

UK GOVERNMENT ANNOUNCES INSOLVENCY AND CORPORATE GOVERNANCE REFORMS

On 26 August 2018, the Department for Business, Energy & Industrial Strategy (BEIS) published a response to its March 2018 consultation on insolvency and corporate governance. BEIS launched that consultation, following a number of high profile company failures, to seek views on proposals to reduce the risk of major company failures occurring through poor governance or stewardship, and to strengthen the responsibilities of directors of companies which are in, or approaching, insolvency.

The response sets out BEIS' proposed actions, subject to further consultation where necessary on the detail. It will provide further details on the measures in the autumn. The proposals include:

Action to further strengthen the UK's corporate governance framework

- **Group structures.** BEIS will consider options to require groups to provide explanations of their corporate and subsidiary structures in order to bolster transparency. Options could include working with industry to improve guidance or introducing a requirement for corporate groups of a significant size to disclose an organogram of their corporate structures, along with an explanation of how corporate governance is maintained through the group.
- **Shareholder stewardship.** BEIS will identify means to incorporate stewardship within the mandates given to asset managers by asset owners and establish safe channels through which institutional investors can escalate concerns about the management of a company by its directors.
- **Dividend payments.** Following a significant number of responses criticising or suggesting improvements to the UK's dividend regime, BEIS will explore further whether a comprehensive review of the dividend regime is needed. BEIS will also take steps to ensure that shareholders of listed companies have an annual say on dividends, if the practice of companies avoiding an annual shareholder vote on dividends by only declaring interim dividends is widespread and

investor pressure proves insufficient to change this. The Investment Association will report on the prevalence of this practice. BEIS also states that it will legislate to require companies to disclose and explain their capital allocation decisions if investor pressure and new section 172 Companies Act 2006 reporting requirements do not deliver on this.

- **Improve boardroom effectiveness.** BEIS has invited ICSA to convene a group to identify further ways of improving the quality and effectiveness of board evaluations, including the development of a code of practice for external board evaluations.
- **Directors' training and guidance.** BEIS will bring forward proposals to strengthen access to training and guidance for directors (including raising awareness of their legal duties when making key decisions), and will consider whether some level of training should be mandatory for directors of large companies.

Action to improve the insolvency framework in cases of major failure

- **Selling subsidiaries in distress.** BEIS will legislate to put in place measures to ensure greater accountability of holding company directors when selling subsidiaries in distress as soon as parliamentary time permits. It firmly believes that holding company directors should consider whether a distressed subsidiary's stakeholders would be better off in an insolvency proceeding rather than pursuing the sale of the business. However, taking into account concerns raised, including that the new measures should not disincentivise rescues or unduly hold directors to account for the conduct of others over which they have no control, BEIS will limit the measures so that the legislation will:
 - not expose directors to liability or sanction if they had a reasonable belief, at the time of the sale, that the sale would likely deliver a no worse outcome for the subsidiary's stakeholders than placing the subsidiary into a formal insolvency;
 - not create a liquidator or administrator action for personal liability of a director, but will allow for the director to be disqualified;
 - only apply where the subsidiary enters into administration or liquidation within 12 months of the completion of the sale; and
 - only apply to sales of large subsidiary companies i.e. those which do not qualify as small or medium-sized under the Companies Act 2006.
- **Value extraction schemes.** BEIS will legislate as soon as parliamentary time permits to enhance existing recovery powers of insolvency practitioners to deal with value extraction schemes designed to remove value from a company at the expense of its creditors when the company is in financial distress. BEIS has acknowledged that this is a better approach than introducing a new power.
- **Investigation of directors of dissolved companies.** BEIS will legislate to give the Insolvency Service the necessary powers to investigate directors of dissolved companies where they are suspected of having acted in breach of their legal obligations. This measure responds to the calls for BEIS to act against the practice of

"phoenixing", where a company is dissolved and another is created soon after to avoid liabilities.

Action to increase protections for creditors, and achieve a fairer balance in insolvencies

The response also includes BEIS' response to the separate consultation published in 2016 on broader aspects of insolvency law. BEIS intends to legislate for a number of reforms, including the introduction of a new moratorium to help facilitate business rescues and the creation of a new restructuring plan that would include the ability to bind dissenting classes of creditors who vote against it. The reforms would also include the prohibition of enforcement by suppliers of termination clauses in supply contracts on the grounds that a party has entered a formal insolvency procedure, the new moratorium or the new restructuring plan to enable companies in financial distress to continue trading. BEIS has described the proposed package of reforms as being aimed at increasing creditor protection whilst striking a fair balance between the rights of the company seeking rescue and the rights of creditors seeking payment of debts.

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