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ECA & BESA response to the consultation on *Insolvency and corporate governance*

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ECA and the BESA welcome the opportunity to respond to this consultation. We jointly represent the interests of over 4,000 businesses covering a broad range of engineering, design, installation and facilities management activity, including electrical, heating, plumbing, energy management, micro-generation, ductwork, ventilation, fire and security, and wireless systems. These works not only form a key part of the UK construction, maintenance and facilities management services supply chain, but they form 40% of sector turnover (£10bn).

Summary of main points:

- The corporate veil, i.e. separation of personal assets and liabilities and corporate assets and liabilities, is a fundamental part of UK corporate philosophy and should remain at the heart of the UK regulatory framework which forms the basis of the UK being a stable and strong corporate environment. Inevitably, circumstances occur and decisions are made, which do not always lead to corporate success. This is an important part of a competitive and entrepreneurial economy.
- However, in order for the UK to remain open, fair and attractive, in the long term, and to ensure the actions of a few businesses do not undermine the reputation of British business generally, the regulatory framework also needs to guard against corporate behaviour in large companies by:
    a) limiting where a distressed or failed company might take decisions or actions which unfairly impact on creditors; and,
    b) helping to prevent irresponsible decisions being taken by directors (and investors) which are more likely to lead a business into distress.
- ECA and BESA would, in pursuance of strengthening corporate governance in pre-insolvency situations, therefore recommend the following in order to create and encourage greater openness, fairness and integrity within the UK corporate landscape:
    - A continuation of the Government’s work to improve, integrate and ensure collaboration on the flow of payment through complex supply chains and a focus on ensuring the many initiatives and regulations implemented to date (Small Business Commissioner, Prompt Payment Code, Construction Supply Chain Payment Charter, Project Bank Accounts, Public Contracts Regulations, Late Payment regulations, Mystery Shopper, Contracts Finder/G Cloud/Crown Market Place) are complied with or integrated and utilised by public sector buyers and suppliers to a far greater extent than is currently the case.
    - In order to encourage a corporate culture within the UK of integrity, growth and prosperity, measures should be implemented to ensure that liabilities/debts/revenue not yet certified (money owed or retained from others) is not able to be presented as an asset, as opposed to a liability or unrealised asset, which by its nature gives a false and misleading picture as to the health of a company.
    - To embed a corporate culture within the UK of integrity, growth and prosperity, measures should be implemented to strengthen the law which specifies that money cannot be extracted from the company where it does not have adequate working capital to meet its liabilities. Working capital should not be able to be extracted through dividend, unless and until a company can demonstrate that it has and will continue to have, post dividend, sufficient working capital to meet its liabilities on an ongoing basis.
    - Currently, money owed to suppliers on a company’s balance sheet at any given moment may be counted towards a company’s working capital. This provides a misleading picture of a company’s financial integrity and thought could be given as to how such funds are readily differentiated and identifiable in some way.

  - We should ensure the purpose of the corporate veil, i.e. separation of personal assets and liabilities and corporate assets and liabilities, is preserved as a fundamental part of UK corporate philosophy as this is an important part of an innovative, competitive and entrepreneurial economy. For this reason, the measures we recommend to tackle the disease of negligent or reckless corporate behaviour (strengthening corporate governance in pre-insolvency situations) should apply to those companies which qualify as 'large'. This will ensure these measures are targeted at those businesses which are most likely to have a profound, adverse and negative impact on the wider economy through failure due to a culture which unduly prioritises profit over stability, growth and investment.
  - Accountancy and insolvency rules should be reviewed to limit the ease of 'pre-packed insolvency', whereby the new corporate officers (including shadow officers and persons with significant control/influence) and entity take on the assets and people from the failed business, while discarding the debts and liabilities to others in the wider economy.
  - We therefore also support the introduction of tough measures where decisions are knowingly taken to restructure or dispose of a company where the direct consequence of that transaction is that it will cause harm to stakeholders, such as the supply chain.

- Linked to this, is the issue of retentions – on which the Government has recently consulted and which was crystalised with Carillion's failure. Retentions are monies (usually 5% of the contract value) withheld from payments which are due in respect of goods/materials and labour already supplied by the paying party and held on trust for the supplier until such time as agreed dates expire. At present, despite their status as monies held by the paying party on implied trust for the supplier, the monies are usually held in the same account as ordinary working capital, i.e. they are not readily identifiable or segregated as funds. As such, they are not only open to abuse (delayed or withheld payment), but they are also at high risk of being compromised by the insolvency process due to the failure to segregate and identify the monies as held on trust. The Government should legislate for a system whereby these funds are independently held in order that both payer and the supplier have mutual security over the retention monies pending their release.

Sales of Businesses in Distress

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

Yes – If the UK is to be a prosperous, stable place to start and grow a business, Government should look to introduce measures which embed integrity into the corporate landscape.

The UK has a number of areas of commerce in which large corporate groups exist and whose success in delivery of product and/or services is predicated on their disproportionately fragmented and disaggregated supply chains. The large corporate business usually comprises a number of corporate delivery vehicles designed to fragment and ring-fence liability as a method of ensuring divisional commercial problems do not infect other parts of the corporate group. However, there is currently no protection in that context to guard against reckless decisions made within the corporate group, to the detriment of subsidiary stakeholders, regarding those divisional problems (specifically where subsidiary stakeholders will obviously be harmed as unsecured stakeholders even though that harm is reasonably foreseeable at the time of the sale).

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

Yes (to the first question) – New measures should extend to acts procured by the parent (through its directors), which operates to the prejudice of the creditors of the subsidiary once that subsidiary is insolvent. For the avoidance of doubt, this should include acts taken by the parent company which could knowingly limit the ability of a subsidiary to continue to trade and pay current or foreseeable debts.

This issue is simply about clarity – by extending the nature of the current duties to act in the best interests of the company (undefined), to which all corporate officers are subject through the use of criteria and prioritisation of criteria to be considered, Government will be giving much greater certainty to shareholders, corporate officers and suppliers alike, as to what the regulatory expectations are in how they will conduct the affairs of the business.

Coupling this clarity with a punitive sanction for not acting in accordance with the duty by reasonably foreseeing the impact of decisions on wider stakeholders, or stakeholders of the subsidiary company, will ensure the duty carries the necessary weight required in order to make a difference and introduce positive behavioural change.

Last, if new measures are not put in place in such situations, the directors of the subsidiary will argue that their scope for avoiding insolvency and harm to stakeholders like suppliers is reduced by their primary duty of having to prioritise the ability of the subsidiary company to survive/ recover and to protect shareholder investments.

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

   The targets should primarily be the subsidiary company for any adverse consequences of its trading. However, the targets should be prioritised as follows:

   a) The corporate officers of that company should be held responsible under the legislative duties for the consequences of their actions if found to be acting negligently or recklessly contributing to the **prejudice of the creditors of the subsidiary once that subsidiary is insolvent**.

   b) This should be coupled with confirmation that corporate officers will not have fulfilled their duties to act in the best interest of a company where they negligently or recklessly act or fail to act in a way which both considers and takes reasonable steps to minimise any adverse impact of their actions or inactions on the company's stakeholders.

   c) Parent company board directors – simply by virtue of being corporate officers of the subsidiary and having a view of what is in the best interest of the subsidiary which is compromised by the need to prioritise what is in the best interests of the parent company – need to fall within the scope of being targeted. They also need confirmation that the best interest of the company is to be interpreted as including the interests of creditors of the subsidiary should that subsidiary become insolvent.

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

   We agree that the bullet point criteria on page 10 are well designed to exempt 'honest' situations – that "at the time the decision to sell the company was made, the director would not have reasonably believed the sale would lead to a better outcome for those creditors than placing it into administration or liquidation".

   As per the points noted in our summary, the purpose of the corporate veil is to allow for honest mistakes and there are some sales which will, with hindsight, look like poor decisions. The aim should not be to limit this, or punish people who make judgments on the best information available; rather the focus should be on decisions which negligently, recklessly or knowingly are likely to deprive stakeholders of monies they are owed.

Value extraction scheme

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

   Yes – Recent events (for example, Carillion) have illustrated that antecedent recovery powers do not adequately cover investment schemes or transactions (such as a company being 'rescued' by investors who then extract value to return at least part of their investment through management fees, excessive interest or loans, excessive pay, property charges, and sale and leasebacks). We therefore agree powers need to be in place to allow insolvency practitioners to tackle this. Such activity could reasonably be seen to put other creditors in a worse position in terms of recovering their monies and insolvency practitioners should, in light of their independent nature and duty to the courts, be under a similarly clarified duty to ensure that their actions do not directly or indirectly compromise the interests of wider corporate stakeholders such as creditors within the supply chain.

We suggest that the 'look back period' of only six months where there is no connection with the debtor company – a trade supplier with no common directors/owners with the debtor company is inadequate to give unsecured company stakeholders within the supply chain adequate comfort or protection from value extraction schemes.

We would welcome insolvency practitioners having new antecedent powers to disclaim preferential security put in place within a year prior to insolvency and commensurate claw-back powers to challenge value extraction schemes and recover monies paid in preference to those creditors. This would better enable insolvency office-holders to tackle complex transactions that strip companies of their value prior to an insolvency, or place certain parties in an unfairly advantageous position when assets are distributed after a company has become insolvent.

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

Yes – However, we believe that value extraction schemes are not limited to schemes where companies have received new investment. If Government is to have a significant impact in tackling reckless or negligent corporate behaviour which has a demonstrable adverse impact on wider corporate stakeholders such as the supply chain, this must be addressed.

We believe a combination of the insolvency test coupled with the test of the behaviour having unfairly put the beneficiary in a better position than other creditors in a subsequent formal insolvency (liquidation/administration) than would otherwise have been the case, would be the most effective way to tackle the problem of value extraction schemes which promote negligent corporate behaviour to the detriment of wider corporate stakeholders, such as the supply chain creditors.

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

No - The Government's recommendations on page 15 seem appropriate and sensitive to the fact that we do not want to discourage investment which could save struggling businesses. Whilst it is clearly important not to jeopardise legitimate recovery schemes, the proposal for insolvency office-holders to have new powers to enable more complex transactions to be better scrutinised should not simply be limited to those transactions whereby value has been invested in simple pecuniary terms, allowing for a fairer distribution of a company's assets to be made when a company fails. This would be more equitable and will limit the negative impact upon the wider economy, in terms of depriving jobs, training, investment and growth.

Greater transparency provided to creditors regarding the purchase and subsequent investment plans could serve as a preliminary protection to investors – such plans should be lodged with Companies House and be a matter of public record. It should also mean that it does not limit responsible investment, only irresponsible investment.

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

We would suggest that Government should lead by defining what excessive and unfair means through the provision of ratio tests, i.e. tests which require the value extraction transaction to fairly balance:

a) the prospects of the transaction to enable recovery whilst protecting investors,

against;

b) the risk that if recovery is unsuccessful:
(i) connected persons will be preferred within the insolvency process to the detriment of pre-existing and future unsecured creditors, and,
(ii) pre-existing unsecured creditors will have had their exposure unreasonably increased as a result of the value extraction system.

A robust option would be to provide creditors with an opportunity to consent to the deal or object to the sale/purchase on the grounds that "creditors are being disadvantaged more than is commercially reasonable" in any rescue deal, to quote the consultation document (page 17) – this would need to be supported by an expeditious court declaration that the challenge is legitimate and that the creditors are, on a balance of probabilities, being disadvantaged more than is commercially reasonable. Additionally, if the sale goes through, any deviation from the consented plans which negatively impacted on creditors to a significant extent could be subject to challenge in any subsequent insolvency by the insolvency practitioner.

Dissolved companies

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

Yes – We support a change to the scope of the current investigation and enforcement regime to extend to include former directors of dissolved companies. While we should allow honest mistakes as part of an entrepreneurial economy, and for a trader to resume his/her profession in running a new business, the new provision will help deter and make it easier for the Insolvency Service to review cases where there are issues of wrong-doing. For example, where a corporate officer negligently, knowingly or recklessly uses the dissolution of a company as a mechanism to avoid the stigma or scrutiny of the insolvency system.

We would suggest that the consultation partly holds the answer to this issue in highlighting that there is no requirement for an office holder's report where a company is in dissolution rather than insolvency. If such a report were a mandatory requirement, it could be required to outline the nature of the dissolution and the reasons for the same. This would in turn allow the insolvency service to collect data on dissolutions through Companies House which would over time highlight both trends and irregularities (specifically where individuals or connected persons are involved).

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

Yes – However, we would seek clarification on what is meant by 'in the public interest' or else the scope for involvement, monitoring and enforcement action will be severely limited to those large companies which have a higher public profile and where the economic case for prosecution is well made. Otherwise, we would suggest the requirement for action to be 'in the public interest' is removed to ensure the ability of the Secretary of State is unfettered and is allowed to scrutinise behaviour in cases which do not simply have high profile and/or a public sector dimension.

More broadly, we recommend that the ease of 'pre-pack insolvency' needs to be reviewed – the new entity takes on the assets and people from the failed business, while leaving the debt – we would support a strengthening of the accountancy rules or insolvency regime which might make this harder to achieve. Businesses who owe creditors significant debts compared to assets and working capital can less easily threaten this 'phoenix' course of action as a means of commercial leverage (in return for a part write-off of debt) – or indeed go ahead with it as a means of writing-off problematic contracts, long term liabilities (pensions), negative trading positions etc.

Strengthening Corporate Governance in Pre-Insolvency

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

Yes - As we have noted, the primary duty of a director or corporate officer is to act in the best interests of the company, whilst in small to medium size businesses this duty can be fairly obvious and clear, in more complex group structures, this is often subjective and has little clarity over how the duty should be considered and construed. This leaves the individual to his/her discretion in the hope that they act with integrity, fairness and professionalism.

In more complex group structures, corporate decisions as to what is in the best interests of the company concerned, are often defined, by what is in the best interests of the parent. In this way, the decisions and health of a parent company can directly negatively affect the subsidiary business. Inter-group transactions, where assets are transferred from the subsidiary business in question to other parts of the group or sold, should be notified to the subsidiary's suppliers as this will have a direct impact on the trading position/credit rating and stability of the relationships in place.

In addition to the proposal where we have outlined above that 'large' companies and businesses should be required to ensure they maintain sufficient assets and working capital to meet their current and ongoing liabilities, measures should also be in place to ensure that where a company is not 'large', but is a constituent part of a group structure, it similarly should have to prove that it has sufficient assets and working capital to meet its current and ongoing liabilities. This would ensure that inter-group transfers cannot be implemented solely with the purpose of reducing the loss to the group where a subsidiary is likely to become insolvent.

It would also ensure that fragmented groups are not created in order to circumvent compliance with regulatory measures put in place to deal with large companies.

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

The options for reform laid out in the consultation document on page 27 seem sensible and we support those. Others will have more detailed comments, but in the absence of legislation the Financial Reporting Council's Stewardship Code and obligations placed upon listed companies must be robust in requiring shareholders to demonstrate a level of satisfaction that the directors and other officers of the company have taken reasonable steps to demonstrate sustainable compliance with their duty under section 172 of the Companies Act 2006 to have regard to employee interests, good relations with suppliers and customers and other matters. We suggest that this could be centered on ensuring there is a clear definition of what working capital is required before profit can be withdrawn through dividend.

This is because we believe the UK has a high instance of 'phoenix' trading and that there are insufficient measures within the laws which specify that money cannot be extracted from the company where it does not have adequate working capital to meet its liabilities. Working capital should not be able to be extracted through dividend, unless and until a company can demonstrate that it has and will continue to have, post dividend, sufficient working capital to meet its liabilities on an ongoing basis.

Availability and transparency of public data is important (such as mandatory payment reporting for large companies together with an account of the residual liability the company carries for interest that it will owe on monies overdue). This would enable investors to have a range of information to understand a company's performance and level of liabilities, as well as its ethos and trading culture.

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

There should be limitations on money being extracted from a company, such as in the form of a dividend, where it does not have adequate working capital to satisfy its current liabilities (including trade debts, pensions, tax and employee liabilities). To achieve this, it will be critical to implement measures to ensure that liabilities (monies owed to or retained from others) are not able to be counted as an asset which would give a false picture as to the financial health of a company.

We appreciate that page 28 of the consultation states:

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

However, we believe the UK has a high instance of 'phoenix' trading and that there are insufficient measures within the laws which specify that money cannot be extracted from the company where it does not have adequate working capital to meet its liabilities.

Fundamental to wider economic growth and stability, working capital should not be able to be extracted through dividend, unless and until a company can demonstrate that it has and will continue to have, post dividend, sufficient working capital to meet its liabilities on an ongoing basis.

Clearly the definition of "distributable profits" is no longer 'fit for purpose' and this should be made sufficiently robust so as to allow scrutiny. Decisions taken by companies on how to allocate capital as between competing demands of investment in R&D, human capital, skills, media/marketing/communications etc, at a high level could be set as part of an annual return requirement for 'large' companies to allow shareholders and other investors transparency over the long-term sustainability of the company or group.

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

Professional advice should support a director in best discharging his/her duty. Yet, professional advice may not always enable a director to reach the right outcome. Carillion is well-publicised case in point. Amendment to the legislative duties around this issue should be made to confirm that the overarching responsibility remains with the director regardless of what reliance they place on third party professional advice. This, coupled with guidance issued to confirm how directors should; engage, brief and analysed professional advice, would help to alleviate confusion in this area. As the consultation points out, there is also clearly a need for directors to be aware of the difference in duties owed under regulation and those owed to them by their professional advisers – ultimately directors need to understand that, because of their invasive and wider knowledge of the company or group, procuring third party advice does not re-insure them in their capacity as directors against fulfillment of their duties.

We would suggest there is a need for the duty of directors in section 172 under the Companies Act 2006 to be more explicit on the circumstances when professional and objective advice may be or is needed to ensure compliance. Government will want this to become a ’normalised’ route for directors to ensure they have hedged the risk of their own negligence through the procurement of independent expert advice, verifying the director’s decisions and prospective steps.

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

We would recommend that the level of ring-fenced money (known as the “prescribed part”) set out in the Insolvency Act 1986 (Prescribed Part) Order 2003 should be specified at a percentage relevant to the amount of debt/liability the company carries. This would more sensibly and strategically ensure that in the event of insolvency, unsecured supply chain creditors as a class (who rarely recover more than 6 pence back in every pound owed) are not unfairly compromised to the preference of secured creditors.

It also is important to note the duty to report on payment referred to in the consultation has four fundamental weaknesses:

a) the reporting does not differentiate between purchase ledger and supply chain ledger payments. In other words, small high volume instantaneous transactions such as card based expenses are not differentiated from supply chain payments made on the basis of agreements which incorporate delayed payment provisions. The combining of purchase ledger data with supply chain ledger data will provide an artificially improved picture of the company’s trading risk and ethos.

b) large corporate groups comprising many small to medium sized companies will not have to comply with the duty as each part of the group will not qualify as a large company.

c) the BEIS website which houses the data is not integrated with Companies House beta website, Contracts Finder, G-Cloud or Crown Market Place website, Small Business Commissioner or Mystery Shopper systems.

d) failing to publish or to publishing a false or misleading statement may be a criminal offence, but what is unclear is how the system will be monitored or policed. In essence, company subject to the duty to report will publish a statement, but there will be little scope for verifying whether that statement is accurate.

However, the duty and reporting is a monumental step forward, under the public sector policy of open and transparent data, to allowing trading entities visibility and transparency over how large companies and groups of large companies commercially behave.

We consider that it is important to limit the situations in which SMEs’ money may be held by a larger company and which could be subject to abuse in the form of late, withheld or unrecovered payment. Money needs to flow through the supply chain faster and in a transparent way in order to fuel wider economic prosperity and growth.

The steps that the Government has taken in the last eight years to help firms get paid in a more timely fashion are very positive and have all been welcomed by our sector. We list these as:

- Prompt Payment Code / Construction Supply Chain Payment Charter
- Mystery Shopper scheme
- Central Government payment targets
- Mandatory reporting of payment practices for large companies
- Public Contracts Regulations (PCR) 2015
- Promotion and use of Project Bank Accounts in public sector
- Greater direct engagement between the contracting body and sub-contractors

- Contracts Finder, G Cloud and Crown Market Place
- Supply chain finance initiatives
- Aims to outlaw ‘grossly unfair’ contractual practices and allowing trade bodies to act on behalf of an aggrieved claimant
- Establishment of a Small Business Commissioner
- (And previous to this, amendments to the Housing Grants, Construction and Regeneration Act 1996, and an amendment to the Late Payment of Commercial Debts (Interest) Act)

Despite this body of work, these measures have arguably not yet had a demonstrable impact, achieved a critical mass, nor have they been mutually reinforcing.

We have consistently and strongly advocated that Government should link the acquisition of new business (I.e. procurement) and the performance of how firms pay their suppliers. This is an important link in order to improve corporate culture by eradicating businesses from future work opportunities, who fail to demonstrate adequate compliance or an ability to remedy those failures. Furthermore, it begins to integrate and connect the initiatives and regulations that the Government has already delivered upon.

The current Government proposal to link prospective supplier’s performance in terms of its payment practices to the procurement and tender criteria – is therefore extremely welcome. This is because the proposal seeks to join up some of the above initiatives and regulations; and strengthens their impact which is an issue we have been highlighting and working with Government on for some time.

We fundamentally believe that implementing measures to link contractual performance/behaviour and procurement award systems is the only way to seek to drive improvement in commercial behaviour.

This will also limit the scope for intermediaries supplying into the public sector to generate profit through the exploitation of their supply chains to the detriment of the quality and value for money received by public sector clients. For example, linking payment performance/compliance to future procurement awards creates a reason to improve upon past mandatory reporting of payment practices. This will also drive suppliers demonstrating their payment performance under such a procurement framework, to sign up to the Prompt Payment Code. It will also give the Code a more robust framework and those that are signed up may follow it more rigidly. The Small Business Commissioner, if empowered, could play a role as an independent regulator and adjudicator over how such systems work strategically and ensuring supplier feedback informs future procurement decisions (it should be noted that currently complaints cannot be made to the Commissioner where there exists, as in construction, statutory adjudication, i.e. most of the construction supply chain are outwith the Commissioner’s jurisdiction).

We also feel that where a proportion of monies already due to the supply chain in respect of labour and materials already supplied, are withheld, then those monies need to be independently held so as to ring-fence them from the risk of trustee insolvency.

Their practical success lacks a) critical mass in the industry and b) a clear monitoring and enforcement system.

The Public Contracts Regulations regulate the duration of tier 1, 2 and 3 supply chain payment periods to 30 days, but as we have seen in the aftermath of Carillion, compliance, monitoring and enforcement remain fundamental obstacles to the practical success of this intervention.

If these measures and laws achieved a critical mass and were rolled out and adopted on a widespread level, less of SMEs’ money would be held in order for it to be susceptible to the threat of insolvency. We urge a prioritisation of such moves.

Allied to this, Government should support the move to digital payment systems to generate faster transfer of payment. This won’t stop the willful withholding of other businesses’ monies, but there will be less excuse to.

Project Bank Accounts

Project Bank Accounts (PBAs) should be deployed on a widespread basis, and indeed, should be a requirement for public work. Hopefully, the political awareness around Carillion's collapse will support Government's appetite to drive a greater roll-out.

By way of background, UK Government has defined Project Bank Accounts (PBAs) as follows – "*Project Bank Account is a ring-fenced bank account from which payments are made directly and simultaneously by a client to members of his supply chain. PBAs have trust status which secures the funds in it and can only be paid to the beneficiaries – the supply chain members named in the account. Payments out of the PBA are made simultaneously to all parties. The account is held in the names of trustees; likely to be the client and lead contractor (but could also be members of the supply chain)*."

The Environment Agency and Highways England, for example, are among several UK Government clients that are successfully using PBAs to improve payment practices on their projects. PBAs are used by several councils in Wales (Flintshire, Swansea and Torfaen Councils) and the option to adopt PBAs also features in the North Wales framework agreement for delivery of future schools building programme incorporating all six North Wales Local Authorities.

In Scotland, following the successful completion of the trial programme recommended by the Review of Scottish Public Sector Procurement in Construction, Scottish Government bodies must include PBA in tender documents for contracts commencing procurement procedures from 31 October 2016.

Northern Ireland introduced the use of PBAs in January 2013 on all construction projects above £1m in value.

Retention of monies

As noted, the system of retentions is too open to abuse and upstream insolvency.

Retentions are a percentage of monies owed which are retained as security against the risk of supplier insolvency or defects. However, recent BEIS commissioned research by Pye Tait indicated that the system is less beneficial as security, and more open to abuse. The report highlighted that £700m of retention monies was lost due to upstream insolvency in the last three years. This means that the construction industry is hemorrhaging almost £1m for each working day, £4.5m a week £20m a month.

Abuse of the current retentions system is widespread, as can be seen (below) from the results of our member survey, conducted in late-2017[1].

- 92% of respondents have been a recipient of work held as a retention in the last three years; and looking at all current construction contracts, they on average faced retentions in around two-thirds of cases.
- 56% faced total retentions of over £100,000 against their current contracts. Around three quarters of businesses faced a value held of over £20,000.
- Our research shows that respondents must wait longer to get their monies than the typical 12 months defects liability period; 6 months more on average.
- The average amount of monies held over the past three years, which has not been paid back after the completion date and remains outstanding, is £34,826.
- With 5% on average held, there is no clarity on what monies will arrive and when. This makes planning for the monies (and investing it in people, equipment or new markets) remarkably

[1] The survey of ECA and BESA members was undertaken between 29 November and 18 December 2017. 113 members responded.

difficult; especially when typical profit margins within the supply chain are typically around 2-3%.

On a macro level, over £10.5bn of SME working capital is locked in retentions annually with cash flow issues leaving suppliers unable to invest in skills, training and ways to improve productivity.

Abuse of retentions and non-payment has been legislated against in many other countries, including the USA, Germany, France, New Zealand, Australia and Canada.

BEIS has completed its consultation exercise recently – we believe there is a clear, present and compelling case for the findings to deal with both: the potential for legislative abolition of retentions in the short term and/or a legislative framework for mutual security over retention monies (a deposit scheme).

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

We would recommend that cap on the level of ring-fenced money (known as the "prescribed part") set out in the Insolvency Act 1986 (Prescribed Part) Order 2003 should be removed and replaced with a specification of an amount representing a percentage relevant to the amount of debt/liability the company carries. This would more sensibly and strategically ensure that in the event of insolvency, unsecure supply chain creditors as a class (who rarely recover more than 6 pence back in every pound owed) are not unfairly compromised to the preference of secured creditors.

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

As we have noted earlier, but which is not specifically considered within the consultation, we support more robust limitations on the definition of capital available as 'profit' able to be extracted from a company as a 'dividend' where it does not have adequate working capital to meet its debts/liabilities.

Further, we support ensuring that liabilities (money owed to or retained from others) cannot counted as an asset which can fundamentally misrepresent to the health of a company.

More widely, we would like to see Government take steps to prohibit working capital owed to suppliers listed on a company's balance sheet as being counted towards a company's capital. This provides a fundamentally misleading picture of a company's financial integrity and stability and these monies should be differentiated in some way so as to avoid the prolonged trading of companies whose insolvency is masked by aggressive or misleading accounting techniques.

We wholly support the linking of supplier's performance in terms of its payment practices to the procurement and tender criteria – we view this an integral 'nudge' and 'behavioural defining' mechanism to improve corporate behaviour in this area pre-insolvency.

We would also like to see Companies House become the recognised repository for compliance data in a more aggregated and transparent way that allows debtors and creditors to make informed decisions as to trading risks. This should include data derived from public sector procurement, duty to report on payment, commitments to codes and charters, and interventions with the Small Business Commissioner.

The ECA and BESA – Working together to represent the engineering services sector

- *ECA and the BESA collaborate on a range of issues affecting the engineering services sector.*
- *The partnership brings together the two leading trade associations representing the interests of engineering services contractors, representing some 4,000 businesses with a combined annual turnover of almost £10bn.*
- *Together, ECA and the BESA cover a broad range of engineering, design, installation and facilities management activity, including electrical, heating, plumbing, energy management, micro-generation, ductwork, ventilation, fire and security, and wireless systems.*
- *Joint working includes representation and services in key areas such as contracts, procurement, payment and health and safety.*
- *Overall, the engineering services sector is estimated to account for some 40% of UK construction and maintenance turnover.*