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Dear Madam,

City of London Law Society Insolvency Law Committee response to the Law Commission Consultation Paper entitled "Consumer Prepayments on Retailer Insolvency"

INTRODUCTION

1. We refer to the Law Commission Consultation Paper entitled "*Consumer Prepayments on Retailer Insolvency*" published in June 2015 (the "**Consultation"**) and to the executive summary of the Consultation, which was published at the same time (the "**Consultation Summary"**).

2. The City of London Law Society ("**CLLS**") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

3. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response has been prepared by the CLLS Insolvency Law Committee. Members of the working party listed in the Schedule attached will be glad to amplify any comments if requested.

GENERAL POINTS

4. The treatment of consumer prepayments and gift cards in a retail insolvency context is often a particularly emotive issue, as the law as it currently stands does not necessarily reflect the expectations of consumers. Our experience is that the resulting frustration and anger felt by customers is often taken out on employees and other front line staff, who may themselves be facing redundancy as a result of the retailer's insolvency. We therefore welcome the fact that the Consultation is focusing on these problematic areas.

5. We agree with the Commission's view,[1] following the approach adopted by the Cork Committee, that consumer claims as a whole should not be moved up the repayment hierarchy and that they should therefore not be given priority over the claims of the company's other unsecured creditors.

6. We are, however, not convinced that an overwhelming case has been made out for providing additional protection in relation to certain limited categories of consumer claims, thereby potentially giving customers different levels of protection depending on:

(i) their status under the Consumer Rights Act 2015;

(ii) the method used for making payment; and

(iii) whether the loss which they suffered related to defective goods, the payment of a deposit, the purchase of a gift voucher, the making of a misleading statement when goods were sold to them, being given a credit voucher on a return of goods or losing extended warranty protection.

There is a risk that introducing such measures could simply increase uncertainty and customer confusion, rather than creating the transparency which the Commission is seeking to achieve.

7. In addition, the Consultation assumes at several points[2] that a person who is not a consumer would be in a better position to assess the relevant credit risk and that they should therefore be given less protection, or a lower priority on insolvency, than consumers. We would question whether this assumption is correct, as small suppliers, such as the *City Link* delivery drivers, or individual contractors, such as cleaners, cannot realistically be said to have made a more informed credit decision, when choosing to go to work, than an individual customer when ordering a new kitchen. Moreover, a customer has an unrestricted choice as to which retailer to use; people such as cleaners or the *City Link* drivers cannot as easily choose to turn up for work somewhere else.

8. We would also question whether it is correct to adopt a "one size fits all" approach in relation to some of the proposals set out in the Consultation. While this approach is unavoidable in some cases, given the confusion that could result from having different levels of consumer protection depending on the size of the retailer, it is important to bear in mind, particularly when considering the possibility of further mandatory regulation, that the retail sector covers a very wide spectrum, ranging from listed PLCs with multiple outlets to charity shops and sole traders with market stalls.

9. Overall, we would therefore prefer a "light touch" approach, which encourages best practice, does not penalise unsecured creditors and avoids unnecessary complexity and regulation, particularly if such regulation could result in increased costs being passed on to the customer. We believe that many elements of a solution which meets these

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[1] Set out in Section 12.7 of the Consultation.

[2] Including at Section 7.3(2) of the Consultation Summary.

requirements are already in place, but that they are either not fully understood or not publicised sufficiently.

10. We would therefore suggest that the Commission's recommendations should focus on proposals to:

(i) publicise both the existing chargeback scheme and the protection provided by Section 75 of the Consumer Credit Act 1974 (the "**CCA**"), in order to increase consumer awareness of the benefits of making prepayments using a credit or debit card rather than paying by cheque or by cash;

(ii) introduce a new Statement of Insolvency Practice (SIP), as proposed in Section 9.12 of the Consultation, to make it clear that insolvency practitioners should provide consumer creditors with information about how to obtain a refund, either (if they used a credit card) pursuant to Section 75 of the CCA or (if they used a debit card) by raising a chargeback[3];

(iii) require all card issuers to provide consumers with a brief explanation of how to obtain a refund under either Section 75 of the CCA or the chargeback scheme, including details of situations in which consumers may be entitled to a refund, what documentation needs to be provided to support a claim for a refund and contact details if the consumer wants to make a claim; and

(iv) explore whether there is a potential market for establishing a bonding scheme for retailers who accept prepayments above a certain level.

While possibly outside the scope of the Consultation, we also believe that it may be worth considering whether charging (sometimes significant) supplements when goods or services are paid for by credit card may be incentivising cost conscious purchasers to pay by cash or by cheque rather than by credit card, despite the additional risks that this may entail.

Save for the bonding scheme, we appreciate that these measures do not specifically assist those who make payment using cash or by cheque, but we believe that it would be better to encourage consumers to make payments by other means than to put in place complex and potentially confusing measures which might offer a partial solution but which might also have knock-on effects in other areas (which we have sought to highlight in our response) and which might also have unintended consequences.

SPECIFIC PROPOSALS

Proposal 1(a) – Insolvency practitioners should give information to consumer creditors about potential chargeback claims

11. We agree that, in the event of a retailer insolvency, insolvency practitioners should be encouraged to give information to consumers about the possibility of asking their card issuer to raise a chargeback, in the same way that customers are generally reminded about the statutory protection available to them if they paid by credit card.

12. While noting the concerns expressed by some insolvency practitioners that telling consumer creditors to contact their card issuer, in order to raise a chargeback, might be seen as giving them preferential treatment, our experience is that insolvency

[3] As a practical matter, this process may be assisted by establishing a specific website that consumer creditors could be referred to by any insolvency officeholder.

practitioners (particularly those appointed in respect of larger retailers) will often make aggrieved customers aware of this possibility, sometimes through FAQ sections on the retailer's website.

13. Given the uncertainty identified in the Consultation as to what constitutes best practice in this respect,[4] we agree that there would be merit in the creation of a new Statement of Insolvency Practice (SIP), as proposed in Section 9.12 of the Consultation, to encourage insolvency practitioners to provide consumer creditors with practical details about how to contact their card issuer in order to raise a chargeback.

Proposal 1(b) Insolvency practitioners should make available on the retailer's website a confirmation that the company is in administration or liquidation

14. We believe that this point is already addressed in the Insolvency Act 1986 ("**IA**" or "**Insolvency Act**"), as Paragraph 45(1) to Schedule B1 to the Insolvency Act provides that:-

> "*While a company is in administration, every business document issued by or on behalf of the company or the administrator, and <u>all the company's websites</u>, must state—*
>
> (a) *the name of the administrator, and*
>
> (b) *that the affairs, business and property of the company are being managed by the administrator."*

15. Similar provisions apply:-

(i) to liquidators (Section 188(1)(b) IA);

(ii) to receivers (Section 39(1)(b) IA); and

(iii) where a moratorium is in force in relation to a proposed Company Voluntary Arrangement (Paragraph 16(1) to Schedule A1 to the Insolvency Act).[5]

16. The more difficult point is the subsequent suggestion, contained in Section 9.13 of the Consultation' that it might also be helpful to place a document on the retailer's website, which consumers could download and present to their bank, confirming that goods or services were unlikely to be delivered.

17. In many cases, 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, as:-

(i) The administrator will be actively seeking purchasers for all or part of the business. The question of whether or not orders would be fulfilled will often depend on the outcome of that process, and the attitude taken by any potential purchaser; and

(ii) There will probably not be a hard and fast rule, at least at the outset, as to whether or not orders would be fulfilled,[6] not least as this may depend on the size of deposit paid in respect of a particular order.

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[4] As discussed in Section 9.11 of the Consultation.

[5] References to websites having been addressed in the Companies (Trading Disclosures) (Insolvency) Regulations 2008 (SI 2008/1897).

[6] As noted in Sections 8.14 and 8.15 of the Consultation Summary: "*In practice, problems are unlikely to arise where the consumer has paid only a small deposit. Here the administrators will be keen to complete the sale and*

A similar position would apply in liquidation, although there would be a significantly greater probability that orders would not be fulfilled.

18. As the administration progresses, the customer would expect to receive a communication from the administrator (albeit possibly only in the form of an update report) indicating how their claim was likely to be treated. The practical answer may therefore be that individual customers have to wait until they receive that communication before making a chargeback claim and that the 120 day deadline for submitting claims[7] should therefore be extended, when the retailer is in administration or liquidation, to take account of this.

Proposals 2 and 3 – Publicising chargeback

19. As noted on the *Which?* consumer rights website: "*Chargeback is not very well known about and some bank staff may not be aware of this rule*." We therefore agree that, in the interests of transparency, all card issuers should give consumers a brief explanation of how to raise a chargeback, with that explanation including:

(i) Contact details (including a phone number and website address);

(ii) Details of situations in which consumers may raise a chargeback and what documentation needs to be provided to the bank; and

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

If this information is provided on-line, the relevant card issuer should clearly distinguish between guides to chargeback aimed at customers and guides to chargeback aimed at retailers, as the latter are likely to be more focussed on issues such as fraud protection which could confuse or deter a customer who was simply trying to find out how to apply for a repayment.

20. We can also see the merits of the argument that major card schemes such as Visa and MasterCard should provide a publicly available, authoritative, guide on the situations in which a chargeback may be available. 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 on-line, is around 574 pages long, including its appendices, with much of its content comprising very technical detail.

21. We believe that there is also a good argument for encouraging banks to standardise both their chargeback procedures and the information which they require in an insolvency scenario. At the moment, each bank's process for completing the chargeback application tends to be slightly different, with some requiring the completion of a specific claim form and others simply asking a series of questions about the relevant transaction.

22. We also agree with the provisional view reached by the Commission that chargeback arrangements should not be put onto a statutory basis, as:

(i) This could have potential cost implications, with the possibility of any increased costs being passed onto customers or retailers;

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receive the balance of the payment. The greatest problems arise where the goods have been paid for in full, but ownership has not passed. Here administrators have no commercial reason to complete the order."

[7] Referred to in Section 5.36 of the Consultation.

(ii) A mandatory regime might potentially cause a change in attitude on the part of the merchant acquirer when it comes to holding back funds; and

(iii) It seems somewhat counter-intuitive, when considering a voluntary scheme that seems to work well, to impose further costs and regulation on those running the scheme, in case they were, at some future date, to change the way in which the scheme runs. 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.

Possible means of Protection – Directors' duties

23. The Consultation perhaps underestimates the impact that the combination of a director's fiduciary duties, wrongful trading legislation and the director disqualification regime would have on a director when he or she was considering (for example) whether or not to accept further prepayments at a time when their company was facing a real prospect of insolvency, particularly given recent changes to wrongful trading legislation which are intended to make claims against directors easier to pursue. While it is true that any recovery made in respect of a successful claim would not be available for specific creditors, in our view the existing regime should focus directors' minds.

24. The Consultation Summary suggests[8] that "*Businesses with financial problems…may seek to increase prepayments from consumers in the knowledge that the goods or services may never be delivered. … This may provide an incentive for businesses and their floating charge holders to inappropriately require increased prepayments in the weeks and months leading up to insolvency.*". This suggestion does not reflect our general experience, when dealing with a properly advised board of directors, as they should be aware of the significant personal consequences of adopting such a course of action.

Possible means of Protection – Trusts

25. The potential use of trusts invites several questions, which perhaps highlight the potential complexities inherent in this solution. The first is that of whether all prepayments should be held on trust or whether the trust should only arise at a time when a company was facing financial difficulties (and, if so, what the trigger for the creation of the trust would be)?

26. If all prepayments, whenever made, were to be held on trust, it would presumably follow that they would either be paid into a segregated trust account (in which case there would typically be a risk of a shortfall caused by delays in the cash sweep mechanism and/or administrative errors) or that some form of statutory trust would arise (possibly similar to that arising under the CASS rules so that money is automatically held on trust and then, following the occurrence of an insolvency event, pooled and divided between those who have made prepayments). In either case, there would be two options:

(i) The first is that the retailer would be able to use all or part of the prepayment to pay the supplier in question or, potentially, to cover the costs of running its business (in which case the cash might only be in the trust account for a relatively short time, and the resulting value of the trust mechanism might be relatively limited).

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[8] At Section 3.6.

(ii) The second is that the prepayment would be retained until delivery of the ordered goods to the customer (in which case the retailer would have to fund the purchase of those goods out of its own resources, with the customer prepayment simply providing a deposit to ensure that the customer paid for the goods when delivered).

27. The possibility that all prepayments, whenever made, should be held on trust would seem to penalise the retailer, potentially putting pressure on liquidity (depending on the circumstances in which monies could be withdrawn from the trust account) and imposing additional administrative, legal, trustee and accountancy costs (which might disproportionately impact small to medium size businesses) while providing no significant benefit for the consumer, as long as the retailer continued to trade successfully.

28. The alternative option, as noted in the Consultation, would be for the company to decide, when confronted with significant financial difficulties, to set up a trust to protect future consumer prepayments. The risks inherent in adopting this option would seem to be that:

(i) Creating a last minute trust of this nature in very challenging circumstances can lead to imperfect structures, the validity of which may be challenged on insolvency;[9]

(ii) Taking this route may create additional liquidity issues for the company, at a time when its working capital is likely to be very constrained; and

(iii) Directors may be criticised for protecting prepayments in this way if they did not also take steps to protect other new exposures incurred by the company after the date on which the trust arrangement was set up. How, faced with the prospect of insolvency, could directors justify protecting some new creditors but not others, whether consumers, suppliers or employees?

29. As a practical matter, the “last minute” trust option may do little to reassure customers, as they would only know about the existence of the trust if its creation was publicised, but the company in question would normally be extremely reluctant to do so. Announcing that the company’s directors felt that its financial position had become so precarious that it was now necessary to create a trust mechanism of this nature would be expected to significantly hasten the demise of the retail business, as suppliers and credit insurers took immediate (and drastic) steps to protect their position.

30. It is also likely that such a trust structure would provide an incomplete solution. It is anticipated that there would often be a shortfall in the identified trust assets, either due to administrative or financial reasons, or because the timing of the creation of the trust will leave some consumers without protection.

31. In summary, there will always be circumstances in which it is appropriate to establish a trust in order to protect new exposures incurred at a time when the future of a business is uncertain, but any attempt to make the creation of trusts mandatory is likely to create a legal minefield which will, at best, lead to increased costs and bureaucracy.

Possible means of Protection – a statutory “consumer charge”

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9 Given the risks inherent in creating last minute trust arrangements, and the fact that negotiating the terms of such trusts can prove an unhelpful distraction at a time when management efforts should be focussed on saving the business, we can see, in answer to Question 7 of the Consultation, the potential advantages of developing a series of standard trust deeds which businesses could use to protect consumer prepayments, should they decide to go down this route.

32. As noted in our general comments, we agree with the Commission's view that consumer claims as a whole should not be given priority over the claims of the company's other unsecured creditors. We are, however, not convinced by the Commission's arguments for providing additional protection in relation to a limited category of consumer claims.

33. We therefore have significant reservations about creating a permanent first ranking floating charge securing certain types of consumer claim, both for policy reasons and because the creation of such a charge would give rise to intercreditor and enforcement issues in circumstances where lenders require the retailer to grant them a typical security package.

34. To take one example, having to notify the "consumer charge" security trustee of an intention to appoint an administrator, as would be required by Paragraph 15(1) of Schedule B1 to the Insolvency Act, could well delay the enforcement process and thereby potentially increase the overall loss to creditors, particularly where the "consumer charge" security trustee was not in a position to respond swiftly.

35. We are also unclear, as a practical matter, how a retailer would comply with this requirement where, for example:

(i) It has already created security which prohibits the creation of further floating charges; or

(ii) The retailer is not an English company and is incorporated in a jurisdiction which does not recognise the concept of a floating charge; or

(iii) The retailer has separate companies for each store – would there be a floating charge created by each company to cover all prepayments made to any member of the group or would each company create a floating charge to cover the specific prepayments which it had received (in which case, would there be limitations on each company's ability to transfer cash to other group companies, such as a group treasury company, in order to maintain the value of the floating charge which they had created?)

36. It also appears possible that, if floating charge realisations were only sufficient to pay the "*prescribed part*" (payment of which would rank ahead of any liabilities secured by the floating charge) and those consumers benefitting from the floating charge would not share in the "prescribed part" payment[10], this proposal could potentially leave those creditors who made prepayments with cash or by cheque worse off, in terms of recoveries from the insolvent company, than those who made prepayments by credit or debit card.

37. Overall, given the complexities involved in the "consumer charge" option, we feel that (while not recommending this option) granting preferential status to such claims would be a more practical solution than the "consumer charge", if it were decided, as a matter of policy, to give such claims priority status on insolvency. It would also be better for the relevant consumer, given the prior ranking nature of a preferential claim and the gradual erosion of the value of a floating charge.

Possible means of Protection – Bonding/Insurance

38. Requiring retailers who accept prepayments above a certain level to have either insurance or bonding in place would seem an attractive option, assuming that a market for providing such cover could be developed, but:

[10] As implied by Section 7.12 of the Consultation Summary.

(i) This solution would work most effectively if the insurer was required to provide cover, whatever the financial position of the retailer, and could not, as with credit insurers, withdraw cover if faced with what they saw as an unacceptable credit risk. The practical concern is that an insurer faced with a retailer in financial difficulties might attempt to withdraw cover at the very time when it was most needed or might significantly increase the premium, both of which could accelerate the demise of the retailer;

(ii) As noted in the Consultation,[11] customers may, based on the experience of other protection schemes, be required to take steps to register for prepayment protection, potentially within a relatively tight deadline. Those who failed to do so, whether because they lacked on-line access, were averse to filling in forms or simply forgot, would potentially be left in the same position on the retailer's insolvency that they are in today; and

(iii) It is unclear how any generic industry-wide solution covering all retailers who took prepayments in relation to the provision of goods or services would interact with existing, more bespoke, schemes which were tailored to the specific requirements of certain sectors (such as the ATOL and ABTA arrangements applicable to the travel industry).

We would, however, encourage the Commission to explore the viability of this option further.

Proposals 4, 5, 6 and 7 – A need for regulation?

39. We doubt, in response to the question posed in Section 6.6 of the Consultation Summary, that it would be possible to limit any new regulation to identified "*high risk areas*", as the risk of insolvency depends not only on the sector in which a retailer is operating, but also on factors such as the strength of its balance sheet, the availability of additional funding to address any liquidity concerns, the ability of the management team, brand strength, its e-shopping offering, store location and correct stock choice and pricing.

40. As a general point, we would also argue that the costs and time involved in satisfying any new mandatory regulation should be commensurate with the size of the problem that the new regulation is seeking to address.

Gift cards and vouchers

41. In this context, we agree with the view expressed in the Consultation that most gift cards and vouchers should not be regulated. Introducing a mandatory regulatory regime to protect the holders of gift cards would seem disproportionate, as while this is often an emotive issue at the time of a retail insolvency and one which may generate media interest, the size of the problem appears to be comparatively insignificant, with the cited average loss of *Zavvi* gift card holders, to take a figure at the lower end of the range, being only £8.12.

42. We assume that the most likely mandatory regime would involve a percentage of any gift card which is sold being paid to a central body, which would then deal with any compensation claims on the retailer's insolvency. While the cost of setting up and running a system of this type would presumably represent only a small proportion of the £5.4 Billion per annum figure for the gift card and voucher market cited by the UK Gift

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[11] At Section 6.43.

Card and Voucher Association, the key question is how much value such a body would deliver in practice, given the size of the claims that it would typically be dealing with and the frequency with which such claims are likely to be made.

43. On balance, our view is that, it would seem hard to justify forcing those who sell gift cards or vouchers to fund a mandatory system of this type, in circumstances where it is probable that the administrative cost of dealing with many of the claims made would exceed the amount claimed, particularly taking into account the need for the potentially expensive checks and balances which would be required to deter fraud.

44. Introducing any form of mandatory protection in relation to gift cards or vouchers could also, we believe, lead to confusion and unintended consequences. To take five potential issues:

(i) Would such protection extend to those gift cards which were paid for by credit or debit card (thereby making the card issuer the main beneficiary of this protection), or would it be limited to cards paid for by cash or by cheque, in which case how would the holder, often the beneficiary of a gift, be able to prove how payment was made?

(ii) Would such protection apply to gift cards which could be used at a wide variety of retailers, should one of those retailers cease to honour those gift cards, or would such protection be limited to simple contractual promises from a single retailer to provide goods or services up to certain value in circumstances where that retailer has become insolvent and is no longer accepting gift cards?

(iii) Would such protection extend to business to business transactions, which the Consultation notes "*now account for about half of the market*",[12] or, given the focus on consumer protection, would it extend only to consumers, in which case what, other than a mandatory registration scheme, would prevent the owner of a business from giving gift vouchers which were worthless in its hands, to relatives or employees, for whom those vouchers would have real value?

(iv) If, however, customers were required to register for such protection, would it be realistic to expect those returning from a shopping trip to go on-line and register for protection when they had only purchased a gift voucher for £5 or £10?[13]

(v) If such a system was considered necessary, despite its cost, in order to maintain consumer confidence, would its existence result in the purchaser of a business feeling under less pressure to honour gift vouchers in order to maintain goodwill, or in the administrators of the insolvent retailer losing the ability to use the promise of honouring gift vouchers as a tool to increase footfall and sales, as occurred during the *Borders* administration?

45. While noting the Commission's desire to increase consumer awareness as to whether gift cards or vouchers are protected, we would question whether the best solution would be to require the providers of a voucher to state in its terms and conditions whether or not any protection was in place in the event of insolvency. There are two main reasons for this:

(i) The first is that "*protection*" may take many forms. The voucher might state, for example, that protection was in place, in the form of a parent company guarantee. An individual consumer might take comfort from this, but the value of

[12] Section 7.12 of the Consultation.

[13] A possibility suggested by Section 5.12 of the Consultation Summary.

this protection could well prove illusory, should the problems faced by the subsidiary impact on its parent.

(ii) The second is that, 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.

Savings schemes

46. We can see a much stronger argument that firms should be prevented from marketing a scheme in a way which suggests that it is suitable as a savings vehicle unless it protects the funds in some way, preferably by setting up a trust or through bonding arrangements. In particular:

(i) the potential customer exposure (using the *Farepak* £400 per customer figure as a benchmark);

(ii) the relatively limited number of retailers operating such schemes; and

(iii) crucially, the fact that any retailer who cannot comply with the new regulatory regime could simply change the way in which their product was marketed;

would all seem to make this an appropriate area for further regulation.

Voucher Intermediaries

47. We were not entirely clear how Proposal 7 fitted into the general scope of the Consultation, as while “Voucher Intermediaries” sell gift vouchers, their position seemed broadly similar in many respects to other service providers who might require some form of up-front payment or deposit in relation to the provision of services at a future date.

48. As noted in Sections 6.17 and 6.18 of the Consultation Summary, whether or not this business model is potentially problematic from the consumer’s point of view depends on how the voucher intermediary runs its business. If it is well run, with sufficient liquidity, there is no obvious reason why that business should be penalised by the imposition of additional regulation.

49. Other operators may run their business less prudently, but any consideration of whether “aggressive” operators should face additional regulation seems to stray into a much wider debate about “high risk” businesses, and the level of protection which should be granted to the creditors of such businesses, the implications of which go considerably wider than the retail sector.

Deposits for furniture and home improvements

50. Turning to the question of protecting deposits, we felt that any mandatory deposit protection scheme would create very much the same issues to those discussed above in relation to a mandatory trust mechanism. In particular, would the mandatory deposit protection scheme apply to all deposits (which, as we noted above in relation to trusts, would penalise the retailer while delivering little positive benefit to the consumer, as long as the retailer was clearly solvent), or would the retailer only be required to transfer the deposit into the scheme when it was facing financial difficulties (and, if so, what would be the trigger for making such transfer)?

Proposal 8 – Limited preferential status for consumers

51. As noted in our general comments, we agree with the Commission's view, following the approach adopted by the *Cork Committee,* that consumer claims as a whole should not be moved up the repayment hierarchy and that they should therefore not be given priority over the claims of the company's other unsecured creditors.

52. We do, however, have significant reservations about the proposal that a limited category of such claims (namely prepayments and purchases of gift vouchers where a payment in excess of £100 was made with cash or by cheque) should be granted preferential status, ranking ahead of (for example) the unsecured claims of employees, small businesses which supply the retailer, contractors, customers with defective products and, most significantly, those consumers who made payment with a debit or credit card.

53. We understand that it may be argued that the main objective of granting such claims preferential status would be to give the company in administration a further economic motivation to fulfil orders, but we would suggest that in many cases the question of whether or not an order would be fulfilled would still depend, given the other priorities of the administration on (i) the cost of fulfilling that order, (ii) whether the company had sufficient funds available with which to meet that cost and (iii) the amount payable on fulfilment of that order.

54. We were also unclear as to the precise mechanics of what was proposed. Specifically:

(i) Would the proposed category of "second tier" preferential claims rank ahead of, or behind, the "*prescribed part*" reserved for payment of unsecured claims under Section 176A of the Insolvency Act? If this payment were to rank ahead of the prescribed part, the new "second tier" preferential claims might, depending on the level of floating charge realisations, partially or totally use up the cash otherwise available to pay other consumers their share of the prescribed part.[14]

(ii) Where the retailer operates through a number of companies, would the preferential status extend to a group treasury company into which all prepayments and other cash were swept at the end of every day? If not, the most likely beneficiaries of this proposal would be those lenders who had taken a floating charge over the assets of that treasury company as part of a typical group security package, while those losing out might, as noted above, be the company's unsecured creditors.[15]

55. In summary, the proposal that prepayments and purchases of gift vouchers which were made by cash or cheque in excess of £100, should be granted preferential status would appear to be a slightly more practical, but still problematic, variant of the "consumer charge" option discussed above, presenting many of the same problems.

56. There is also a risk that this solution could have an unintended consequence, as giving preferential status to payments by cash and cheque might give rise to a (mistaken) belief that you were better off, in terms of insolvency protection, paying by cash or cheque than paying using a credit or debit card.

Proposals 9 and 10 - Amending the Sale of Goods Act 1979

57. The proposals that:

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[14] It might be argued that such prescribed part payments are likely to be so small that the other consumers would not notice, but this would be to ignore the policy considerations underlying the introduction of the prescribed part.

[15] Which would be an unfortunate outcome, given the Commission's stated concern "*about a body of legal rules which allows floating charge holders to benefit from additional deposits taken from consumers at a time when those "in the know" realise that contracts may not be fulfilled"* - Section 7.3(3) of the Consultation Summary.

(i) in consumer contracts for specific goods, ownership should pass on conclusion of the contract, even where the seller is required to do something further to the goods (such as adapt them to the buyer's specifications); and

(ii) in consumer contracts for unascertained or future goods which are not identified at the time of the contract, ownership should be transferred when the goods are identified for fulfilment of the relevant contract,

both have an initial attraction where the goods in question are owned by the retailer, or where the retailer has authority to sell them on behalf of the legal owner. Making this the default position, unless the parties agree otherwise, would arguably be consistent with the expectations of most customers without a legal training when they are, in their view, "buying" an item.

58. The position is, however, possibly more complex than it initially appears. In many cases, the goods in question will be subject to a retention of title (or ROT) clause. This will generally not prevent title from passing to the customer, as the retailer is normally expressly or impliedly permitted to on-sell goods which are subject to ROT claims in the ordinary course of business. There may, however, be cases where the supplier's terms of business do not permit an on-sale before the supplier has been paid in full for the goods in question.

59. This will, we believe, be a very unusual scenario, but it would be important to ensure that any new statutory provision contemplated by these proposals does not limit the existing protections contained in Section 21 of the Sale of Goods Act, which provides that "*where goods are sold by a person who is not their owner, and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell*."

60. In addition, in order to protect the position of the retailer, particularly if even the payment of a small deposit was sufficient to transfer title to specific goods, it would be important to make it clear that any new statutory provision contemplated by these proposals does not limit the retailer's existing statutory protection, as set out in Section 39(1) of the Sale of Goods Act, which gives a seller a lien on the goods which have been sold and (although not specifically referred to in the Consultation Summary) also gives the seller the specific right, while the goods remain in the seller's possession, to sell the goods if they are not paid for in accordance with the terms of the contract.[16]

61. A further point arises in relation to warehouse liens, as the goods may (particularly in the case of on-line retailers) be owned by the retailer but stored in a warehouse. If the owner of that warehouse has the right to exercise a lien over that stock until any outstanding storage costs have been paid in full, would title pass to the customer despite the existence of that lien?

62. Overall, the proposed changes to the Sale of Goods Act may seem to be relatively straight-forward, but, as acknowledged in the Consultation (see paragraph 13.48), the changes would have relatively limited effect and as such we question whether a proposal for a statutory change is a proportionate response to address the number of issues that arise in practice.

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[16] This power would go some way to addressing the concern raised in Section 13.36 of the Consultation that an immediate transfer of ownership may create difficulties where a customer does not pay for the goods.

63. In addition, we believe that there may some related points (such as the status of warehouse liens, protecting the rights of suppliers with ROT claims, ensuring that the retailer retains the right to sell the goods in question if they are not paid for and providing guidance as to what amounts to the "identification" of goods for these purposes and when goods can be treated as "specific") which would need to be addressed. Given these complexities, we query whether any changes would ultimately simplify the position for the benefit of consumers.

Other areas for consideration

64. The Consultation asks whether there other sectors in which consumer prepayments are particularly problematic in the event of retailer insolvency. One such area which may require further consideration, although not in the traditional retail sector, is that of companies, other than banks, which carry out foreign currency transfers. The typical business model of such companies involves taking a customer's payment in £ sterling and arranging for a recipient located in another jurisdiction to be paid an equivalent amount in the currency of that jurisdiction a few days later.

65. There are a number of variants of this business model, including *Hawala*, where a customer gives money to a hawaladar which then is banked in the UK, with an equivalent amount being given in rupees to the recipient, usually in Pakistan. The risks for the customer inherent in a Hawala structure have been identified in a number of cases, most recently Mirza v Dayman[17].

66. Using foreign currency transfer companies to make payments to acquire a property aboard, or to make payments to relatives in another country, will often prove a commercially attractive option, as such companies generally charge lower fees than banks, and offer better exchange rates. Customers making payments through such companies may, however, be unaware that they are at greater risk, in the event of the relevant company's insolvency, than if they had made the payment through a bank.

67. Given that the amounts involved may be very significant for the individual in question, we believe that this sector may merit further consideration, in relation to possible customer protection measures.

Yours faithfully

THE CITY OF LONDON LAW SOCIETY INSOLVENCY LAW COMMITTEE

[17] [2015] EWHC 1902 (QBD)

Schedule

THE CITY OF LONDON LAW SOCIETY INSOLVENCY LAW COMMITTEE

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