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**Consumer Prepayments on Retailer Insolvency:
Summary of responses to consultation paper**

**This document summarises the responses to the Law Commission's Consultation Paper No 221 on
Consumer Prepayments on Retailer Insolvency**

December 2015

THE LAW COMMISSION

CONSUMER PREPAYMENTS ON RETAILER INSOLVENCY

SUMMARY OF RESPONSES TO CONSULTATION PAPER NO 221

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Approach taken in this paper

Describing responses

This paper describes the responses we have received to the questions and proposals set out in our consultation paper, Consumer Prepayments on Retailer Insolvency, published in June 2015. This document aims to report the arguments raised by the consultees. It does not give the views of the Law Commission.

Comments and Freedom of Information

We are not inviting comments. However, if having read the paper you do wish to put additional points to the Commission, we would be pleased to receive them.

Please contact us:

By email at commercialandcommon@lawcommission.gsi.gov.uk

By post, addressed to Laura Burgoyne, Law Commission, 1st Floor, Tower, Post Point 1.52, 52 Queen Anne's Gate, London SW1H 9AG.

We will treat all responses as public documents. We may attribute comments and publish a list of respondents' names.

Information provided, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (such as the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002 and the Data Protection Act 1998). If you wish your information to be confidential please explain to us why and whilst we will take a full account of your explanation, we cannot give assurance that your confidentiality will be maintained in all circumstances.

1. INTRODUCTION

- 1.1 Consumers often pay for goods and services in advance of receiving them. This is common practice for a range of products - from furniture to flights, and football season tickets to magazine subscriptions. In addition, in 2014, the UK gift card and voucher market was valued at £5.4 billion, with consumers and businesses paying immediately for a card or voucher allowing the holder to obtain an item or experience at some stage in the future.
- 1.2 If the company holding the prepayment becomes insolvent, consumers risk losing their money. Insolvency law does not give consumers any special protection. Along with trade suppliers, landlords, HMRC and others, consumers are unsecured creditors. They will not receive anything until preferential creditors (such as employees) and secured creditors (such as banks and investment funds) have been paid.
- 1.3 In September 2014, the Department for Business, Innovation and Skills (BIS) asked the Law Commission to examine the protections given to consumer prepayments; to consider whether such protections should be strengthened; and to look at the options for doing so.
- 1.4 We published our consultation paper on 18 June 2015, setting out the current position, considering the detriment suffered by consumers in recent retailer insolvencies, and suggesting possible avenues for change.¹ The consultation period ran until 17 September 2015.

RESPONSES

- 1.5 We received 41 responses to the consultation paper, which can be broken down into the following categories:

Insolvency Practitioners	13
Gift Voucher Sector	7
Consumer Interests/Protection	6
Academic	3
Card Scheme	3
Other	9

- 1.6 A full list of respondents is included at the end of this paper. Only two responses were confidential.
- 1.7 This paper provides a summary of the responses the Law Commission received and includes key quotes to demonstrate the views expressed by respondents.

¹ Law Commission, *Consumer Prepayments on Retailer Insolvency: A Consultation Paper*, No 221, available at: <http://www.lawcom.gov.uk/project/consumer-prepayments-on-retailer-insolvency/>. An executive summary is also available.

NEXT STEPS

- 1.8 This project was not motivated by any particular insolvency. Instead we take a long-term look at the issue. Our aim is to generate informed public debate about these issues and to identify possible solutions which the Government could take forward. We have not been asked to draft legislation.
- 1.9 We aim to publish a report, with recommendations, in summer 2016.

THANKS

- 1.10 We would like to thank all the consultees who responded to our consultation paper, or who met with us or contacted us to express their views. Whilst we are unable to directly quote all consultees' submissions in this brief summary, those views are important to us as we put together our recommendations for the report.

2. THE NEED FOR REFORM

- 2.1 In Chapter 8 of the consultation paper, we assessed the scale and nature of the problem and asked if there was a need for reform.

Q 1: A NEED TO RECONSIDER CONSUMER PROTECTION ON RETAILER INSOLVENCY?

- 2.2 We asked whether consultees agreed that the protection given to some types of consumer prepayments on retailer insolvency should be reformed.
- 2.3 We received 31 responses to this question. Of these respondents, 20 (65%) agreed that this was an area in need of reform.

Arguments in favour

- 2.4 Five consultees representing consumer interest groups all favoured reform. They focused on the sheer number of prepayments made each year and the potential detriment to consumers in the event of an insolvency.
- 2.5 Citizens Advice estimated that there were 24.5 million prepayments in 2009, and thought this number may have risen significantly with the growth of e-commerce. The Farepak Victims Committee stated that between 2007 and 2009 consumers had lost £133 million on prepayments.
- 2.6 They also noted the significant difference between the perceptions of consumers as to what is fair, which influences their expectations in an insolvency, and their actual legal status and rights. Jessica Morden MP added:

Too many consumers who can ill-afford the loss of a service or goods have experienced such a loss. They often feel they have little recourse to remedy the situation, while other established institutions ensure they are always in a position to recoup the majority, if not all, the monies they are owed.

- 2.7 Several other consultees contrasted the apparent lack of protection consumers were afforded with the severity of the potential detriment and the fact that prepaying consumers provided businesses a valuable source of “new money”.
- 2.8 The Competition and Markets Authority (CMA) added that consumers require protection because they are unable to assess insolvency risks:

We believe that consumers paying in advance are not well placed to assess insolvency risks in relation to particular businesses or sectors. We would therefore favour measures that provide such consumers with improved protection given their limited ability than other creditors to assess and manage the potential likelihood of, and risks arising out of, insolvency.

- 2.9 The Association of British Travel Agents (ABTA) thought much could be done to mitigate the risk of consumer detriment. It noted that consumer protection had had a positive impact in the travel industry:

Package Travel and certain other types of travel arrangement enjoy a high level of consumer financial protection, both by virtue of statutory and voluntary arrangements. This has been a good thing for both consumers and industry, because consumers are able to continue to book with confidence through economic and geopolitical periods of uncertainty. That confidence has then enabled the industry to plan and trade with greater confidence than would otherwise have been the case, ultimately reducing the number of insolvencies and consumer detriment compared with an unregulated environment.

- 2.10 Consultees from the gift voucher sector generally supported the notion of revisiting the protections available for consumer prepayments but were keen to stress that they did not think it was required in their sector, as gift vouchers generally presented little risk. They were concerned that regulation would involve costs which would have to be passed on to consumers. The UK Gift Card and Voucher Association (UKGCVA) said:

If as a result of this consultation, retailers are required to take certain steps to strengthen consumer protection or raise awareness to the risks in making a prepayment, those steps must not devalue the gift card or voucher itself.

- 2.11 Most respondents recognised that protection should not come at a significant cost and would have to be proportionate to the risk and potential detriment. Into the Blue noted:

The cost of any scheme needs to be balanced against the likely hardship caused to consumers. In the case of gift vouchers, which tend to have a fairly low average value and the fact that they are bought as a gift would suggest that actual hardship caused by an administration would usually not be of a very high order.

Arguments against

- 2.12 Only three respondents (10%) thought that reform was not required. The Insolvency Lawyers' Association (ILA) thought that any legislative changes would be "unduly complex". They went on to say:

we see no reason in principle why this class of creditor should obtain benefits not available to others (for example employees) who may arguably be equally "vulnerable", and whose losses in the event of an insolvency may exceed those suffered by consumers who have purchased gift vouchers or made prepayments for a limited category of goods, with consequent greater hardship.

- 2.13 The Association of British Insurers (ABI) also doubted how serious an issue this is, stating that they were:

not aware of evidence that points to a widespread or systemic issue in terms of consumer detriment or a high frequency of insolvencies impacting adversely on customers.

Other

- 2.14 8 respondents (26%) answered “other”. They tended to support consumer education but expressed doubts about the impact of amendments to insolvency practice and legislation. For example, the R3 Scottish Technical Committee (R3 STC) stated that consumers needed more awareness of the risks and protections involved with making a prepayment:

The nature of the contract needs to be clear to both, ie the responsibilities, rights and protections available, particularly where one of the parties is a member of the general public.

- 2.15 Book Tokens Ltd said that providing protection for a large number of small claims can be disproportionately expensive:

there is very little evidence to support additional protection for products that have low value, where the product is a gift and where the product can be used/redeemed immediately.

Q 2: PARTICULAR SECTORS IN NEED OF CONSIDERATION

- 2.16 We identified two particular sectors where consumers risk losses on retailer insolvency: gift vouchers and deposits in the furniture and home improvement sectors. We asked whether there were other sectors in which consumer prepayments are particularly problematic in the event of retailer insolvency.

- 2.17 We received 29 responses to this question, with many other sectors identified. The funeral services industry was mentioned most frequently, with 6 respondents raising it. The CTSI Consumer Coders Approval Board (CCAB) said:

Priority areas have been identified for codes, via work completed by the Consumer Advisory Panel, led by Citizens Advice. Funeral Services and Funeral Plans are both areas where CCAB are actively seeking an approved code, and work is ongoing to identify a suitable Code Sponsor in the sector.

- 2.18 Holidays and weddings were the next most frequently mentioned, with 4 respondents each. These are all areas in which PWC observed there is a “deep emotional response” when prepayments are not fulfilled.

- 2.19 Four respondents identified Christmas “savings schemes” as problematic, with the Chartered Trading Standards Institute (CTSI) describing them as “the most obvious case where insolvency can cause the considerable detriment to some of the more vulnerable people in society”. The Insolvency Practitioners Association (IPA) said that quasi-savings schemes should be differentiated from gift vouchers and should fall under banking regulations.

- 2.20 The following sectors were also suggested:

(1) concerts and sports tickets (3);

- (2) building trade (3);
- (3) major functions (2);
- (4) car hire and sales (2);
- (5) online transactions (2);
- (6) telecommunications;
- (7) media;
- (8) utilities;
- (9) currency exchange; and
- (10) storage services.

2.21 The Farepak Victims Committee and Jessica Morden MP suggested that protection should be extended to all prepayments – not just the two sectors mentioned. Book Tokens Ltd and CMA agreed. The key factors were the size of the prepayment and the length of time it was held for - not the commercial sector in which the prepayment was made. ABTA commented that it was these factors which led to consumer protection in the travel industry and said:

It would appear equitable that where the potential detriment is similar in nature that similar protections should be in place”.

2.22 Some respondents thought that gift vouchers do not pose a particularly high risk. UKGCVA, supported by gift voucher retailers, stated that they believed the risk of loss in relation to gift vouchers was low.

3. CHARGEBACK

- 3.1 In the consultation paper, we explained how consumers who pay by credit and debit card may seek recourse against their card issuer if the goods or services are not delivered. Our analysis showed how important this is on retailer insolvency.
- 3.2 A consumer who makes a purchase with a credit card is protected under section 75 of the Consumer Credit Act 1974, provided that the price of the item is more than £100 and not more than £30,000. For those buying on a debit card, or for those making smaller purchases on a credit card, the protection has been described to us as “voluntary”. Card issuers may decide to reverse the transaction and recover the money from the merchant acquirer, using the chargeback procedures set out in the Visa and MasterCard scheme rules.¹
- 3.3 The non-statutory chargeback arrangements have now become part of the consumer landscape. Although they do not benefit consumers who pay by cash or cheque, they play an important role in the overall package of protections for consumer prepayments.

Q3. THE NEED FOR TRANSPARENCY

- 3.4 We said that the main problem with chargeback is the lack of information about how it works. Consumers may not know how to request a chargeback, or how to pursue the request if they meet an initial rebuff. We were told that card issuers take different approaches to how they train their staff to respond to chargeback claims, with some card issuers doing much more than others.
- 3.5 We made three proposals to improve access to information about how the chargeback system works. There was widespread support for more information about chargeback.

3a. Insolvency practitioners

- 3.6 We suggested that insolvency practitioners should tell consumer creditors about the possibility of asking their card issuer to raise a chargeback. We also said insolvency practitioners should make available on the retailer’s website a confirmation that the company is in administration or liquidation, which a consumer could give to their card issuer as evidence.
- 3.7 We asked if consultees agreed. 34 respondents answered this question, with 31 (91%) of those agreeing.

Information about chargeback

- 3.8 Some commented that this requirement would be easy to implement and would not burden insolvency practitioners.

¹ We have been told that card issuers may also voluntarily undertake to bear the loss suffered by the consumers in some circumstances, without raising a chargeback under the card scheme rules.

- 3.9 Several insolvency practitioners said that they already do this. For example Chartered Accountants Ireland said that practitioners in Northern Ireland currently inform consumers about the chargeback process. Deloitte, discussing websites set up for insolvency appointments, said:

These websites are already populated by responsible IPs with general information such as validity of gift vouchers and other frequently asked questions. It would not be difficult to add chargeback information but this should not remove any responsibility on the part of either card issuers or retailers to better publicise the facility and how it operates.

- 3.10 The Finance and Leasing Authority said:

the provision of such information should be necessarily high-level and restricted merely to the possibility of raising a chargeback. An insolvency practitioner will not be able to determine the likelihood of a successful chargeback in individual cases or be expected to comment on differences between chargeback schemes.

- 3.11 PWC commented that the most vulnerable consumers may struggle to use the internet or not have easy access to it. They therefore argued for wider dissemination of the information.

Evidence of insolvency

- 3.12 Citizens Advice called for insolvency practitioners to provide consumers with evidence of insolvency, saying that a lack of such evidence often prevented consumers from exercising their s75 or chargeback rights. CMA agreed that such a document would be helpful to consumers.
- 3.13 Other consultees pointed to the Insolvency Act 1986, Schedule B1, para 45. This requires all company websites to state that the business is being managed by the administrator and to give the administrator's name. Some insolvency practitioners thought that this was sufficient.
- 3.14 The Association of Business Recovery Professionals (R3) could see "no merit in requiring an additional notice duplicating those already issued". The City of London Law Society (CLLS) added:

particularly in the retail sector, an administrator will not be in a position to make a definitive statement on this point, at least during the initial period following their appointment.

3b: Card issuers

- 3.15 We suggested that all card issuers should give consumers a brief explanation of how to raise a chargeback. We thought this should include:

- (1) Contact details (including a phone number and website address);
- (2) Details of situations in which consumers may raise a chargeback, including when a retailer enters administration, and what documentation needs to be provided to the bank;

- (3) A statement that consumers who think they have met with an unreasonable refusal may complain to the Financial Ombudsman Service.

3.16 We asked whether consultees agreed. Of 35 respondents who answered this question, 34 (97%) agreed.

Agreement

3.17 Several consultees argued that the card issuers were best placed to provide this information because of their contractual relationship with the consumer which may allow refunds even when a chargeback is not raised. Visa said:

As the issuers have the direct contractual relationship with cardholders, it is only appropriate that the Issuers detail such information under the terms and conditions of the card issued.

3.18 Many consultees asked for simple, easy to understand language. Jessica Morden MP said:

I would add that the language and layout of such information should be easy to understand and not jargon heavy. Many people would lose confidence in going through the process if the language used is impenetrable for normal people.

3.19 There was some disagreement as to how this information should be provided. Several consultees suggested that it should be in the terms and conditions of a card, or clearly stated at the point of sale. CTSI said:

This proposal does offer the potential for pre-contractual information increasing consumer confidence in the market place.

3.20 However, more consultees seemed concerned that if this was the case, the information would be lost or “buried” in the small print. For example, KPMG said:

On taking out a new card, any detail on the chargeback claim process is likely to get lost in other detail and misplaced by the consumer.

3.21 CMA thought that the solution to this would be to inform consumers about chargeback on issue of a credit or debit card, at the point of sale and at the time of insolvency. PWC and R3 STC suggested a mailshot.

Disagreement

3.22 Only Michael Bridge disagreed. He thought that the current chargeback system fails to provide adequate protection for the more financially vulnerable consumers. Instead he suggested extending some of the protections under section 75 to debit cards:

On the assumption that a card issuer's liability is ultimately passed on card users as a community, section 75 liability may be seen as a type of disguised insurance system which, if extended to debit cards, would cover most consumers who make prepayments. This may be a better proposal – so long as it is confined to insolvency protection and does not go to the extremes of conferring on debit card holders a “like claim” to the one they have against the supplier.

3c: Card schemes

- 3.23 We suggested that card schemes such as Visa and Mastercard should provide a publicly available authoritative guide on how chargeback works. We received 33 responses to this proposal, with 30 (91%) of those in favour.

Agreement

- 3.24 Several insolvency practitioners supported an emphasis on consumer education rather than legislation. For example, Deloitte said:

The issue would appear to be that lack of awareness/confusion on the part of the consumer of the existence of the facility rather than avoidance on the part of the card issuers, and thus perhaps better served through education/clarity of information rather than legislative measures.

- 3.25 The UK Cards Association thought that this information should be provided by cards schemes as the chargeback processes can differ between them.
- 3.26 Many consultees advocated high-level information in clear, easy to understand language.
- 3.27 CTSI worried about “consumer information overload”. CLLS added:

We do, however, question how useful this would be to the general public, if “authoritative” is taken to mean “comprehensive and legally binding”. Our concern in relation to this point is highlighted by the fact that the current Mastercard “Chargeback Guide” (October 2014 edition), which is available online, is around 574 pages long, including its appendices, with much of its content comprising very technical detail.

Disagreement

- 3.28 The remaining 3 respondents answered “no”, based on two points:
- (1) The scheme rules are a contractual agreement between the card issuer and the merchant acquirer. The Finance and Leasing Association said that the rules can therefore “evolve organically” which would lead to practical difficulties in keeping a guide accurate and up to date.
 - (2) The complexity of the card scheme rules. The rules are aimed at issuers and acquirers not consumers. Consumers would find them difficult to grasp and attempting to simplify them could be misleading and add to confusion.

Q 4: IMPLEMENTATION OF INFORMATION PROPOSALS

- 3.29 We asked whether consultees had any comments on how these proposals should be implemented.
- 3.30 We received 24 responses to this question providing a broad range of comments. PWC, R3 STC, Jessica Morden MP and the Farepak Victims' Committee all suggested that a marketing or media campaign would be an effective way to provide consumers with this information. Moore Stephens suggested a dedicated website for the consumer chargeback industry.
- 3.31 There was little consensus about where responsibilities lay. The Financial Services Ombudsman, Financial Conduct Authority and R3 were all put forward as suggestions.
- 3.32 Two consultees (R3 STC and the Institute of Chartered Accountants of Scotland (ICAS)) advocated a new statement of insolvency practice (SIP). R3 STC said:
- guidance could be provided to the Regulated Professional Bodies (RPB) by the Joint Insolvency Committee (JIC). The RPBs can then monitor and review IPs' compliance with any such requirement.
- 3.33 However, we understand that the Joint Insolvency Committee has suggested that the "mandatory nature" of SIPs made them unsuitable for use in relation to chargeback.

Q 5: THE VOLUNTARY NATURE OF CHARGEBACK

- 3.34 In the consultation paper we said that the current chargeback system appears to work well. On that basis, we set out our provisional view that chargeback should not be required by legislation. We sought views for and against legislating for new legal duties to be imposed on card issuers to refund payments in circumstances currently covered by chargeback.
- 3.35 Generally, respondents agreed with the Law Commission's view that chargeback should not be required by legislation. Of the 29 respondents who commented, 20 expressed a view that chargeback should remain voluntary.
- 3.36 The main reasons against introducing legislation requiring chargeback were:
- (1) The current system works well as it is.
 - (2) There would be costs associated with regulating a legislative regime which would in all likelihood be passed on to consumers.
 - (3) A mandatory regime could encourage merchant acquirers to withhold more collateral to protect against chargeback claims straining the cash flow of businesses.
- 3.37 Transpact suggested that the Government should legislate for reserve powers in the event that banks and card issuers fail to fulfil their current chargeback policies or the rules are changed and the Home Insulations and Energy Systems Scheme (HIESS) agreed this should be kept under review.

3.38 CLLS argued against this:

The knowledge that any attempt to change the current voluntary scheme would invite regulatory intervention should, we believe, provide a sufficient deterrent to making any significant changes to the existing chargeback scheme.

3.39 Three respondents felt that chargeback should be made mandatory immediately. Moore Stephens said:

We consider that consumer protection by a mandatory scheme should be available irrespective of the consumer's choice between debit and credit card.

3.40 ABTA suggested that the growing popularity of debit cards and the development of new forms of mobile payment are likely to increase the importance of these protections. They also thought that recent changes to European regulations provided an ideal opportunity to formalise chargeback arrangements.

4. POSSIBLE MEANS OF PROTECTION

- 4.1 In the consultation paper, we talked about trusts, bonding and insurance as the main options open to retailers wishing to provide additional protection for consumer prepayments. We sought to identify ways in which it might be made easier for businesses to use these mechanisms to introduce protections for consumers.

TRUST ARRANGEMENTS

Q 6: Holding a proportion of funds on trust

- 4.2 We asked whether trusts designed to protect some rather than all prepayments would be an acceptable compromise in situations where ring-fencing all prepayments is not practical or affordable for the business. This could mean, for example, allowing for funds to be drawn-down in certain circumstances, or putting only some proportion of each prepayment into trust.
- 4.3 We received 29 responses to this question. Only 6 (21%) were in favour of the proposal; 14 (48%) were against it and 9 (31%) answered “other”.

Agreement

- 4.4 Acorne plc agreed with the Law Commission that some protection must be better than no protection:

Partial protection, especially of low-value high-volume payments, must be better than no protection, providing the terms are made clear to the consumer.

- 4.5 Citizens Advice thought it would reduce the balance of risk assumed by the consumer.

CONSUMER CONCERNS

- 4.6 Some felt that consumers would be confused by not knowing how much of their prepayment was protected. Jessica Morden MP thought that the system could be too easily avoided by businesses:

it might leave an avenue for some businesses, if not the majority, to persuasively argue that in their case it is neither practical nor affordable to ring-fence prepayments.

INSOLVENCY PRACTITIONERS CONCERNS ABOUT TRUSTS

- 4.7 None of the insolvency practitioners who addressed this issue were in favour of the proposal. Instead, they expressed general concern about any attempt to extend the use of trusts.

The costs of administering a trust

- 4.8 First, they thought that the costs of setting up and maintaining trusts would be disproportionate. The Institute of Chartered Accountants of England and Wales (ICAEW) said:

We think that a trust system could be costly and difficult to operate in this context, and believe that the Law Commission should assess how much consumer cash would be saved if a scheme like this were to be in operation compared to, for instance, the total amount of prepayments made annually.²

- 4.9 R3 questioned how the additional costs of dealing with a trust in an insolvency would be paid.

The management and policing of the trust

- 4.10 Insolvency practitioners thought it would be difficult to reliably create, enforce and police a trust account. They also said that the requirements for a trust vary across the different legal jurisdictions of the UK and this would create problems for businesses operating across them. They also lead to tax and VAT issues.

Restrictions on a business' working capital

- 4.11 Finally, trusts were thought by some consultees to deprive businesses of working capital and to disadvantage other creditors.
- 4.12 ILA thought that the intended protection could prove detrimental:

The trusts would likely be commercially unworkable as, with the resulting reduction in working capital, the risk of the business' failure may be heightened and the business, deprived of the possibility of trading out of the situation with formal insolvency becoming inevitable.

Q 7: Standardised trust deeds

- 4.13 We asked whether it would be useful to develop a standard trust deed which businesses could adopt on a voluntary basis. This would protect consumer prepayments and standardising the deed could reduce the complexity and costs of establishing a trust.
- 4.14 Of the 27 respondents who answered this question, 12 (44%) were in favour, 7 (26%) were against it and 8 (30%) marked "other".
- 4.15 Those representing consumer interests were in favour of the proposal. Citizens Advice noted that certain codes of practice did require protection mechanisms but the scope of these could be quite limited. They concluded that standardised trust deeds would be beneficial in bolstering the protection afforded to consumers.
- 4.16 The gift voucher sector was split on this proposal. UKGCVA said that there was a place for trusts, but not in the gift voucher sector. Park Group plc and Acorne plc took a different approach, saying standardised documents would be helpful if trusts were to be made mandatory. However Park Group plc noted that:

² All comments attributed to ICAEW found in ICAEW representation number 126/15 Consumer prepayments on retailer insolvency

The trust deeds would need to be flexible because each business will operate differently and it may not be appropriate to operate in a specific way contained in the standard trust deed.

- 4.17 Insolvency practitioners were also split. Only KPMG expressly stated that standardised deeds could reduce the legal costs and complexities usually associated with trusts. By contrast, ILA said that trusts was too complex an area of law in which to attempt to standardise terms. R3 STC said:

the position is complex, trust law is different in the various jurisdictions of the UK and no trust deed could potentially cover all situations.

- 4.18 CMA thought that the proposal would not solve the problem:

The experience of the OFT strongly suggests that it is in practice difficult to satisfy both the desire of businesses to be able to use pre-payments for commercial purposes and the interest of consumers in their being protected in the event of insolvency, and the standardisation of trust deeds does not represent a solution to this problem.

- 4.19 Transpact promoted the use of escrow services, describing them as providing the same protection of a trust but being “quick, efficient, automated and open to both business and consumer clients immediately”.

INSURANCE

Q 8: Consultees’ insurance experience

- 4.20 We asked if consultees had any experience of prepayment insurance. In particular we asked if consultees could provide information regarding to the cost and terms, the claims process and the interaction between insurance and section 75 claims.
- 4.21 We received 20 responses, covering a broad range of views. Opinion was split as to the availability of suitable insurance. Chimera stated that they provided prepayment insurance for several large retailers, and UKGCVA said that they were in discussions with insurers about a commercially acceptable insurance product for the gift card and voucher market. On the other hand Park Group plc said that “there do not appear to be any available providers”. ABI added that the market offered through its members is only small.

Who bears the cost?

- 4.22 ABTA said that the costs of insurance are generally borne by the trader. CMA said that OFT had encountered examples both where consumers were to bear the cost of insurance, and where the business was to bear that cost. The more prevalent view however, was that, one way or another, consumers bear the cost of insurance. ABI said:

We would expect the cost of insurance to ultimately be borne by the customer, either indirectly through a higher cost of any products purchased, or directly through an insurance premium that is paid.

The cost

- 4.23 Several respondents said that insurance is usually expensive. CMA stated that OFT had found that for higher risk businesses it might be “prohibitively costly (or impossible) to obtain insurance”.
- 4.24 ABTA said that fewer than 5% of its members used an insurance product, as options such as bonding or reserve fund insurance are more cost effective. However, even bonding has costs: Acorne plc told us that they had obtained a quote for a bond with a minimum premium of £50,000.
- 4.25 HIESS operates an insurance backed deposit protection scheme. It was the only respondent to suggest insurance was generally affordable. It said that, for an individual job, it could be obtained for as little as £10-£15.

Coverage and claims procedures

- 4.26 ABTA said that limitations and exclusions are an issue but that it combats this by:
- only approving for use by Members policies with underwriters prepared to enter into a Deed with ABTA effectively waiving any right that might otherwise arise to determine a claim against the underlying purpose of the policy to protect the consumer.
- 4.27 ABI said that coverage and claims procedures are commercial matters for insurers, though they have to be in accordance with FCA rules and the Treating Customers Fairly Initiative. ABTA was not aware of any problems with consumer claims.

Interaction with section 75

- 4.28 Only two respondents addressed this point. ABI said it would
- expect consumers to first pursue other avenues of redress such as section 75 claims where available, before being able to make a claim under an insurance policy.
- 4.29 Correlation Risk Partners agreed, asking how an insurance policy could “step in front of legislation”.

Q 9: Barriers to insurance

- 4.30 We identified registration and lack of data as significant barriers to insurance and asked what could be done to overcome them. We received 21 responses.
- 4.31 Consultees identified two further barriers to insurance. First, the cost was thought to be prohibitive and could effectively become another “tax” on consumers. R3 STC said:
- if retailers pass the cost to the consumer by increasing prices (and if the policy is aimed at “the most vulnerable”) the price may then become unaffordable).

- 4.32 The second barrier was the lack of demand, from either businesses or consumers. ABI thought that the level of consumer demand was “too low for a market to develop”:

Consumer losses on insolvency are usually moderate, with vouchers being honoured or losses to individuals being low. The result is that insolvencies have not led to lasting reputational damage of the gift voucher industry. Ultimately, consumers do not feel they are likely to lose out as the chance of insolvency is deemed very low, and if they do, the value of any loss is so low as to negate any demand for insurance or some form of protection.

- 4.33 HIESS, Moore Stephens and CTSI thought that the best way to generate this demand was through making insurance mandatory. CTSI said that unless required, traders would be very reluctant to offer insurance because of the potential competitive disadvantage.
- 4.34 Neither Chimera nor Correlation Risk Partners, both insurance firms, thought that there were actually any barriers to insurance. Chimera said that labelling insurance was as expensive as “completely inaccurate”, concluding:

there is an existing market, there is claims experience and capacity will move into the sector if there is a need.

Q 10: DEVELOPING A NEW “CONSUMER CHARGE”

- 4.35 We asked if there was any merit in developing a new statutory “consumer charge” to be registered at Companies House. We suggested that businesses could use it on a voluntary basis and that it would provide consumer creditors with greater protection without the cost and capital restrictions of trusts and insurance.
- 4.36 We received 32 responses to this question. Only 8 consultees (25%) were in favour of developing a consumer charge and 18 (56%) were against it, including 12 insolvency practitioners. 6 consultees (19%) answered “other”.

Arguments in favour

- 4.37 ABI concluded that (compared to insurance) a consumer charge would overcome the problems of registration, obtaining data and lack of demand. Transpact and CTSI thought that it was the best possible protection available to consumers whilst Acorne plc simply thought it answered the “political clamour that ‘something must be done’”.
- 4.38 ABTA responded in favour of the charge, but added reservations:

While we are not against this as an interesting new option with potential, we do not think that it would add to consumer certainty.

Problems

4.39 There was a recurring concern that pushing one class of creditors up the insolvency hierarchy is inevitably at the expense of another class. KPMG said this was against the *pari passu* principle, which they described as “ingrained within insolvency legislation”.

4.40 More practically, the proposed “consumer charge” would need the consent of other existing floating charge holders and several respondents thought that this was unlikely to be obtained. As Professor Sheehan put it:

Turkeys tend not to vote for Christmas.

4.41 ICAS said:

- The proposed ranking of the charge may adversely affect the availability and pricing of working capital finance.
- How would the creation of the charge be viewed within an established business? Would its creation be interpreted as a signal to consumers that it was in financial difficulty with directors taking steps to protect customers?

4.42 Insolvency practitioners were also concerned at the administrative difficulties in identifying which consumers would be protected by the charge. Several respondents thought that a consumer charge would increase the cost and time of administering in an insolvency.

4.43 There were also concerns that consumers would not understand the protections they were offered. Chimera observed:

If there are a plethora of protection mechanisms with differing regulatory requirements, confusion could ensue.

5. REGULATION

- 5.1 In the consultation paper, we discussed methods of protecting gift voucher holders, particularly in the context of Christmas savings schemes and voucher intermediaries which we thought posed higher risks to consumers. We sought to determine whether regulation should be introduced in these and other potentially high risk sectors.

GIFT VOUCHERS

Q 11: Protection for gift vouchers

- 5.2 Recent government policies have focused on trade bodies agreeing voluntary schemes of protection, but these have had mixed success. We asked whether consultees agreed that encouraging retailers to protect gift vouchers voluntarily was preferable to introducing a mandatory requirement.
- 5.3 We received 34 responses to this question. 21 consultees (62%) agreed that encouraging voluntary protection was preferable. 9 (26%) disagreed, and 4 (12%) marked “other”.

Arguments against mandatory protection

- 5.4 Of the 7 respondents in the gift voucher sector, 6 agreed with this proposal. National Book Tokens answered “other”, stating that most gift card issuers already had adequate measures in place. This was echoed by others in the industry, and they thought that spreading these practices was a better solution than mandatory measures. Society of London Theatre said:

There are already operators like Theatre Tokens in the market that take a prudent and responsible approach to protecting consumer funds. We welcome transparency and the dissemination of good practice and not mandatory prepayment protection.

- 5.5 Most insolvency practitioners thought that the emphasis should be on informing consumers about the risks prior to purchase. Deloitte said:

Vouchers should be clearly differentiated as between those underpinned by a trust (the savings scheme products) and those that are not. In the latter case, any notification that the value of the voucher will likely be lost on insolvency should be sufficiently prominent to alert the consumer to the possibility that the intended gift may be worthless.

- 5.6 The Department of Enterprise Trade & Investment – Northern Ireland Insolvency Service (DETINI) agreed:

What is important is that customers should be made fully aware to what extent their prepayments are or are not protected.

- 5.7 Several respondents commented that the size of the problem in relation to gift vouchers had been overstated: mandatory regulation would be disproportionate for such a small issue. ILA said that the problem was not sufficiently acute or widespread as to merit regulation of any kind. Similarly CLLS said:

Introducing a mandatory regulatory regime to protect the holders of gift cards would seem disproportionate, as while this is often an emotive issue... the size of the problem seems to be comparatively insignificant, with the cited average loss of Zavvi gift card holders... being only £8.12.

Arguments for mandatory protection

- 5.8 Citizens Advice thought that mandatory measures should not be ruled out:

This could be pursued as a voluntary commitment with industry in the first instance. However, the Government should not rule out the possibility of introducing statutory protection at a later date if necessary.

- 5.9 Others thought that voluntary arrangements lacked the required bite to work and questioned the value and impact of kitemarks. Richard Palmer added:

I don't think discretion or voluntary codes would work for administrators who like certainty and may feel pressure from fixed/floating charge holders.

- 5.10 Chimera said that attempting to introduce voluntary measures put businesses at a competitive disadvantage whereas mandatory measures provided a level playing field. Jessica Morden MP questioned the effectiveness of relying on businesses to adopt voluntary measures which would presumably be at the expense of some profit.
- 5.11 Transpact called for all gift cards to be brought within the scope of the EU E-money directives and thus be regulated in that way.

Q 12: Statement that a voucher is not protected

- 5.12 Consumer education was a key theme in our consultation. We believe that consumers should be in a position to make informed decisions. We asked if gift voucher providers should state in the terms and conditions of the voucher whether or not the value of it is protected in the event of an insolvency. We also asked if this would require legislation to be introduced.
- 5.13 31 consultees responded to this proposal: 26 (84%) were in favour; and 5 (16%) opposed it.

Should there be a statement?

- 5.14 Those in the gift voucher sector were in favour of the proposal but were also keen to point out that this practice is already recommended in the UKGCVA voluntary code of conduct and adhered to by several respondents.

- 5.15 Several respondents thought that this measure would be part of improving consumer awareness more generally and would help consumers to make informed decisions. For example, Citizens Advice said:

[We] believe that consumers should have all of the information they need to make an informed choice before making a purchase.

- 5.16 There were however, concerns that consumers do not read the terms and conditions and therefore the statement should be included on the face of the voucher or made clear at or before the point of sale. Deloitte said it would ideally be on the face of the voucher like a health warning on smoking products but was aware that retailers would be opposed to this.

- 5.17 KPMG noted that any warning or statement on the voucher was likely to deter voucher purchases and others questioned the value of “robotic” statements in terms and conditions which were unlikely ever to be read. CLLS illustrated the point:

as a practical matter, it feels improbable that (for example) a relative looking for a last minute £10 gift for a young nephew, with a queue forming behind them, would, prior to making that purchase, read the terms and conditions of the voucher (if available) and then make a decision as to whether or not to proceed with the purchase based on that review.

- 5.18 CLLS also raised questions over what the term “protection” would incorporate and the potential for businesses to place a statement on the card saying the value of it was protected when in reality the protection was only “illusory”.

Should the statement be mandatory?

- 5.19 Not all respondents addressed this but those that did generally favoured a mandatory scheme. It was felt that if it was not mandatory, businesses would not comply with it. The few respondents supporting voluntary measures thought that the risk was low and did not justify regulation.

Q 13: MARKETING SAVINGS SCHEMES

- 5.20 Consumers who are saving money expect protection, as if saving with a financial institution. However, Christmas and similar savings schemes are not currently required to provide that protection yet the detriment to consumers can be great if these schemes become insolvent (as evidenced by the collapse of Farepak). We suggested that it should be unlawful to market a scheme in a way which suggests it is a suitable savings vehicle without putting some form of protection in place, and asked if consultees agreed.

- 5.21 28 consultees responded: 23 (82%) agreed and 5 marked “other”. No-one disagreed with the proposal.

- 5.22 9 insolvency practitioners were in favour of the proposal, with 6 of them arguing that schemes marketed as “savings schemes” should be subject to the same regulation as other financial services. ICAEW expressly proposed that they should be regulated by the FCA. ILA added:

retail businesses marketing a scheme to consumers as a “saving” scheme (and which consumers would understand as a “saving” scheme) should be subject to the same requirements as those providing financial services.

5.23 CLLS pointed out that any retailer who could not comply with the new regulatory regime could simply change the manner in which they marketed their product.

5.24 Consumer groups argued that consumers should not be misled. The Farepak Victims Committee thought that “the word ‘savings’ gives the impression that your money is safely deposited in a ‘savings account’”. Jessica Morden MP said:

Most people would assume anything marketed as a saving scheme that their money is safe and in an account. In practice, this is not how the system operates and leads to huge confusion when things go wrong.

5.25 CTSI added:

With reference to Christmas Clubs, again Financial Inclusion Strategies may steer vulnerable consumers towards schemes that should be beneficial. Therefore misleading information about such schemes should be unlawful.

5.26 UKGCVA and the 6 voucher retailers who responded all favoured this proposal. UKGCVA and 3 others added that they did not endorse gift cards and vouchers as products suitable to be used for saving.

Concerns

5.27 Those who responded “other” were primarily concerned about the potential impact on small businesses. R3 STC said:

In our experience, smaller retailers may be offering a “savings scheme” as a benefit or selling point, with the best of intentions and in good faith to support their communities and customer base.

5.28 These respondents also identified issues with the definition. IPA thought that the definition should not be centred on marketing as this was “too subjective a measure”. Similarly CMA said:

We have some reservations as to how far it will protect consumers in relation to prepayments generally. It seems likely to give rise to arguments as to what does and does not amount to a suggestion that a scheme can be used as a savings vehicle.

5.29 Very few respondents who answered “yes” commented on the definition. Book Tokens Ltd said it needed further consideration whilst ICAS and Deloitte supported a wide definition with ICAS saying:

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

- 5.30 There was little comment on the cost, though ICAEW said that lighter touch FCA regulation could be used to avoid disproportionate costs.

Q 14: RESERVE POWERS

- 5.31 Voucher intermediaries do not hold stock and are less likely to involve well-known brands. They are therefore less likely to trade in administration and administrators and future purchasers may be less likely to accept vouchers in an insolvency. They often hold significant funds for long periods of time and therefore we identified them as higher risk, though many voucher intermediaries already take steps to avoid putting consumer funds at risk.
- 5.32 We asked if the Government should have reserve powers to regulate high risk voucher intermediaries which do not protect consumers' funds.
- 5.33 Of the 24 consultees who answered this question, 11 (46%) were in favour of the proposal and only 4 (17%) were against it. 9 consultees (38%) answered "other".
- 5.34 The 5 pro-consumer consultees who answered this question all responded in favour. Farepak Victims Committee cited the lack of protection afforded to prepaying consumers by insolvency law and how the current law allows businesses to keep accepting prepayments when there is little chance of orders being fulfilled (as seen in Farepak).
- 5.35 Jessica Morden MP expressed concern that the only way the Secretary of State could demonstrate the need to exercise reserve powers would be the collapse of another business at the expense of ordinary consumers. ICAS thought that the case for legislation should be made out when measures were to be introduced and thus opposed reserve powers.
- 5.36 Gift voucher retailers and their representatives were split on the issue, but expressed similar concerns in their responses. UKGCVA, Acorne plc, Park Group plc and Society of London Theatre all said it was unclear what the terms "high-risk" and "significant funds" captured. Deloitte and IPA also thought "high risk" was too subjective a test.
- 5.37 Book Tokens Ltd went further and said:

We do not recognise the term "high-risk voucher intermediaries" and, as we have stated clearly in the past, have not seen any evidence to support this potentially damning categorisation.

- 5.38 The gift voucher sector also argued that legislation would lead to shorter expiry dates to the detriment of the consumer; and that the proposal failed to consider the different business models used by intermediaries. Finally, UKGCVA said that intermediaries are already under commercial pressure to operate on a sound financial basis:

It should also be borne in mind that intermediaries will be subject to commercial and financial scrutiny by those businesses (retailers) that it works with, because the retailers have an interest in protecting their brand and reputation from being adversely impacted by the acts or omissions of a party with whom it works.

Q 15: COSTS TO VOUCHER INTERMEDIARIES

5.39 Requiring businesses to protect consumer prepayments would likely be an administrative and financial burden. We asked what the risk and potential costs for any voucher intermediary would be if they were required to introduce protection through the likes of trusts, insurance or bonding.

5.40 We received 18 responses to this question, but no one provided figures.

5.41 Gift voucher representatives stressed that voucher intermediaries typically work on a low margin high volume basis, so the cost of compulsory protective measures would be passed on to customers and could lead to voucher provider insolvencies.

5.42 The Society of London Theatre said:

Any protection mechanism brings with it enhanced costs and for Theatre Tokens, a not-for-profit organisation operating a low margin business in order to support the theatre industry, these are likely to have a significant impact on the activity, possibly resulting in its demise.

5.43 UKGCVA thought the costs would be disproportionate:

[T]he reality is, looking past administrators, that the average gift card value is generally low (less than £10) so we would question the economics of putting such systems in place for use by the administrator.

5.44 Others were not sympathetic to these concerns. The Farepak Victims Committee thought that businesses which could not absorb those costs should not be permitted to issue vouchers and HIESS thought that the costs could be covered by unredeemed vouchers. Louise McDaid thought it was an opportunity for businesses:

There will be costs to the business however with good marketing – “Your money is protected” the opportunities for increased sales would far [outweigh] the costs.

5.45 Chimera Insurance Agency did not provide premium estimates based on the limited information in the consultation paper but said that insurance:

Provided to minimum standards, competitive pressures between underwriters, subjected to regulatory requirements and most importantly TCF [Treating Customers Fairly], would ensure that voucher holders were not only protected but within an emulous environment.

Q 16: SECTOR-SPECIFIC REGULATION

5.46 We identified the home improvement and furniture sectors as particularly high risk and noted that voluntary schemes within specific sectors are not always successful. We asked whether consultees agreed that sector-specific regulation was not the most suitable mean of protecting consumer prepayments in the furniture and home improvement sectors.

5.47 26 consultees answered this question: 13 (50%) agreed that sector-specific regulation is not suitable; 9 (35%) thought that it was suitable; and 4 (15%) answered "other".

5.48 Generally, insolvency practitioners thought there was little justification for protecting purchasers of certain items not others. R3 STC commented:

It is the activity of taking prepayments in any form that requires protection, not specific sectors.

5.49 ICAEW thought that sector-specific action had the potential to cause confusion:

Indeed, defining 'consumer', 'prepayments' and 'retail' in this context will not be without its difficulties and may result in anomalies that would be hard to justify to creditors who do not fall within the definitions in this context.

Sector-specific regulation could also produce unfair results and cause confusion to consumers if the purchaser of, say, a sofa, were to be protected, but the purchaser of a sun lounger were not.

5.50 Those in the gift voucher sector argued that umbrella regulation would not work as it would cover sectors such as gift vouchers which did not pose a risk to consumers. UKGCVA said:

It is important to identify the real and significant risks to consumers and if there is a risk to a particular sector then sector specific regulation may be a solution. The danger with introducing general regulation is that it unwittingly catches sectors that are not actually a high risk to the consumer.

5.51 ABTA was also in favour of sector-specific regulation, pointing out that it has worked within the package travel sector. It said that sector-specific regulation might work if the named sectors were "so high risk and the detriment so great" that it justified that approach.

6. LIMITED PREFERENTIAL STATUS FOR CONSUMERS

- 6.1 In the Consultation Paper we proposed that a limited category of consumers should have preferential status in the insolvency hierarchy, ranking behind employees but ahead of floating charge holders. We suggested that the category should be limited to prepaying consumers who had provided a significant sum of new money to the business in the run up to insolvency, using a payment method which did not offer a chargeback remedy.

Q 17: THE POLICY BEHIND A LIMITED PREFERENTIAL STATUS

- 6.2 We do not think that all consumer claims should be given preferential status as the costs could be disproportionate to the returns. However we did argue for giving preferential status to a limited category of prepaying consumers. We asked consultees if they agreed with the policy behind this proposal.
- 6.3 31 consultees responded to this question: 10 (32%) were in favour of the proposed preferential status; 16 (52%) were against it; and 5 (16%) were undecided.
- 6.4 The proposal was well supported by pro-consumer respondents. The Farepak Victims Committee wanted to avoid a repeat of the kind of trading seen towards the end of that administration. This point was also raised by CMA:

We agree that it would have the benefit of eliminating any potential 'perverse incentive' on floating charge holders to encourage accumulation of prepayments. It would similarly help to eliminate any potential 'perverse incentive' around the timing of insolvency of businesses that are subject to seasonal factors that might cause consumer prepayments to accumulate at a particular time of year (e.g. in the run up to Christmas or other holidays).

- 6.5 Both bodies also questioned the reasoning behind limiting the charge to prepayments which did not offer a chargeback remedy. CMA thought the voluntary nature of chargeback might leave some gaps in the protection whilst the Farepak Victims Committee felt this was an unfair benefit conferred on failing businesses.
- 6.6 12 insolvency practitioners were against the proposal. Their main issues were:
- (1) Giving some consumers preferential status necessarily involves a value judgement that they warrant greater protection than other creditors such as suppliers. According to the ICAS this would "result in a higher ranking than involuntary creditors which would seem a strange situation".
 - (2) Preferential status is no guarantee of recovery.
 - (3) It would undermine the position of creditors who have tried to protect themselves by taking floating charges. This could, according to the R3 STC, "lead to other classes of creditors seeking to improve their ranking with fixed charges".

- (4) This would impact on the borrowing costs to the retail sector. Correlation Risk Partners said that banks would be less inclined to lend, whilst others argued that the cost of borrowing would correspondingly go up.
 - (5) The administration would add to complexity, delays and costs. ICAEW said it would add “a great deal of complexity” leading to “uncertain results” and R3 said an additional category of preferential creditor would “add both delay and cost because of the need to scrutinise a large number of small claims”.
- 6.7 Others raised concerns that consumers would be confused and unsure as to whether their prepayment was protected and that it would possibly lead to bogus claims. It was also suggested that further preferential claims might reduce the prescribed part for distribution to unsecured creditors.
- 6.8 ABTA thought that it would be unfair to treat consumers who had dealt with a trader at an earlier time differently to more recent customers. They also thought it would introduce a lack of certainty in dealing with struggling businesses.

Q 18: THE “RUN-UP” TO INSOLVENCY

- 6.9 We proposed that the category of consumers to be protected should be limited to those who had made a prepayment in the “run-up” to insolvency. In the months leading up to insolvency the financial problems of the company are likely to be apparent to those running the firm, secured lenders and others but not to consumers. We asked whether consultees that the category should be limited in this way, and in particular whether it should be limited to consumers who had made a prepayment in the three months prior to the insolvency.
- 6.10 We received 28 responses to this question. 9 consultees (32%) were in favour of a time-limit, 7 (25%) were undecided and 12 (43%) were against it.

In favour of a time limit

- 6.11 Mainly, it was those representing consumer interests who were in favour of the time limit, as well as two consultees from the gift voucher sector and two academics. Comments made by those consultees generally focused on the length of the time period rather than reasons for supporting it.
- 6.12 ICAS opposed a new preference but added:

Should preferential status be pursued then we would agree that a set period would be an appropriate way of assessing the ‘cut-off’. This is consistent with other areas of legislation (for example unfair preferences).

Against a time limit

- 6.13 The main argument against a time limit was that it would be arbitrary and unfairly exclude some consumers. Citizens Advice, for example, said that there was:
- no compelling reason that consumers who paid for their goods more than three months in advance should be denied the same level of protection.

- 6.14 Moore Stephens felt an arbitrary cut-off could anger some consumers:

The arbitrary nature of the cut-off point for the set time period demonstrates how problematic these proposals are which we believe could lead to consumer resentment if they miss out on being given preferential status simply as a result of a timing issue.

- 6.15 R3 and other insolvency practitioners thought that a threshold would increase the complexity of administration and encourage abuse.

How long should the time limit be?

- 6.16 Three consultees agreed with the 3 month limit, but only CTSI elaborated saying:

CTSI supports the three month limit as the likely time scale in which directors might seek a remedy to financial difficulty and the time when insolvency legislation might apply.

- 6.17 Professor Sheehan thought that the time-limit should be six months, to align it with insolvency legislation on preferences. He argued that the rationale behind the 6 month time limit under section 239 of the Insolvency Act 1986 was that the business has at that time the opportunity to assess the risk of insolvency and that assessment influences the decision to make a payment. At the same time the business is able to continue to take advantage of consumers who are unable to assess that risk. He said:

The only justification – to me – for not linking the timescale to preferences and having a 6 month period (at least) would be that there would be no (or almost no) pre-payments that far ahead.

- 6.18 The consumer groups also argued that the time limit should be extended. The Farepak Victims Committee stressed that Christmas savings scheme, running on a 10-12 month basis, would take large prepayments over a long period and it would be unfair not to protect these.

- 6.19 Professor Twigg-Flesner was the only consultee to argue for a shorter limit:

There is now the statutory requirement – which is subject to contrary agreement – in s28 CRA 2015 that delivery must occur within 30 days, so perhaps the relevant period could be aligned with that section?

Q 19: A “SIGNIFICANT SUM”

- 6.20 We proposed that the preferential status should be limited to claims which are sufficiently large as to justify the costs of distribution. We asked if consultees agreed that there should be such a limit and if it should be set at £100.

- 6.21 25 consultees answered this question. 10 (40%) were in favour of a limit to potential claims, 8 (32%) were against it and 7 (28%) were undecided. The pattern of answers was much the same as the previous question, with mainly consumer groups in favour of the limit, insolvency practitioners against the limit and gift voucher consultees arguing that the proposed preference would not work in their sector.

- 6.22 Out of the consumer interest consultees, only Citizens Advice thought that a limit should not be imposed. Others recognised that the administrative costs of refunding a large number of small claims would be disproportionate and therefore a de minimus limit would be needed. CMA thought that the limit should be very low to ensure the measure was effective and would maintain consumer confidence
- 6.23 By contrast, many insolvency practitioners thought that placing time and financial limits on the category would only serve to make the administrative exercise of identifying claimants more burdensome, with consequential increases in time and costs.
- 6.24 KPMG suggested a higher limit. Their argument was that prepayments are often for amounts far in excess of £100, for example in respect of furniture, motor vehicles and holidays, and such a low limit would offer floating charge holders very little protection:

This will therefore provide no real limit to protect the floating charge holders and will also create a significant level of additional work and additional associated time costs to agree and pay these claims in an insolvency.

They also thought that any minimum limit would leave some consumers feeling cheated if their prepayment fell short of the limit.

- 6.25 ICAS offered a different solution. They proposed that if a limit was to be imposed, it should be based on the value of the dividend to creditors, rather than the amount of the prepayment, and subject to a maximum limit:

This is because it [is] not guaranteed that any preferential creditor will receive 100p in the £. We consider that if there is a case for a preferential deminimus level (on the grounds that the claims must be sufficiently large enough to justify the cost of distribution) then the deminimus level should be linked to actual distribution value rather than claim value alone. It may therefore be more appropriate to set an upper limit for the value of claims (as is the case for preferential employee claims for unpaid wages) and a deminimus value of actual dividend payment.

- 6.26 Moore Stephens again felt consumers might feel aggrieved to narrowly miss out on protection. ABTA made a similar point:

It also seems to us that there could be some unfortunate and unfair consequences to such an approach. A prepayment of £101 could be returned in full, but a deposit of £99 might be lost in its entirety.

Q 20: GENERAL IMPACT

- 6.27 We sought views on the general impact of this proposal. In particular, we asked if retailers could keep records of prepayments made by cash or cheque, if floating charge holders could monitor these sums and if many business relied on these prepayments.

- 6.28 We received 19 responses to this question, dominated by answers from insolvency practitioners and those in the gift voucher sector.

Records

- 6.29 The general opinion of insolvency practitioners was that the quality of records kept is very mixed. PWC noted:

Accounting for vouchers and such is often not one of the strongest areas within the types of distressed retailers we have come across.

- 6.30 Deloitte suggested that businesses would generally record the amount of deposits or prepayments but not whether they were by cash or cheque. However other practitioners thought that either this information would already be available through businesses' EPOS systems or could be made available through minor amendments to that system.

Floating charge holders

- 6.31 Several insolvency practitioners pointed out that the nature of a floating charge is not to provide the holder with control over the assets. They expressed concerns over the potential for floating charge holders to become shadow directors.

- 6.32 R3 STC for example said:

the whole concept of a floating charge is not designed to give control, and introducing the need for charge holders to monitor such funds may alter the nature of the charge and introduce the risk of shadow directorship to any bank seeking to intervene in a customer's commercial activities.

Reliance on prepayments

- 6.33 Finally, it was generally accepted that many businesses and industry sectors rely on prepayments – including furniture, home improvement and travel. However, ABTA went on to remark that cash and cheque payments are uncommon in the travel sector.

Q 21: BUSINESSES RELYING ON PREPAYMENTS

- 6.34 We had no information about how many businesses rely on deposits paid by cash or cheque and thought this number would be declining. We asked if consultees had any knowledge of businesses which relied on prepayments but did not have secured creditors, or if they could provide any examples of businesses which had successfully traded their way out of trouble by relying on consumer deposits paid by cash or cheque.

- 6.35 We received only 6 responses to this question. Both Deloitte and IPA said that there would be no way of knowing if a business had survived in this manner. IPA commented:

it would be unlikely that events of that type would come to the attention of the insolvency profession. It would be more likely that we would encounter instances where such practices had been attempted unsuccessfully.

7. TRANSFER OF OWNERSHIP

- 7.1 In the Consultation Paper, we identified a lack of clarity surrounding the application of the rules in the Sale of Goods Act 1979 on transfer of ownership in the consumer context. We proposed amending the rules for consumers, to make the rules easier to understand and apply in practice for the benefit of both consumers and insolvency practitioners.

Q 22: AMENDING THE RULES

- 7.2 In relation to specific goods, we proposed that ownership should be transferred at the time the contract is made, even if the retailer has agreed to alter the goods for the customer (for example, a curtain shortening service). This would effectively remove the requirement for the seller to put the goods into a “deliverable state” before ownership can pass. For unascertained goods, we suggested that ownership should pass when goods are identified for the fulfilment of the contract.
- 7.3 We asked consultees if these amendments would make it easier for administrators to decide whether to fulfil consumer orders and what impact they would have on other creditors.
- 7.4 We received 28 responses to this question and consultees were evenly split on the issue. 11 (39%) were in favour of the proposals, 11 (39%) were against them and 6 (21%) marked “other”.
- 7.5 5 consultees representing consumer interests were in favour of the proposals. Their concerns focused on the unfairness and perceived injustice of the current rules regarding the transfer of ownership and the confusion it caused amongst consumers who could not understand why goods they had paid for were not theirs. Citizens Advice said:
- Our clients’ sense of confusion and injustice was heightened in cases where the insolvent retailer was taken over by another business or the decision was taken to trade in administration. Clients could not understand why goods which they had already paid for, and had been told would not be delivered, were available for other consumers to pay for and take away.
- 7.6 Chartered Accountants Ireland thought certainty would help administrators in deciding whether or not to fulfil outstanding orders.
- 7.7 CLLS thought that the proposals would have a relatively limited effect (such that a legislative response appeared disproportionate). In contrast, R3 described the amendments as “fundamental” and having “far-reaching consequences” with the potential to upset retention of title arrangements, security arrangements, insurance and tax.
- 7.8 PWC made a similar point:

Any change of this sort would only serve to increase complexity in the competing claims of different stakeholders to the same goods - adding consumers to a list that could include some or all of: Retention of Title claims, general or special liens, resellers, and in Scotland, landlords under hypothec.

7.9 KPMG added:

in practice it will incur significant additional costs in the logistics of repatriating goods to consumers. The additional time will be incurred in reviewing the validity of the claims to ownership and then attending various locations to oversee the collection.

- 7.10 The academics provided more detailed responses. Professor Sheehan generally supported the proposed change for specific goods, but he did not see the benefits of the change in relation to unascertained goods, concluding that:

Getting hung up on unconditional appropriation vs identification is just to get hung up on words. As soon as you have labelled them sufficiently well on your view property should pass. But then it has been, in effect whatever label you attach, unconditionally appropriated.

- 7.11 Michael Bridge also thought the meaning of unconditional appropriation was clear and that identification was simply a different label for the concept of ascertainment. He was, however, in favour of amending the Sale of Goods Act 1979, s18, Rule 2 to remove requirement relating to deliverable state.

- 7.12 There appears to be a mismatch between the views of academics that property already passes when goods are labelled and the views of insolvency practitioners that acting on this rule would be a major change in practice.

Q 23: NATURE OF THE RULES

- 7.13 We asked consultees if the proposed new rules on passing of property should be mandatory and therefore applied to all contracts or if parties to a contract should be able to agree alternative provisions as the current law permits.

- 7.14 We received 20 responses to this question. 11 consultees (55%) believed these rules should be mandatory and only 2 (10%) thought that the parties should be able to agree alternatives. 7 (35%) answered "other". The comments provided in addition to these responses were very brief.

- 7.15 5 consultees representing consumer interest believed these rules should be mandatory but only Citizens Advice provided further comments, believing it would provide clarity in a complex area of law.

- 7.16 CMA commented that allowing parties to agree different terms might result in unfair terms being agreed but noted that unfair contract terms were already regulated.

- 7.17 ICAEW said that allowing parties to agree alternatives would allow them to recreate the existing position and also add an extra layer of complexity. Chimera thought that if not mandatory, the impact could be very varied.
- 7.18 The 7 respondents to answer “other” were all insolvency practitioners, who repeated that they did not agree with the proposed changes to the law.

Q 24: IMMEDIATE TRANSFER OF OWNERSHIP

- 7.19 We asked consultees if there were any arguments in favour of transferring ownership of goods to consumers immediately upon the conclusion of the contract. We received 15 responses to this question.
- 7.20 Farepak Victims Committee, Citizens Advice and Jessica Morden MP all thought the current system was unfair to consumers and that property should pass sooner. Jessica Morden MP said:

The item or items being bought should be the consumer’s property immediately and this would rebalance the system in favour of ordinary consumers in the event of insolvency.

- 7.21 This view was supported by Moore Stephens who argued that ownership should pass on the conclusion of a contract and IPA who stated that ownership should pass once a contract has been completed.
- 7.22 There was a difference of opinion in response to the suggestion that, where the number of orders exceeds the level of available stock, goods should be distributed to those consumers who had paid earliest. DETINI said:

It could be better for some customers to receive what they had ordered than for all customers to receive a nugatory payment.

- 7.23 Arguing the opposite, ABTA stated:

If ownership passed to those who had paid in full, they would be effectively 100% protected at the expense and to the detriment of those who had only paid a deposit, who might then receive nothing in a liquidation. That would not be right.

APPENDIX: LIST OF RESPONDENTS

A.1 The following table shows the businesses, organisations and individuals who responded to the consultation paper and the commercial sector which they either practice in or represent:

	Name	Sector
1	Association of Business Recovery Professionals (R3)	Insolvency Practitioner
2	Chartered Accountants Ireland	Insolvency Practitioner
3	City of London Law Society (CLLS)	Insolvency Practitioner
4	Deloitte	Insolvency Practitioner
5	Insolvency Lawyers' Association (ILA)	Insolvency Practitioner
6	Insolvency Practitioners Association (IPA)	Insolvency Practitioner
7	Institute of Chartered Accountants of England and Wales (ICAEW)	Insolvency Practitioner
8	Institute of Chartered Accountants of Scotland (ICAS)	Insolvency Practitioner
9	KPMG	Insolvency Practitioner
10	Moore Stephens	Insolvency Practitioner
11	Richard Palmer	Insolvency Practitioner
12	PWC	Insolvency Practitioner
13	R3 Scottish Technical Committee (R3 STC)	Insolvency Practitioner
14	Acorne plc	Gift Voucher
15	Book Tokens Ltd	Gift Voucher
16	Into The Blue	Gift Voucher
17	Park Group plc	Gift Voucher
18	Signet Trading Ltd	Gift Voucher
19	Society of London Theatre	Gift Voucher
20	UK Gift Card and Voucher Association (UKGCVA)	Gift Voucher
21	Chartered Trading Standards Institute (CTSI)	Consumer Interests/Protection
22	CTSI Consumer Codes Approval Board (CCAB)	Consumer Interests/Protection
23	Citizens Advice	Consumer Interests/Protection
24	Farepak Victims Committee	Consumer Interests/Protection
25	Louise McDaid (individual affected by Farepak insolvency)	Consumer Interests/Protection
26	Jessica Morden MP (speaking in personal capacity after consulting victims of Farepak insolvency)	Consumer Interests/Protection

27	Michael Bridge FBA, Cassel Professor of Commercial Law, London School of Economics, Professor of Law, National University of Singapore	Academic
28	Professor Duncan Sheehan, Professor of Commercial Law, University of East Anglia	Academic
29	Professor Christian Twigg-Flesner, Professor of Commercial Law, University of Hull	Academic
30	UK Cards Association	Card Scheme
31	Mastercard	Card Scheme
32	Visa	Card Scheme
33	Competitions & Markets Authority (CMA)	Other
34	Department of Enterprise Trade & Investment – Northern Ireland Insolvency Service (DETINI)	Other
35	Association of British Insurers (ABI)	Other
36	Chimera Insurance Agency (Insurance provider)	Other
37	Correlation Risk Partners (Insurance provider)	Other
38	Finance and Leasing Association	Other
39	Transpact (escrow service)	Other
40	Association of British Travel Agents (ABTA)	Other
41	Home Insulations and Energy Systems Scheme (HIESS)	Other