Consultation on the Modernisation of Insolvency Law

INTRODUCTION

The Government's Island Plan has as one of its strategic objectives, the aim of building a strong and diverse economy[1].

> "Our vision is for a strong and diverse economy which is sustainable, ambitious and built on firm foundations to provide economic success, rewarding career opportunities and prosperity which positively impacts all residents of the Isle of Man.
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> Our vision will be successfully realised by:
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> SECURE
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> • Supporting and providing the right conditions for the development, diversification, growth and opportunity for the Island's economy and business sectors.
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> • Meeting or exceeding global standards and enhancing our reputation as an internationally responsible and increasingly sustainable jurisdiction.
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> • Ensuring supporting infrastructure is world class and provides a resilient and business friendly environment.
>
> VIBRANT
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> • Ensuring our Island is a place where people have opportunities to fulfil their potential.
>
> • Creating the environment for vibrant economies where everyone, including entrepreneurs can achieve and prosper, recognising the important role they play in making the Isle of Man an attractive place to live, work and invest.".

Keys to this diverse economy include the willingness of experienced people to set up businesses, and to take on financial risks in the hope of profit, and of the continuing success of existing businesses on the Island.

It is a fact of life that not all businesses succeed, and not all businesses carry on forever. Some businesses, whether large or small, either become insolvent or decide to cease trading.

Also the Island has long prospered by its reputation to provide international corporate structuring where credit protection plays a key driver in ensuring the Island remains a competitive jurisdiction amongst the international financial centres of the world. It is important, therefore, for the Island's economic and social well-being that Government ensures our insolvency law is effective, competitive and fit for purpose in the 21st century.

BACKGROUND

Insolvency law in the Island is located in a number of different pieces of law from the Companies Act 1931 to various laws relating to bankruptcy enacted in the 1800s, and the Preferential Payments Act in 1908. The law has been under review since at least 1994.

[1]Our Island Plan, GD 2022/0004, Page 10. Approved by Tynwald on 2nd February 2022.

Based on the fact that insolvencies and winding up proceedings continue as they have done since the various laws were enacted it may be concluded that our insolvency and bankruptcy laws are fit for purpose and do not require reform or improvement.

Government is aware, nevertheless, of a view amongst at least some of those involved in insolvency and bankruptcy proceedings in business, the legal profession and the courts that the law in this field would benefit from updating, if not wholesale reform, in at least some aspects.

There are two main grounds for this view. One ground is that in seeking to promote the Island as a suitable, indeed an excellent, place to do business in the 21st century it is impossible to avoid revealing that the main insolvency provisions are in the Companies Act 1931, and the bankruptcy provisions are in Acts dating back to the 1800s. It could either be argued that the Island has good law that has stood the test of time, or alternatively that its laws are based on English Victorian and Edwardian statute law, which at the very least give the impression of outdated legislation.

The second ground relates to the fact that society has changed, and indeed the way business is done has changed. Government believes the law ought to be modernised to reflect the 21st century, rather than the community of the 1930s or the 1800s. Also, to ensure the Island remains competitive as a jurisdiction of choice in which to do business, it is important that we are seen to be continuously evolving to create a pro-business and wider economic environment, which supports our other core businesses, to ensure we all prosper.

WHY CONSULT ON PROPOSALS FOR THE REFORM OF INSOLVENCY LEGISLATION NOW?

Government has been aware for a number of years that, whilst insolvency law has proved its worth, it would nevertheless benefit from review and modernisation.

In recent years the Treasury has embarked on a 3-phase project to review and reform the laws relating to the whole area of debt and debt recovery.

- Phase I resulted in the Administration of Justice and Other Amendments Act 2021, which makes provision to empower the publication of a publicly accessible register of debtors.
- Phases II and III, relate to the reform of insolvency and bankruptcy law and the law and functions relating to Coroners.

Following the General Election in September 2021, the formation of the new Government, and the approval of the Government's 'Our Island Plan' in February 2022, it is considered that the time is right, at this stage in the life of the Government, to seek views on overall policy and proposals for law reform.

You are invited, through this consultation document, to provide your views through the answers you may give to the questions. The answers you contribute will help to shape the form and content of insolvency law so that it is effective and meets the needs of our society in the 21st century.

BROAD POLICY QUESTIONS

"Creditor friendly" insolvency law?

To date, and in practice, the Island's insolvency law has sought to be creditor friendly. That is to say that, in any proceedings for an insolvent company, the priority has been to favour creditors, and in particular secured creditors. The latter, secured creditors, are typically financial institutions such as those that hold a real estate mortgage or otherwise have the right to keep possession of property belonging to another person until the debt owed by that person is discharged.

The key benefit of this policy has been to ensure the Island is attractive to investors, to banks and to the corporate finance sector, which is a key component of our economy. The use of Manx companies as vehicles through which lending is structured is a well-trod road. It has allowed us to remain competitive as an international financial centre of choice in which to conduct business, particularly with secured foreign held assets. This has provided income, and with it a vibrant and successful fiduciary and banking sector within the economy, creating many jobs[2] for the Island's residents.

The importance to these business creditors is the question of how easy it is to get their money back when a company they have been in business with fails. The benefits also apply to smaller businesses that wish to acquire funds in order to expand their business.

The potential risk of continuing with the current creditor friendly legislation is that companies that could otherwise have been saved with appropriate support go under needlessly, although there is little empirical evidence of this.

Question 1:

Is the risk to some outweighed by the benefits of lenders being attracted to, and having confidence in, the Island?

Question 2:

At what point should creditors have the upper hand (if any)?

[2]Over 9,000 people currently work in the financial and professional services sector.

"Creditor accessible" insolvency law?

The current insolvency regime set out in the Companies Act 1931 was established in a different era. It made provision for creditors to obtain monies owed via a process of Court application to wind up. It also provided for the appointment of an Official Receiver as short-term Provisional Liquidator, and the discovery of assets and liabilities (or early indication there are no realisable assets). Meetings of creditors and contributories would follow to decide, in light of the knowledge now available, the direction of the winding up, and the identity of their chosen Liquidator, with the result that assets are realised and distributed to creditors.

The effectiveness of the current regime, or aspects of it, and its fitness for 21st century use in the Island, has been a concern for some time. One of the issues is that the process is lengthy and success is not guaranteed, even if court and other processes are followed. The creditors applying to court for winding up must secure a willing candidate (and often make financial provision for) for the role of Provisional Liquidator deemed Official Receiver before they have any knowledge of the solvency of the debtor or the prospects of recovery of their original debt.

Government is aware of a concern that current insolvency law does not, in effect, protect all creditors, in that creditors are unwilling to commence proceedings when there they are unable to carry out any meaningful cost/benefit analysis of doing so.

On the other hand, current law offers (aside from reaching voluntary agreement with creditors) no protection for debtors either. The argument might be that whilst the debtor still owes money, greater provision could be made that would give the debtor a better opportunity to pay their debts.

Question 3:

Do you agree the Isle of Man should be a jurisdiction that continues to have primary regard to the interests of creditors?

If you have answered yes, please explain why you think it important to prioritise the interests of creditors.

If you have answered no, it would be helpful if you would explain why you do not agree, and say what alternative, in your view, insolvency system the Island should adopt?

"Debtor friendly" insolvency law?

A debtor-friendly jurisdiction would be one that provides an insolvent business with the best possible chances to restructure in order to survive. The law would provide for procedures that generally allow existing management to stay in place and give the business adequate time to draw up a restructuring plan. This is sometimes referred to as Company-friendly bankruptcy process or as fostering a "rescue culture".

The advantage of this kind of jurisdiction is that it may be possible to save some businesses that would otherwise go under, and it could mean that employees do not lose their jobs. Furthermore, if people can be kept in employment then there is reduced call on the public finances in terms of unemployment and other benefits.

The disadvantages of a debtor-friendly jurisdiction are that it can mean that some businesses are kept going when there is no realistic prospect of the business actually becoming viable, and may mean that creditors are unable get their money back. This may ultimately mean people would be reluctant to provide credit to a company based on the Isle of Man with the consequent risk the Island ceases, in practical terms, to be an attractive place in which to do business because, in order to expand or indeed to start up, businesses often require funds.

Question 4:

If you answered no to Question 3, do you think the Isle of Man should change its focus and instead become a jurisdiction that has primary regard to the interests of debtors?

If you have answered yes, please explain why you think it important to prioritise the interests of debtors.

If you have answered no, it would be helpful if you would explain why you do not agree, and say what alternative insolvency system the Island should adopt?

The Challenge and the Opportunity

The central principle in Our Island Plan is that "Our culture should be one of People First"[3]. This begs the question: in terms of insolvency law and practice, who are the people affected by insolvency law? Or put another way, what is the best means to achieve a regime that works for insolvent companies, a diverse range of creditors from large corporate entities to medium and small enterprises, micro-businesses and individuals on the one hand, and yet also has room for compassion sufficient to empower those who get into debt to find a way out of debt to the benefit of themselves and those to whom they owe money?

Government wishes to rewrite insolvency law so it works for all in our society, so everyone feels their interests are being taken into account. Government is seeking a model that charts a course between big commercial and international financial organisations and local trading companies. Creditors have a right to expect that they will, in due and proper time, receive the monies that belong to them, as far as is possible. Government recognises that some people may get into debt, and wishes to explore ways to make provision that enables ordinary people to get out of debt and pay their dues.

Question 5:

Is there a "third way", an "Island friendly" way, that meets the concerns of creditors, who want to be sure they will get their money back, and those who have got into debt and who wish to clear their debts?

Your views would be helpful. You may feel that a jurisdiction has to be either creditor friendly or debtor friendly. If you do, it would be useful to know why you feel the Island cannot be open to both in the community.

[3]Op.Cit, p5

POLICY AND PROPOSALS FOR A BILL

Key objectives of reform –

- Create a consolidated body of modern law that takes into account the diverse needs of the community of the Isle of Man;
- Separate insolvency legislation from companies legislation;
- Cut out unnecessary red tape;
- Remove uncertainty where it exists;
- Make insolvency and bankruptcy law user friendly, including employing modern language.

In considering what is required in terms of fresh legislation, Treasury has engaged over a period of time with a working group of those involved in insolvency matters in collaboration with the Isle of Man Finance Agency of the Department for Enterprise. In broad terms the following proposals were considered in principle as items that should be incorporated in an Insolvency Bill.

- Whether or not to make provision for the receivership of companies. Receivership is a method by which a secured creditor can enforce the security against specific assets of the company. There are a number of options. One option could be that no provision should be made for the receivership of companies. Another option could be that a subsequent Bill should make some provision, but only for "simple" receiverships. The third option would provide for administrative receiverships. Administrative receiverships are a remedy available only to a secured creditor of a limited company or a PLC, who has a floating charge over the company's assets and a fixed or floating security over all, or substantially all, of those assets. The security is usually in the form of a debenture with contractual receivership provisions. Although normally conducted without court assistance, a power to apply to the court for directions in relation to the conduct of the receivership could be included in the Bill.

  Question 6:

  Do you believe administrative receiverships should be available in certain circumstances?

  If you do believe administrative receiverships should be available, please explain why and outline the appropriate circumstances.

  Question 7:

  If you do not believe administrative receiverships should be available please explain why, and suggest what alternative provision (if any) you think ought to be made in terms of receivership.

  If you believe there should be provision, but only for "simple" receiverships, please define "simple".

- It would be proposed to include provisions, which are applicable in relation to both liquidations (of companies) and bankruptcies (of individuals). These could include statutory set-off provisions, which would take effect at the commencement of the liquidation or bankruptcy (as the case may be). There would be strict mutuality of dealings requirements. Whilst insolvency set-off is otherwise automatic and mandatory, provision could be made for a creditor to be able to waive the benefit of the set-off, except to the extent that this would prejudice another creditor.

- A significant part of the proposed Bill would deal with the liquidation of companies. A company may be put into liquidation either voluntarily or by the court. If the company is solvent at the time the liquidator is appointed (and remains solvent), the company goes into "members' voluntary liquidation" (or "a members' voluntary winding up"). If the company is insolvent it may go into "creditors' voluntary liquidation" (or a creditors' voluntary winding up"). Unfortunately, creditors will lose money. However, the "voluntary" process attracts a more streamlined and, potentially, faster liquidation process, as well as being the less costly form of liquidation than a court liquidation. Additionally, such a company in voluntary liquidation has greater scope as to who may act as its liquidator. In all other cases, only eligible insolvency practitioners (or the Official Receiver, if appointed) may act as liquidators. This would present current law in this matter in modern form.
- A part of the proposed Bill would specify certain transactions, which are voidable in the event of a liquidation. There would be four types of such transaction: unfair preferences, undervalue transactions, voidable floating charges and extortionate credit transactions. These must have been entered into within the relevant "vulnerability period", which is measured backwards to the onset of insolvency. This would be an important part of the Bill as it would increase the powers of the liquidator in challenging situations, and increase the likelihood of recovery for the benefit of unsecured creditors.
- Provisions dealing with malpractice in connection with a liquidation ought, Treasury believes, to be included as a part of the proposed Bill. This would include the power for the liquidator (and others) to take proceedings covering, essentially, misfeasance (i.e. performing a lawful action in an improper fashion or an improper/corrupt motive), fraudulent trading and wrongful trading. Wrongful trading is a concept that would be new to Manx law.
- General provisions about companies, which are insolvent or in liquidation, including provisions about statements of affairs and examination, before the court, should, it is suggested, be included within the proposed legislation. These provisions would re-enact current law in modern form.
- Another set of provisions in any proposed Bill would be concerned with making modern provision for the bankruptcy of individuals. Only the official receiver or an eligible insolvency practitioner may be permitted to act as bankruptcy trustee. Bankruptcy would be subject to the control of the court. In relation to bankrupts, Treasury is considering introducing new provision for the automatic discharge of bankrupts (unless ineligible for any reason) after 3 years.

Question 8:

Do you have any views in relation to –

(a) the concept of the automatic discharge of bankrupts, unless circumstances dictate otherwise, and

(b) the period – 3 years is suggested?

- Provision must be made for certain bankruptcy offences. These include non-disclosure, concealing assets, falsifying documents and making false statements. This is considered important in terms of increasing the powers of a Trustee in Bankruptcy to challenge the conduct of a bankrupt.
- A Part would specify certain transactions, which would be voidable in the event of a bankruptcy. It is proposed these would include unfair preferences, undervalue

transactions, voidable assignments of book debts and extortionate credit transactions. In this way it would be intended to increase the power of the Trustee in Bankruptcy to recover the assets of a bankrupt for the benefit of the creditors.

- This Part would make certain general provisions about insolvency proceedings, including the establishment of a creditors' committee and the remuneration of liquidators and bankruptcy trustees. This would modernise current law in this area.
- There has been some debate as to whether or not there is a need to provide for the licensing of insolvency practitioners in the Island.

Question 9:

Do you think there should be a list of recognised (licensed?) insolvency practitioners?

- If you think there should be a list, what do you think the requirements for inclusion on the list ought to be (qualification based? Or requirements met by regulatory means?)? Considerable discussion has taken place with practitioners and with other parts of Government concerning whether or not there is a need in the Isle of Man for the position and role of Official Receiver. There has been provision in the Companies Act 1931 for the appointment of an Official Receiver, and there was a person who fulfilled the role until retirement in 1950. Treasury is aware of a variety of views including the fact the Island seems to have coped without an Official Receiver since 1950, and the question of how the official Receiver might be funded. Views in favour of providing for the active role of an Official Receiver are the idea that such a person could offer a degree of independence from executive Government, be able to exercise some oversight and control of liquidations that might ensure greater value for money, and may be able to take a greater role in calling to account poor practice, not least on the part of directors, that has resulted in a liquidation.

Question 10:

Do you agree there should continue to be provision for the appointment of an Official Receiver?

If you do agree with provision for an Official Receiver, please offer your suggestions as to how that person should be appointed (including the appropriate qualifications you think are required), funded and in which Department or Office of Government that person should be located.

- If you do not agree, please explain why and suggest your preferred alternative. Another matter on which views are sought is the order of preferences for payment in insolvency, bankruptcy or other debt related proceedings. Currently the order of priority is set out in section 3 of the Preferential Payments Act 1908 (as confirmed by reference in section 249 of the Companies Act 1931). The current preferences are to ensure money owed to the State, on behalf of the taxpayer, are paid off first. The money owed to Government contributes towards the provision of public services, which we may all access.

Question 11:

Do you think the order of priorities for the payment of debts is correct?

If you think the priorities for the payment of debts ought to be varied, please specify in what way and why you think your alternative order of priorities would be fairer than currently applies.

- The Bill would include numerous repeals, including the repeal of all insolvency related provisions from the Companies Act 1931, the Bankruptcy Act 1988, the Bankruptcy Code 1892, the Bankruptcy Code Amendment Act 1903, and the Bankruptcy Procedure Act 1892. The Preferential Payments Act 1908, the Preferential Payments and Other Acts (Financial Adjustments) Act 1973, and various other Acts will need to be amended in whole or in part.

The main focus so far has been on insolvency law, bankruptcy, and business. This next section invites your views on what provision, if any, you think should be made for individual/ordinary (i.e. non-business) debtors.

The individual and debt resolution

Whilst the main focus of this consultation exercise has been on business insolvency and bankruptcy, the Government's Our Island Plan sets out in its Principles for One Government the key principle of "one Government" within a culture of "People First"[4].

This means not just building a strong and diverse economy focussing solely on the business community, important (indeed essential) though that is, but also building great communities and securing an Island of health and wellbeing within which individuals can thrive and contribute to community life. As noted in the Plan "There is a fundamental link between our economic success and our health and wellbeing."[5]. Debt is an issue that affects us all, whether directly or by virtue of the fact there are people in our community who need help to manage their debts and other people who are owed money.

The Island's personal bankruptcy legislation was established (as noted earlier) in the 19th century. Since that time, access to borrowing for the ordinary citizen has changed out of all recognition. In parallel with this expansion in the supply of credit there has been a normalisation of its use. Whilst this has benefited many, and forms part of the way we conduct our lives, it does carry with it the risk of credit being stretched, and individuals getting into debt.

Government is concerned to explore ways, in terms of legislative provision, by which Manx residents may be supported so they are able to address personal debt situations. Indeed, it is possible to see an argument that provision for a more debtor-friendly regime specifically for Manx residents who get into relatively small amounts of debt is justifiable on grounds of supporting particularly the mental health and well-being of citizens. The argument goes further in that it is important to make provision to support the individual debtor not just for that person's well-being but also for their friends and families who may also be affected by the citizen's predicament.

Government is aware of the following provision in the UK –

i. Debt Relief Orders (DRO) relate to those who owe less than £30,000, do not have much spare income and do not own a home. Creditors are restricted from recovering their money as they need the court's permission, and the person may be discharged from their debts after 12 months.

   The holder of a DRO would still have to pay:

   - rent and bills;
   - certain debts, such as student loans, court fines, etc.

   DROs could be cancelled if:

   - the person's finances improve; or

[4]GD 2022/0004, page 5.
[5]Page 8.

- the person fails to co-operate with the Official Receiver (or other person appointed for this purpose in the Island) – for example if the person does not provide the required information.

If the person went on to get into further or new debt after the approval of the DRO, the following could occur:

- bankruptcy (with or without any prospect of discharge);
- the person could be prosecuted if the new creditors are not informed about the DRO.

The DRO would be included on a register, and would be removed 3 months after the DRO ends. However, the DRO will be entered on the public debt register for 6 years.

ii. Breathing Space (Debt Respite Scheme), which enables a person to get temporary **protection from creditors** whilst the person obtains debt advice and make a plan to get out of debt. The breathing space lasts up to 60 days but the person must still make debt repayments.

If Breathing Space is granted then:

- a person is protected from enforcement action (during the period);
- creditors cannot contact the person about the debts included in the breathing space, and
- interest or charges may not be added to the person's debt.

A UK-type Debt Respite Scheme would provide for a person receiving mental health crisis treatment to get extra protection from creditors lasting for the length of the treatment + 30 days.

Question 12:

Do you think the Island should adopt some form of provision for ordinary debtors such as those suggested above?

If you agree, do you think the Debt Relief Order, and/or the Breathing Space (Debt Respite Scheme) (or Manx variations) would be appropriate in the Isle of Man?

If you do not favour either or both of these suggested provisions, please explain why.

Question 13:

Following on from Question 12, if you favour debt provision but not the UK model, what model, and from which country, do you think would work better for us in the Isle of Man?

Please explain why you think the model you have suggested would be better suited to the Isle of Man than the UK model. Your explanation could help us to frame more appropriate provision.

Question 14:

Views on other issues

Do you have any other views that you feel would assist Government in improving our current legal provision in the Island in relation to insolvency or bankruptcy law, or provisions for debtors and creditors in general?