionals. It is unlikely that any significant unexplored options will be able to be identified through collective consultation. Collective consultation should therefore have a focus on ensuring that proposed redundancies do not have unintended consequences which would impact on the insolvency practitioner’s strategy or outcome.
16 Our detailed responses to the questions posed within the Call for Evidence are set out in Appendix 1

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Appendix 1 – Responses to questions posed in the Call for evidence

Current Practices

1) **What are the considerations undertaken when deciding whether or not to start consultation? How is this decided in practice where an employer is facing, or has moved into, insolvency? Please provide examples where possible.**

The considerations undertaken will partly depend upon whether the company has engaged specialist professional advisors prior to the company entering a formal insolvency process or whether the company has moved into a formal insolvency process without the ability to engage with professional advisors and in particular the insolvency practitioner who is appointed to the company.

Where an insolvency or restructuring professional has been engaged by the company prior to the company entering insolvency, factors which would normally be taken into account in deciding whether or not to commence employee consultation would include (which are not presented below in any particular order):

- Customer vulnerability
- Order book vulnerability
- Supplier vulnerability
- Employee vulnerability
- Management relationship with workforce
- Erosion of goodwill value
- Cashflow impact
- Adverse publicity
- Statutory responsibilities – in particular under employment legislation, Companies Act legislation and insolvency legislation
- Skill and resource availability to carry out consultation

Where the insolvency appointment has been made without prior engagement with the insolvency practitioner (for example where the insolvency appointment has been instigated by a creditor) then there is no opportunity to engage with the management team prior to the appointment of the IP in order to discuss the impact on employment. In these cases the IP will go in ‘blind’ and our members report that in the vast majority of cases the IP will have no funds available to pay wages. As a result there is little choice but to make redundancies with very little opportunity to consult meaningfully.

While the availability of cash is often the key driver, even where funds are available the IP will need to consider the best use of those funds. The IP has an obligation to act in a fair and reasonable manner to the general body of creditors as a whole and not to favour or prejudice one class of creditors over another. The consideration generally made by an IP is therefore whether the dividend payable to each class of creditor will be affected by undertaking a consultation exercise and if so by how much. This will be a combination of variance in asset realisation and variance in claims which will result from the decision to consult or not.
2) **How does meaningful consultation with a ‘view to reaching agreement’ work in practice? How does notification work in practice? Please provide examples where possible.**

A distinction requires to be made between situations where it is not possible because of the insolvency process to either undertake a consultation and those situations where it may be possible to undertake a consultation. Where the insolvency process is terminal for the employer (liquidation) then there is no possibility to enter into a consultation or reach any form of agreement with employees as the insolvency practitioner is under a duty to cease trading as soon as possible.

It would be our expectation in such circumstances that the IP would notify BIS of the proposed redundancies as soon as possible after appointment. Notification to employees will depend upon the number of employees, number of sites, etc. IPs will wherever possible attempt to gather employees together at the earliest opportunity to notify them of the situation. Due to practical necessity, this initially may be carried out verbally and then followed up with written confirmation once employee information has been gathered from the employer.

**Benefits**

3) **What do you understand to be the benefits of consultation and notification where an employer is facing, or has become insolvent? Please provide examples where possible. What further benefits do you think we could encourage?**

While in theory the purpose of a consultation is to ensure that the most appropriate ‘solution’ is identified and to allow employees an opportunity to test an employer’s proposals, where an insolvency or restructuring professional has been engaged by the company the experience of our members suggest that where consultation is carried out it is unlikely that any suggestions provided by employees will not already have been considered by the company and its professional advisors and deemed unsuitable or unworkable in comparison to the final proposition.

As a result the primary benefit of consultation is not actually about the consultation but about the time it affords employees to commence looking for alternative employment. In addition, there is also a benefit to employees in that they have a period of time to adjust and adapt to their new situation. That will encompass physical, mental and financial adaptation.

4) **In practice, what role do employees and employee representatives play in considering options to rescue the business and to help reduce and mitigate the impact of redundancies?**

It is likely that employees and employee representatives will have little input to considering options to rescue the business where the company is facing insolvency. In such situations, the company will already have engaged professional advisors who will have investigated all options available to the business and experience of our members suggests that where consultation has been undertaken then employees and employee representatives are unlikely to come up with options which have not already been considered and discounted.

Employees may be engaged where there may be the possibility for an employee/management buyout of the whole or part of the business. In such circumstances however the involvement is more as a potential purchaser than as employees.

Consultation can however play a useful role where the company must make redundancies in part by ensuring that the redundancies made are at an optimal level. This works particularly effectively for instance where there is a diverse skilled workforce to ensure that the correct skills are retained. Often discussions around the positions which can be made redundant will initially be held with senior management who may be removed from the detailed work environment. It is likely that the impact however is likely to be marginal and it is not the case that significant numbers of redundancies can be mitigated through consultation.
An example of whether this was effective was a software gaming company which entered administration but which was kept trading operationally but without software development being undertaken. While management had identified certain positions as being in relation to development work and therefore to be made redundant, as part of the consultation exercise carried out with employees it was identified that a small number of the positions were actually also required to fulfil operational functions and as a result some redundancies were not made.

**Facilitators**

5) **What factors, where present, best facilitate effective consultation when an employer is imminently facing, or has become insolvent? Please provide examples to illustrate this where possible.**

Effective consultation can be achieved where the following factors are present:

- adequate funding
- strong employee commitment to the employer
- minimal risk to supply chain ceasing
- minimal risk to customer abandonment

The availability of funding is an essential component of effective consultation. Without funding the Insolvency Practitioner faces competing interests in carrying out a consultation exercise and in depleting or severely risking asset recovery values. In order to facilitate an effective consultation there would often need to be a compelling argument to show that increased claims via employee tribunals would prejudice the return to other creditors. In the absence of adequate funding however it is impossible to retain employees for the consultation period.

Risks of employee disenfranchment, disruption to supply chain or stemming of customer sales/orders all require to be low as any disruption to production or loss in sales can render significant increased risk of business failure during the consultation period.

**Inhibitors**

6) **What factors, where present, act as inhibitors to starting consultation or notifying the Secretary when an employer is imminently facing, or has moved into an insolvency process? Please provide examples to illustrate this where possible.**

Consultation is often prevented from being carried out by:

- Lack of funding
- Risk of key employees being lost to other employers during consultation period
- Risk of supply chain disruption
- Risk of loss of customers/orders
- Ability of company/insolvency practitioner to comply with other legislative requirements during consultation period

One, or a combination of any of these factors, may have a significant impact on either the ability to rescue or save the business or on the ability to maximise returns for the creditors as a whole.

Often the company or insolvency practitioner is faced with one or more legislative requirements which will impact on the ability of the company or insolvency practitioner to carry out collective consultation.
Example

An insolvency practitioner could be appointed trustee in the bankruptcy of a partnership which ran several nightclubs and bars. Under licensing legislation, once the bankruptcy is awarded the premises licence required to sell alcohol ceases with immediate effect. The trustee is unable to continue operating the nightclubs and bars without the premises licence. Faced with the inability to operate the nightclub and bars the trustee is unable to pay employee wages during the consultation period and therefore will have no alternative but to make employees redundant without fulfilling the statutory consultation requirements.

In limited circumstance, it may be possible to notify the Secretary of State while not commencing consultations with employees. There is however a degree of reluctance to do so due to a perceived or actual risk of commercial confidence being breached which would then result in an increased risk of business failure. In addition, management will often not wish to notify the Secretary of State where insolvency is a real possibility as this is perceived to be an admission that insolvency is inevitable. In most SME businesses management will usually try and take every action possible in order to avoid insolvency.

Example

An engineering company employing 23 people was facing insolvency. The directors had engaged restructuring and corporate finance professionals for some time with a view to restructuring an unnecessarily complex group of companies, refinancing and allowing additional capital finance to be raised to purchase new equipment to make the engineering process more efficient. Due to a downturn in trade and other factors it was not possible to refinance. Other options such as a sale of the business as a going concern were also investigated.

During this period the company however began to experience significant cashflow difficulties with the insolvency of the company becoming inevitable. Talks were progressing with a potential purchaser of the business with the purchaser being aware that any sale would be under a distressed situation. More time was needed for the purchaser to complete some diligence but despite the advanced state of negotiations and the offer of additional security from the company director’s the bank was unwilling to extend the overdraft terms available to the company.

The employees were highly skilled and as was normal in that sector notice periods were only 1 week. It was anticipated that a significant number of them would find new employment relatively easily. By entering into a consultation period of 30 days there was a severe risk that many of the employees would find alternative employment and leave the company before the end of the consultation period. Without those employees there was no possibility of completing the sale of the business.

Again, typical of the sector there was no firm order book with orders being confirmed only days in advance of the work being scheduled. Work could easily be undertaken by competitors and therefore there was a strong risk that customers would no longer place work with the company once its financial situation was known in the marketplace.

While it was thought that insolvency was inevitable due to a lack of cashflow and an expectation that the potential purchaser would not be in a position to make a final decision quick enough, consultation was not commenced as the risk of employees leaving and customers withdrawing would have ended any possibility of a business sale. The company did eventually end up in liquidation as the purchaser could not proceed fast enough and virtually all employees found alternative employment within 2 weeks of being made redundant.
In addition, where it is possible that a going concern sale may be achieved the risk of redundancies being made and viewed under TUPE as not being for economic, technical or organisational (ETO) reasons presents a risk which will impact on negotiations with any potential purchaser. There may be significant advantages to the wider economy in creating within legislation a presumption that redundancies made by a company in an insolvency procedure are for ETO reasons unless shown otherwise, thereby removing a barrier to going concern sales and leading to a wider protection of employment.

7) What factors, where present, negatively impact upon the quality and effectiveness of consultation when an employer is facing insolvency, or has become insolvent? Please provide examples to illustrate this where possible.

The quality and effectiveness of consultation can be adversely affected by a fear of the consequences of failing to meet precisely the legislative requirements. These can be financial, reputational or operational consequences. Consequently, where consultation can be carried out the focus is often on getting the mechanics correct in order to minimise risks rather than on ensuring that consultation is effective and of appropriate quality.

Director's Role

8) Are advisors (accountants, HR professionals, or where an insolvency practitioner is acting as an advisor pre-insolvency) informing directors of their need to start consultation when there is the prospect of collective redundancies? How do directors respond to such advice?

Accountants and insolvency practitioners are likely to advise directors of the statutory requirements or advise that they obtain specific employment law advice when it is apparent that there is a prospect of collective redundancies.

While directors will often either seek further advice or acknowledge the statutory requirement, they will often balance that requirement with the competing requirements in insolvency legislation to act in the interests of the general body of creditors at a time when insolvency is likely to be unavoidable in making a decision on whether to notify employees and commence consultation. As noted in previous responses above, notice to employees would more than likely compromise the assets of the business, the viability of trading and any prospect of selling the business as a going concern. Given the much wider impact on customers, suppliers and employees who may be able to be retained as part of a going concern sale, it is understandable that directors may decide not to commence consultation at the earliest opportunity.

9) Are directors facing insolvency starting consultation, and notifying the Secretary of State, as soon as collective redundancies are proposed and at the latest when they first make contact with an insolvency practitioner? If not, how can this be encouraged?

No. See comments in response to Q8. Directors will often perceive commencing consultation as admitting that redundancies cannot be avoided when other options still remain open.

10) Normally are employee representatives already in place? What are the practicabilities of appointing employee representatives when no trade union representation is in place?

The majority of insolvencies are in relation to SME businesses where more often than not no trade union representation is in place. In such scenarios it is unlikely that there will be another mechanism already in place where employee representatives will be identified in place at the necessary time.
The process of electing employee representatives can be drawn out depending upon the business structure, number of sites, etc. In practical terms, even in a relatively straightforward business structure it can take a number of days to elect employee representatives. At the same time the insolvency practitioner will have a large number of other matters to deal with in order to take control of the business, protect assets and ensure that optimal conditions are present to maximise return for creditors or achieve a sale of the business as a going concern.

11) How does the hand over from directors to insolvency practitioners work when a company becomes insolvent in relation to engagement with employees?

The handover between directors and the appointed insolvency practitioner will be dependent on circumstances and the nature of an appointment. Where the appointment is creditor led then the involvement between the directors and the insolvency practitioner is likely to be minimal. Where an appointment is not ‘hostile’ then it is likely that there will be much greater opportunity for the directors and the insolvency practitioner to work together as part of the handover.

In all circumstances, the handover will involve:

- consideration of whether any employees can or are required to be retained immediately on appointment. This will involve an initial assessment of order book/WIP, funding availability, skills required to be retained, key employees with information or performing functions which will assist the insolvency practitioner, etc.
- how the employees are to be communicated with. This will include consideration of arrangements for multiple site locations, employees on holiday/sick leave, implications for employees based abroad, whether trade union representatives or other employee representatives are in place, etc.
- whether the directors wish to be involved in speaking with employees to communicate the background to what is happening.
- practical arrangements regarding obtaining payroll and HR data and any continued payroll operations necessary.

Process for Notification and Consultation

12) How might the process for notifying the Secretary of State and sharing information with third parties be improved?

Where an insolvency practitioner is appointed we would recommend that a simplified version of Form HR1 is required. Only 1 form should require to be completed and submitted for each entity rather than a separate form for each establishment. The form should be digitised and completed via a web portal.

There is also concern that an insolvency practitioner is prevented by the Data Protection Act 1998 from sharing employee information with agencies that may be able to assist employees with redundancy support. We would suggest that legislation is brought forward to specifically exempt insolvency practitioners from the Data Protection principles in providing employee details for the purpose of supporting and guiding employees through redundancy and finding alternative employment.
13) **Could the process requirements for consultation be further clarified or improved?**

The process for consultations takes insufficient account of time and financial pressures which exist in insolvency situations. While it is appropriate for some consultation to be carried out there should be a recognition that it is often impossible to consult for 30/45 days. Recognising that there is likely to be a benefit in consulting with employees, we consider that legislation should recognise the difference in situations between insolvency and non-insolvency situations in relation to collective consultation requirements. Insolvency practitioners appointed to an entity should be exempt from the current collective consultation requirements. We recognise that there may be difficulty in framing appropriate legislation to cover the wide spectrum of situations which an insolvency practitioner could be faced with. Collective consultation exercises in insolvency situations should be proportionate to the specific circumstances. We therefore recommend that if insolvency situations were exempted from collective consultations in legislation that this be enacted in conjunction with changes to the insolvency regulation regime through the introduction of a Statement of Insolvency Practice adopted by all Recognised Professional Bodies.

**Guidance**

14) **Would further guidance be helpful and if so, what should this cover, who should it be aimed at and how could it be marketed most effectively?**

We do not consider further guidance to be a priority.

**Incentives and disincentives**

15) **How can Government best incentivise or disincentives the behaviour of directors and insolvency practitioners to ensure that consultation and notification are conducted in a timely and effective way in insolvency situations?**

If there is a requirement to incentivise or disincentivise the behaviour of directors and insolvency practitioners this would suggest that there are currently barriers to collective consultation being carried out. It is our view that these barriers should be removed rather than expending resources on incentivising and disincentivising directors and insolvency practitioners.

The inherent conflict in legislation between employment law and insolvency law requires to be resolved as a matter of urgency. It is inequitable that directors and insolvency practitioners are put into a position whereby they have to choose which area of legislation to comply with in the knowledge that in doing so they are unable to comply with other legislative requirements.

We would encourage the Government to work with the insolvency profession to introduce an agreed standard of working practice which would enable consultation to be carried out in an effective manner. We consider that a principals based approach would work effectively as specific circumstances that present themselves in each situation will affect how effective consultation would look.
16) **What would most encourage constructive engagement by employees when in this situation? And do you have any suggestions for how employee representatives can best be supported?**

We consider that each individual situation is different and therefore it is difficult to set out matters which would encourage constructive engagement by employees. There will be situations where employees simply do not want to engage as they too also accept the company’s financial circumstances and that if appropriate professional advice has been sought then they are unlikely to be able to add to the process. In such situations the employees often do not wish to go through a statutory consultation period which only delays the inevitable.

Where collective consultation is to be carried out then we consider that employee representatives are unlikely to have relevant skills and experience to effectively contribute to a collective consultation. Their involvement could be better supported through access to specialist advice and assistance, possibly provided through government agencies such as PACE in Scotland or an extension to the service offered by the likes of ACAS.

17) **Do you have any examples of where constructive consultation and engagement has happened in an insolvency situation? If so, what was done and how?**

A software gaming company employing c270 persons entered administration with the decision taken to cease development work but retain the online gaming as operational. Management had identified certain positions as being in relation to development work and therefore to be made redundant, but as part of the consultation exercise carried out with employees it was identified that a small number of these positions were actually also required to fulfil operational functions due to their skill sets. As a result some redundancies were not made. The overall consultation period was less than 48 hours.

**Sanctions**

18) **The current sanctions against employers who fail to consult take the form of Protective Awards. Do you think these are proportionate, effective and dissuasive in the context of employers who are imminently facing, or have become insolvent? Is the situation different as it applies to directors and insolvency practitioners respectively?**

**Do you think that the current sanctions for failing to meet the notification requirements are proportionate, dissuasive and effective?**

We do not consider that Protective Awards are effective or dissuasive in insolvency situations but simply add to the complicated and conflicting requirements and considerations that insolvency practitioners and directors have to take into account in balancing all of the legal responsibilities.

Protective Awards may be effective and persuasive in non-insolvent situations to ensure that collective consultations are undertaken.

Similarly we do not believe that it is correct to criminalise the failure of an insolvency practitioner to notify on HR1 or carry out collective consultation where such notification or consultation is impractical. While we anticipate that prosecution in such circumstances may not be deemed to be in the public interest, this should be put beyond doubt in legislation in order to ensure that insolvency practitioners can operate without fear and risk of a criminal record when trying to assist in the rescue of a business which is failing through no fault of the insolvency practitioner. Such penalties are not proportionate, fair, or effective. By decriminalising such matters this will not reduce the effectiveness of potential sanction for any insolvency practitioner who may fail to notify or fail to consult in situations where this would be possible. Regulatory and disciplinary sanctions can be as effective or more effective in dealing with such behaviours. Regulatory financial penalties may indeed be more severe than the financial sanction of £5,000 provided for in legislation.
Memorandum of Understanding

19) How well is the memorandum of understanding between R3, Job Centre Plus and the Insolvency Service working?

The MoU is well understood within the insolvency profession. The effectiveness of support when called upon by insolvency practitioners is often met with varied degrees of success. We would encourage a more consistent approach throughout all regions.