

<b>Title:</b> Continuity of essential supplies to insolvent businesses <b>IA No: BISINSS017</b>  <b>Lead department or agency:</b> Insolvency Service <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>
	<b>Date:</b> 26/01/2015
	<b>Stage:</b> Final
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Secondary legislation
<b>Contact for enquiries:</b> David Miller (020 7637 6445)	

<b>Summary: Intervention and Options</b>	<b>RPC Opinion:</b> Awaiting Scrutiny
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<b>Cost of Preferred (or more likely) Option</b>			
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Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
445.94	378.54	-36.64	Yes	Zero net cost

**What is the problem under consideration? Why is government intervention necessary?**

When a business enters an insolvency procedure, suppliers may invoke a termination clause in their contract purely on account of the insolvency and withdraw their supply. Where those supplies are essential to the continuation of the business, this can have an adverse impact on the likelihood of a successful rescue of the business as a going concern and on the amount returned to creditors. Essential suppliers to an insolvent business may also seek to obtain a commercial advantage from their position by threatening to withhold vital supplies or services unless a 'ransom' payment is made. This market power causes a transfer from the body of creditors of the insolvent business to the essential supplier, undermining the likelihood of a business rescue and reducing returns to the wider body of creditors.

**What are the policy objectives and the intended effects?**

The wider aim of the policy is to enhance the prospects of successful business rescue leading to improved returns to creditors and greater employment preservation.

The main policy objectives are:

- Preventing essential utility and IT suppliers from withdrawing supply to insolvent businesses by relying on contractual termination clauses
- Preventing essential utility and IT suppliers from demanding 'ransom payments' as a condition of continuing supply
- Clarification that 'on-sellers' (intermediate providers) of these essential services would also be subject to the provisions

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

- 1) Exercising powers contained within the Enterprise and Regulatory Reform Act
- 2) A code of conduct for essential utility and IT suppliers

Legislative intervention is required as the policy objectives can only be achieved through amendment to existing legislation by exercise of powers taken in the ERR Act. The Government does not consider that a code of conduct would be workable given the contractual nature of the relationships between parties, and in particular such a code would not provide the required degree of certainty surrounding continuity of supply to be effective. Exercise of the powers would interfere with freedom of contract and Parliament has therefore restricted their possible application, and made provision for important safeguards for those affected.

The Government's preferred option is to implement the powers taken in the ERR Act (Option 1).

**Will the policy be reviewed? It will be reviewed. If applicable, set review date:** 01/2020

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	<b>Micro Yes</b>	<b>&lt; 20 Yes</b>	<b>Small Yes</b>	<b>Medium Yes</b>	<b>Large Yes</b>
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			<b>Traded:</b>		<b>Non-traded:</b>

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible SELECT SIGNATORY: ..... Date: .....

# Summary: Analysis & Evidence

# Policy Option 1

Description: Exercising powers contained within the Enterprise and Regulatory Reform Act

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -131.66	High: 1023.45	Best Estimate: 445.94

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.6	4.0	34.9
High	0.6	48.8	421.1
Best Estimate	0.6	26.4	228.0

### Description and scale of key monetised costs by 'main affected groups'

**To Business:** Familiarisation costs to all essential suppliers. This has been calculated on the basis of 1 hour of Financial Accounts Manager time per business affected, giving a total of £0.05m p.a;  
Initial increase in legal costs £0.59m calculated on the basis that 20% of businesses affected will seek legal or other external advice on the effect of the measures;  
Ongoing transfer cost from reduction in 'ransom' payments to essential suppliers £2.43m, and from utility suppliers not being able to use higher cost contracts following a termination clauses being enforced of £24.0m. Both of these transfers are from utility suppliers to insolvent business/creditors.

### Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0.0	33.6	289.4
High	0.0	123.0	1058.3
Best Estimate	0.0	78.3	673.9

### Description and scale of key monetised benefits by 'main affected groups'

**To Business/creditors:** Increased business rescue resulting in improved returns to unsecured creditors on the basis that there will be a 7% shift in businesses entering the administration procedure instead of liquidation. This is calculated at £51.88m on the assumption that returns to unsecured creditors are 4% higher in administration compared to liquidation ; Transfer benefit to wider body of creditors from prevention of 'ransom' payments £2.43m. Based upon estimates of the quantum of 'ransom' payments presently paid to essential suppliers. An additional transfer benefit to insolvent business/creditors from utility companies not being able use termination clauses that result in higher costs of energy for insolvent businesses/creditors £24.0m

### Other key non-monetised benefits by 'main affected groups'

**Employees:** Enhanced prospect of job preservation through increase in business rescue  
**Government:** Reduction in benefits and statutory redundancy paid out as a result of increased job preservation  
**To Business:** Improved returns to secured creditors (lenders) through enhanced value preservation in business rescue

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

**Assumptions:** The proportion of liquidations that would be avoided, and quantum of 'ransom payments' currently paid by insolvent businesses in order to continue operating (both variables were estimated by a ComRes survey of insolvency practitioners undertaken in August 2013).

**Risks:** That new and/or increased bad debts will be incurred in relation to non-payment for supply of essential services to insolvent businesses. Given the legislative safeguards provided for suppliers we believe this risk is negligible.

That the pricing of supply contracts may be affected as a result of a perceived increase in risk.

### BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:				In scope of OITO?	Measure qualifies as
Costs:	22.1	Benefits:	58.7		
				Yes	Zero net cost

# Evidence Base (for summary sheets)

## Background

1. This Impact Assessment estimates the impact of exercising powers contained within the Enterprise and Regulatory Reform Act 2013 (“ERR Act”) to ensure continuity of supply of essential utility and IT services to insolvent businesses.
2. The Government is committed to ensuring that insolvency practitioners are able to rescue viable insolvent businesses out of formal insolvency wherever possible, and believes that the exercise of these powers will aid this process. A successful business rescue regime can be expected to lead to improved returns to creditors by preserving value that may otherwise be lost, and lead to enhanced job preservation.
3. However, it is recognised that the powers interfere with contractual rights and freedoms, and that the benefits of business rescue need to be balanced against the interests of those suppliers affected. The legislation therefore provides important safeguards for suppliers, including the ability to request a personal guarantee from the insolvency office-holder as a condition of continuing supply, the ability to terminate supply where payment for post-insolvency supply remains outstanding 28 days after payment is due, and the ability to terminate supply with the permission of the court.
4. As this Impact Assessment considers the impact of exercising powers contained within the ERR Act, it is concerned with the continuity of supply of essential utility and IT services only. As such, references to ‘essential suppliers’ within this assessment are taken to mean utility providers (as defined in the Insolvency Act 1986) and IT services.

## Problem under consideration

5. One of the key factors in undertaking a business rescue is the willingness of certain suppliers to continue to supply their services to a business during formal insolvency. Many of a business’s suppliers (in particular utility and IT services) are critical to its day-to-day functioning. Without these supplies, businesses cannot continue to operate.
6. When a business enters insolvency, such essential suppliers may take a number of actions that can severely impede any chances of business rescue (even if their bills are being paid on time and in full). For example, some essential suppliers (such as IT providers) can withdraw their services altogether by relying on ‘termination clauses’ in supply contracts, even though they may be essential for the functioning of the business. Alternatively, suppliers may demand additional payments and/or payment for debts incurred prior to the formal insolvency process (what some insolvency practitioners have called ‘ransom’ payments), before they agree to continue to provide the services they were providing before the insolvency. For the purpose of summarising this concept, the Impact Assessment will refer to these types of payments as ‘ransom payments’. Suppliers may also put businesses on more expensive tariffs as a result of entering formal insolvency.
7. A survey of insolvency practitioners undertaken in August 2013 by ComRes<sup>1</sup>, on behalf of the Association of Business Recovery Professionals (R3), concluded that on average IT suppliers withdrew their supply in 46% of trading insolvencies. Telecoms and utility suppliers withdrew their supply in 26% and 14% of such cases respectively. The survey also concluded that IT suppliers sought to demand a ‘ransom’ payment or renegotiate contract terms as a condition of continuing supply in 55% of trading insolvencies. Such action was taken by telecoms and utility suppliers in 36% and 25% of such cases respectively.
8. Demanding ‘ransom’ payments or varying terms of supply can put even greater pressure on the finances of an insolvent business at a critical time, damaging the chances of survival by consuming funds that could otherwise be used to facilitate rescue. They may also result in certain creditors effectively receiving ‘preferential’ payments at the expense of other creditors, which goes against the

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<sup>1</sup>[http://www.r3.org.uk/media/documents/policy/research\\_reports/R3\\_Membership\\_Survey\\_Termination\\_Clauses\\_09\\_August\\_2013.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf)

basic insolvency principle of *pari passu* (that all creditors of the same class are treated equally) and may result in lower returns to other creditors.

9. Termination clauses are found in many commercial agreements and are a means by which the agreement terminates automatically or gives the right to a party to terminate an agreement on the occurrence of certain events (such as the insolvency of the other party). Where a business is subject to insolvency proceedings, the triggering of a termination clause in contracts with key suppliers can have the effect of preventing a successful restructuring or recovery by disrupting the supply of essential services to the business.

### **Economic Rationale for intervention**

10. The key motivation for intervention is to ensure that insolvency law continues to provide a flexible and modern business rescue regime, maximising value for creditors and enhancing job preservation which can be expected to contribute to economic growth.
11. The ability of essential utility and IT suppliers to either withdraw supply through termination clauses, or to demand 'ransom' payments as a condition of continuing supply, hinders the likelihood of a successful business rescue. The market power exercised by these suppliers effectively causes a transfer from the insolvent business to the supplier, reducing the value in the insolvent business. This in turn affects the wider body of creditors by reducing the likelihood of a business rescue and reducing the amount of funds available to be returned to them – creating a net transfer between these essential suppliers and other creditors. Reducing the chances of a successful business rescue also increases the risk of redundancy for employees.
12. Intervention is necessary to restrict the market power of essential suppliers to businesses in formal insolvency so that the value in the business may be preserved, enhancing the prospects of a business rescue and leading to improved returns for the wider body of creditors.

### **Policy Objectives**

13. The policy objectives are:

- Preventing essential utility and IT suppliers from withdrawing supply to insolvent businesses by relying on contractual termination clauses
- Preventing essential utility and IT suppliers from demanding 'ransom' payments as a condition of continuing supply.
- Clarification that 'on-sellers' (intermediate providers) of these essential services would also be subject to the provisions

### **Options Considered**

14. The Government considered a number of possible alternatives before taking specific powers in the ERR Act to amend insolvency law in this area, including the possibility of non-statutory intervention such as a code of conduct for essential utility and IT suppliers. However, given the nature of the contractual relationship between parties the Government believes that such an approach would be unworkable, and not provide the degree of certainty required around continuity of supply of essential services. The issue of suppliers relying on termination clauses in insolvency has been the subject of much debate and comparison with overseas jurisdictions, particularly that in the US (known as Chapter 11) where, in general terms, an automatic stay operates on the termination of all supplier contracts. Some commentators have called for a similar approach to be adopted in the UK.
15. The Government recognises that preventing suppliers from relying on termination clauses interferes with freedom of contract, which is an important and fundamental concept in English Law. There is no evidence to suggest that the approach adopted in the US is any more effective at facilitating business rescue, and other differences in the underlying law and level of involvement of the courts in the US jurisdiction make direct comparisons difficult. The Government believes that interference in

commercial rights and freedoms is only justified where absolutely necessary, and has therefore taken powers affecting the supply of essential utility and IT services only, as these supplies cannot readily be sourced from alternative suppliers and will often be essential to the survival of most businesses.

16. The Government’s preferred option is to implement the powers taken in the ERR Act, as it considers that implementation of these policies will help to ensure that insolvency practitioners are able to rescue viable insolvent businesses out of formal insolvency wherever possible.

17. Between July 2014 and October 2014 the Government consulted on how it proposed to exercise the power, to seek views especially on the adequacy of intended safeguards for suppliers affected. Around 30 responses were received. Utility providers, in particular independent providers of gas and electricity highlighted that removing the ability of electricity suppliers to terminate or vary their contracts increased the risk that losses will be incurred by suppliers who would not be able to switch providers on to shorter term contracts that more closely match the increased cost and risk of supplying to insolvent businesses.

18. In light of these responses and following further engagement with stakeholders, the detail of the proposals has been refined slightly. When the Order is laid before Parliament a brief summary of the responses and a copy of all those submitted (accept those where confidentiality was requested) will be accessible via the GOV.UK website along with a Written Ministerial Statement laid in Parliament.

19. The substance of the proposals will remain as consulted on but the revisions referred to above may be summarised as follows:

- Suppliers affected will be able to seek a personal guarantee from the insolvency practitioner at any time after the onset of the insolvency to give them more certainty that the post-insolvency supply will be paid for
- The supplier can apply to court to terminate their contract on the grounds of ‘hardship’ which is a lower evidential bar for suppliers than undue hardship, particularly larger suppliers
- Insolvency practitioners will be provided with guidance to encourage them to communicate with suppliers about their intentions in relation to the ongoing supply.

20. In addition, the figures have been updated using the latest available information and responses to the consultation. The next section estimates the costs and benefits of this policy against the baseline ‘do nothing’ option.

**Monetised and non-monetised costs and benefits**

21. Implementing the powers contained in the ERR Act is expected to lead to a range of costs and benefits. Whilst the powers relate to specific policy areas concerning termination clauses, ‘ransom’ payments and bringing ‘on-sellers’ of essential utility and IT services within the ambit of the provisions, it is the cumulative impact of these related policies that is expected to provide the greatest benefit by contributing to the overall objective of aiding business rescue. This should lead to improved returns to creditors and job preservation, bringing wider economic benefits. There is also a transfer cost/benefit from essential suppliers who presently obtain ‘ransom’ payments to the creditors of insolvent businesses, and a number of other potential non-monetised benefits.

22. Table 1 summarises the estimated costs and benefits of exercising the powers in the ERR Act. More detail of the estimates is given in the following paragraphs.

**Table 1: Summary of monetised costs and benefits**

Type of Cost/Benefit	Impact	Low £ million	High £ million	Best Estimate £ million
Ongoing benefits to creditors	Increased business rescue leading to improved returns to unsecured creditors (of which business creditors)	29.64 (26.68)	74.11(66.70)	51.88(46.69)

	Transfer benefit to creditors – essential suppliers no longer paid ransom payments (of which business creditors)	2.06 (1.86)	2.78 (2.51)	2.43 (2.19)
	Transfer benefit to insolvent business/creditors from utility suppliers being unable to use termination clauses (of which business creditors)	1.92 (1.72)	46.06(41.45)	23.99 (21.59)
<b>Non-monetised benefits</b>	Increased business rescue leading to enhanced value preservation for secured creditors			
	Increased job preservation - reduction in social costs			
<b>Total Benefit (PV)</b>				<b>637.9</b>
<b>Transition costs to business</b>	Familiarisation costs to essential suppliers	0.05	0.05	0.05
	One-off transitional increase in legal costs – updating terms and conditions	0.58	0.58	0.58
<b>Ongoing costs to business</b>	Transfer cost to essential suppliers no longer paid ransom payments	2.06	2.78	2.43
	Transfer cost to essential suppliers in utility sector from insolvent businesses	1.92	46.06	23.99
<b>Total Cost (PV)</b>				<b>228.0</b>
<b>Equivalent Annual Net Cost to Business</b>				<b>-36.6</b>

### Ongoing benefits to business

23. The primary benefit arises from an estimated reduction in the number of business liquidations and an equivalent increase in the number of businesses rescued out of formal insolvency procedures. Any increase in the ratio of businesses rescued to those entering liquidation will lead to an improved outcome for creditors, and generally enhanced levels of job preservation. Most creditors of insolvent businesses are businesses themselves<sup>2</sup>, so any improvement in the amount returned to them can be expected to benefit the wider business community.
24. A survey of insolvency practitioners undertaken in August 2013 by ComRes<sup>3</sup>, on behalf of the Association of Business Recovery Professionals (R3), concluded that 7% of liquidations could be avoided if essential utility and IT suppliers were unable to rely on contractual termination clauses and were required to supply insolvent businesses on pre-insolvency terms. A similar survey conducted by ComRes in November 2010 indicated that 14% of liquidations could be avoided<sup>4</sup>. For the purpose of this assessment, the more recent estimate of 7% has been adopted. Those businesses that avoided liquidation would instead be likely to enter into administration – the primary business rescue procedure- which would lead to an improved outcome for creditors.
25. When a business enters into liquidation, the prospects of a business rescue are very limited. Many contracts terminate automatically, and any remaining goodwill on the part of customers and suppliers

<sup>2</sup> The remainder are public sector creditors such as HMRC and local authorities or employees.

<sup>3</sup> [https://www.r3.org.uk/media/documents/policy/research\\_reports/R3\\_Membership\\_Survey\\_Termination\\_Clauses\\_09\\_August\\_2013.pdf](https://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf)

<sup>4</sup> [http://www.r3.org.uk/media/documents/policy/policy\\_papers/corporate\\_insolvency/Holding\\_Rescue\\_to\\_Ransom\\_20Nov.pdf](http://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/Holding_Rescue_to_Ransom_20Nov.pdf)

is often destroyed. The ability of essential suppliers to rely on contractual termination clauses, or to demand 'ransom' payments in order to continue their supply, means that businesses that may otherwise be viable and suitable for rescue are instead entering into liquidation.

26. Returns paid to unsecured creditors in liquidation are extremely low as the value of assets available for distribution is low. An analysis of dividends paid out of the Insolvency Services Account during 2012 in relation to creditors voluntary and compulsory liquidation cases indicates that the average dividend paid to unsecured creditors is effectively zero. Returns paid to unsecured creditors in administration are higher due to enhanced asset value preservation (e.g. goodwill preserved through a business rescue). Research undertaken by the Office of Fair Trading in their 2011 report on The Market for Corporate Insolvency Practitioners<sup>5</sup>, indicates that the average recovery rate for unsecured creditors in administration is 4%. This recovery rate is an average and is therefore not dependent upon a successful business rescue being achieved. The report also found that the average amount due to unsecured creditors of insolvent businesses in administration was £1.2m, based on analysis of data held at Companies House on 500 companies.
27. For the purposes of this assessment it is assumed that businesses that would otherwise have entered into liquidation would instead enter into administration – the primary business rescue procedure - and that the debt profile of businesses entering into the two procedures is the same. If the expected 7% of liquidations were instead administrations, this would result in an additional 1,081 administrations per year based on the total number of liquidations during 2013<sup>6</sup> (15,440x0.07%).
28. In practice, some businesses that would otherwise have entered liquidation may instead enter into a company voluntary arrangement (CVA) rather than administration. Whilst the probability of this is difficult to quantify, the average amount returned to unsecured creditors through a CVA can be expected to be higher than both liquidation and administration. As such, the estimates below represent a cautious assessment of the extent to which unsecured creditors would benefit in the event that a proportion of liquidations were avoided.
29. On the basis that the average recovery rate for unsecured creditors in administration is 4%, and that the average debt owed to unsecured creditors in administration is £1.2m, it is estimated that an additional **£51.88m** (1,081 x £1,2m x 0.04) would be returned to unsecured creditors. This represents an ongoing benefit to unsecured creditors that would not otherwise have been realised, and is attributable to the higher recovery rates achieved from administration in comparison to liquidation. Creditors include a range of different parties not all of whom are businesses other creditors such as HMRC and local authorities will also accrue some of this benefit. For the purposes of One-In Two-Out (OITO) purposes an estimate of the direct impact on business is needed.
30. Analysis of a random un weighted sample of 125 records filed at Companies House over a 3 year period and a OFT market study of insolvency practitioners estimated that non businesses accounted for around 10 per cent of the returns to creditors. Therefore the best estimate impact on business creditors is £46.69m (90 per cent of £51.88m).
31. Table 2 below indicates a range of benefits that may accrue depending upon the number of businesses which could be expected to enter administration instead of liquidation. The most reliable estimate is 7% reflecting the result of the most recent ComRes survey in August 2013.

**Table 2: Range of ongoing benefits through reduction in % of liquidations**

Estimate	Low	Medium	High
% of liquidations avoided	4	7	10
No. additional administrations (based on 2013 statistics)	618	1,081	1,544
Benefit to unsecured creditors (£m)	29.64	51.88	74.11

<sup>5</sup> [http://www.offt.gov.uk/shared\\_offt/reports/Insolvency/oft1245](http://www.offt.gov.uk/shared_offt/reports/Insolvency/oft1245)

<sup>6</sup> <https://www.gov.uk/government/statistics/insolvency-statistics-july-to-september-2014>

## **Transfer costs/benefits to business**

32. In addition to the resource benefit of greater business rescue described above, there is also a transfer cost/benefit to business that would arise as a result of preventing essential suppliers from obtaining 'ransom' payments from insolvent businesses. The effect of obtaining a 'ransom' payment is that those suppliers, who may also be creditors, effectively receive 'preferential' payments at the expense of other creditors, obviating the basic insolvency principle of *pari passu* and potentially resulting in lower returns to other creditors.
33. Whilst the overall impact of 'ransom' payments is difficult to quantify, they can be expected to have an impact on the likelihood of a successful business rescue, in addition to creating a transfer from one group of suppliers to another. This transfer is inequitable and is created by the additional market power of those suppliers that are essential to the continuation of the business.
34. The survey of insolvency practitioners undertaken in August 2013 by ComRes<sup>7</sup>, on behalf of the Association of Business Recovery Professionals (R3), questioned insolvency practitioners on the proportion of trading insolvencies where 'ransom' demands were made or contract terms renegotiated and the average amount paid out in those cases. Table 2 below indicates the estimated proportion of trading insolvencies where 'ransom' demands are made and the median amount paid out. A median figure has been used as the wide distribution of survey responses would result in the average figures being unduly impacted by a small number of outliers.

**Table 3: Estimated proportion of cases where ransom payments made and amounts paid**

<b>Category of essential supplier</b>	<b>Utility</b>	<b>Telecoms</b>	<b>IT</b>
% of trading cases where ransom demands made	25%	36%	55%
Median amount of ransom demand paid (£)	500	1	5,000

35. In order to quantify the overall value of the transfer, it is necessary to estimate the proportion of trading insolvencies. For the purposes of this assessment, the value of the transfer has been assessed for administration and company voluntary arrangements ('CVAs'), as these two corporate insolvency procedures are most likely to result in a business rescue through a continuation of trading.
36. Insolvency statistics<sup>8</sup> indicate that there were 593 CVAs in 2013 – it is assumed that all these cases would result in a continuation of trading and therefore be impacted by a reduction in ransom payments paid to essential suppliers. This would mean that in all CVAs there would be more funds available to the insolvent business to pay creditors and continue trading.
37. There were 2,516 administrations in 2013 and it is assumed that only 10% of these cases would ordinarily result in a continuation of trading, as the procedure may be used for other purposes in order to achieve the particular statutory objective of administration being pursued. This assumption has been modelled in the range of 5% to 15% to demonstrate the impact on the total amount of ransom payments. The impact of preventing ransom payments in administration would only accrue in those cases where trading was continued, as it is only those cases where a continuation of supply of essential services would be necessary and where ransom payments would be made. On the basis of these assumptions, Table 4 below estimates the overall value of 'ransom' payments paid out across different categories of essential supplier, for both the CVA and administration procedures.

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<sup>8</sup> <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/historicdata/HDmenu.htm>



**Table 4: Estimated total value of ransom payments paid in CVAs and administration**

<b>Category of essential supplier</b>	<b>Utility</b>	<b>Telecoms</b>	<b>IT</b>
% of trading cases where ransom demands made	25%	36%	55%
Median ransom paid (£)	500	1	5,000
<b><u>CVAs</u></b>			
No. trading CVAs <sup>9</sup> x % cases where ransom demanded	148	213	326
<b>Estimated total value (£)</b>	<b>74,125</b>	<b>213</b>	<b>1,630,750</b>
<b><u>Administration</u></b>			
No. trading administrations <sup>10</sup> x % cases where ransom demanded			
@5% trading administrations	15,725	41	345,950
@10% trading administrations	31,450	91	691,900
@15% trading administrations	41,175	136	1,037,850
<b>Best estimate total value (£)</b>	<b>31,450</b>	<b>91</b>	<b>691,900</b>
<b>Total ransom payments paid in CVA and administration</b>	Low 2,066,808 <b>Mid 2,428,529 (best estimate)</b> High 2,784,249		

38. The total estimated value of the ransom payments currently paid in CVAs and administration represents an economic transfer from the creditors of insolvent businesses to essential suppliers exercising their market power. As most essential suppliers and creditors are businesses, the overall impact of preventing ransom payments on business is estimated to be close to zero. It is estimated that non business creditors make up around 10 per cent of the impact on creditors meaning the economic transfer will be a net cost to business of £0.24m (best estimate). It is expected that the effect of preventing this economic transfer will be to enhance the likelihood of successful business rescues thereby contributing to achieving the ongoing resource benefits identified in paragraph 31 above.

39. There will be an additional cost to utility providers from the removal of termination clauses. Termination clauses are used by utility providers at the point of insolvency because of the greater risk of supply to an insolvent business. Energy contracts to business are generally provided on a fixed price basis. To provide this price certainty to business energy suppliers purchase requirements in advance using forward contracts. Utility suppliers that fail to match the demand and supply requirements are faced either with the risk of purchasing power requirements on the short market where prices could be above or below the previously agreed terms or incur a cost from regulators for failing to inadequately forecast power needs.

<sup>9</sup> Assumed to be 100% of 593 cases in 2013 based upon insolvency statistics  
<http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/historicdata/HDmenu.htm>

<sup>10</sup> Best assumption to be 10% of 2,516 cases in 2012 based upon insolvency statistics, with a range of 5% to 15%

40. The shorter term contracts used by utility provider that use termination clauses are often at a much higher cost to insolvent businesses to reflect the greater risk of bad debt and the risk of purchases gas and electricity on the short term market. Utility suppliers have told us that the costs of supply to insolvent businesses can be as much as twice cost of a non insolvent business. The removal of termination clauses will effectively transfer these costs of the additional payments from insolvent companies on to utility suppliers. The equivalent benefit will be incurred by insolvent businesses and their creditors.
41. It is difficult to measure the value of this transfer because information on the demand for power in insolvent businesses is not available. However, assuming their requirements are similar to non insolvent businesses of a similar size it is possible to estimate the additional cost of providing power to insolvent business at between £1.9 and £46.1m with a best estimate at the mid point of £24.0m, as shown in table 5<sup>11</sup>. Not all of the transfer will accrue to business as it is estimated that 10 per cent of the returns to creditors accrue to non business creditors such as HMRC and local authorities. Therefore there will be a best estimate net cost to business of £4.61m (£46.06 – (0.9 x 46.06)).

**Table 5: Estimated total value of transfer from the restriction on the use of termination clauses in company insolvency by size of business**

	<b>Estimated number of in scope insolvencies</b>	<b>Lower bound cost to utility suppliers (£m)</b>	<b>Upper bound cost to utility suppliers (£m)</b>	<b>Best estimate (mid point) £m</b>
Very Small/Micro	1,965	0.33	27.04	13.69
Small	29	0.31	4.05	2.18
Medium	5	0.58	4.56	2.57
Large	1	0.69	10.40	5.55
<b>Total</b>	<b>2,000</b>	<b>1.92</b>	<b>46.06</b>	<b>23.99</b>

42. The annex shows how the indicative costs per firm were estimated using different assumptions over expected power consumption. This transfer from utility provider to insolvent businesses will be an ongoing cost/benefit of the legislation.

### **Transition Costs to Business**

43. The transition costs to business will be borne by those essential suppliers who will no longer be able to rely on contractual termination clauses or demand ‘ransom’ payments and include familiarisation costs and an initial increase in legal costs. These costs are not expected to borne by the business population as a whole, as it is only when a business enters formal insolvency that essential suppliers will be subject to the provisions, and only then in instances where trading is continued and the insolvency practitioner deems the supply essential to the continuation of that business.
44. The estimated proportion of businesses that would be expected to enter administration instead of liquidation (as set out in Table 2 above), reflects those cases where the exercise of the powers will necessitate a change of behaviour on the part of essential suppliers. Whilst it is difficult to estimate the precise impact of this, it is assumed that many essential suppliers will not be fully aware of the practical effect of the changes until they are directly impacted by them, when they will either incur direct familiarisation costs or seek external legal advice.

### *Familiarisation costs*

<sup>11</sup> The Department for Energy and Climate Change publish statistics on the price paid for utilities for different sizes of businesses. <https://www.gov.uk/government/collections/industrial-energy-prices>. Business size is stratified into bands based on how much gas and electricity each business type typically uses. For example, a typical small business was estimated to use between 20 and 499 MWh of electricity. It is possible to construct a range of the cost to business by using the upper and lower limits of these size bands per business type and multiplying by the price paid for electricity.

45. The familiarisation costs are expected to arise primarily as a result of the changes preventing essential suppliers from relying on contractual termination clauses, as this is likely to have the greatest impact on suppliers who may otherwise have simply withdrawn their supply. No separate familiarisation costs have been identified for the changes preventing 'ransom' payments from being demanded, as these are very likely to be considered by essential suppliers alongside the changes surrounding termination clauses.
46. Using information from the BIS Business Population Estimate 2014<sup>12</sup> it was estimated that around 5,475 employers exist in the IT services, utilities and telecoms sectors<sup>13</sup>. A significant number of these employers will not be directly involved in the supply of services and/or will not use termination clauses or ransom payments and therefore will not have to incur familiarisation costs of the new legislation. To account for this we assume the proportion of insolvencies where a supplier withdraws their supply is an approximation of the number suppliers who use these contractual terms. This has been estimated from the survey of insolvency practitioners undertaken in August 2013 by ComRes<sup>14</sup>, on behalf of the Association of Business Recovery Professionals (R3), which concluded that on average IT suppliers withdrew their supply in 46% of trading insolvencies. Telecoms and utility suppliers withdrew their supply in 26% and 14% of such cases. These means around 1,954 businesses will be required to familiarise themselves with the legislation change.
47. Based on the proposed reforms we estimate it will require one hour on average for a staff member to become familiar with the changes. This time allows for the variation in impact on businesses affected by the specific changes. In reality, many businesses will be informed of changes by their trade associations and businesses groups, and are likely to read purpose-drafted literature about the changes, which has been accounted for in this estimate.
48. It is expected that familiarisation with the changes would be undertaken at a relatively senior level, given the potential significance of the requirement to continue supply to an insolvent business. It is therefore assumed that this function would be undertaken at Financial Accounts Manager level. The Annual Survey of Hours and Earnings (ASHE) 2013<sup>15</sup> indicates that the hourly rate for this function is £21.40. Based on Eurostat labour cost data<sup>16</sup>, this figure is subject to an uplift of 7.8% to reflect non-labour costs, giving a gross hourly rate of £23.07. On the basis that one essential supplier for every businesses that no longer enters liquidation incurs one hour of Financial Accounts Manager time, the range of familiarisation costs to business is indicated below in Table 6.
49. Table 5 indicates a best estimate of **£45,079** for the direct familiarisation costs to business. It is expected that these costs will be incurred immediately before the implementation of the changes. After this time, it is anticipated that knowledge of the impact and practical effect of the changes would become universal amongst those essential suppliers likely to be effected.
50. Familiarisation costs to insolvency practitioners are expected to be **negligible** given that insolvency practitioners, as regulated professionals, are accustomed to frequent regulatory and legal updates and changes and benefit from regular guidance issued by the Insolvency Service and professional/trade bodies. In terms of suppliers, we will ensure that appropriate guidance is issued alongside the new legislation to ensure that suppliers likely to be impacted by them fully understand the new law especially the safeguards that are afforded to them in circumstances where they are obliged to supply goods or services to the insolvent company.

### *Transitional legal costs*

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<sup>12</sup> <https://www.gov.uk/government/statistics/business-population-estimates-2014>

<sup>13</sup> SIC 07 classifications UK Divisions - Electricity, gas, steam and air conditioning supply; Water collection, treatment and supply, and Information Service Activities ; Telecommunications activities (wired and wireless)

<sup>14</sup> [http://www.r3.org.uk/media/documents/policy/research\\_reports/R3\\_Membership\\_Survey\\_Termination\\_Clauses\\_09\\_August\\_2013.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf)

<sup>15</sup> <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcn%3A77-337429>

<sup>16</sup> [http://epp.eurostat.ec.europa.eu/portal/page/portal/labour\\_market/labour\\_costs/main\\_tables](http://epp.eurostat.ec.europa.eu/portal/page/portal/labour_market/labour_costs/main_tables)

51. In addition to the direct costs to business from familiarisation, there may also be an initial increase in legal advice sought by essential suppliers affected in view of the potential impact on contractual relationships between essential suppliers and their customers. This may involve the consideration of the legal effect of the changes, such as whether or not a particular supplier is subject to the provisions. There would be no automatic need for essential suppliers to change their terms and conditions of supply, as these would be overridden by the new provisions, but it is possible legal advice may also be sought on this issue.
52. An IFF Survey on Consumer Rights and Business Practices<sup>17</sup> undertaken in March 2013, considered the management and legal costs incurred by businesses in order to comply with consumer rights legislation. The survey found that 20% of businesses reported that they had used the services of private law firms to provide advice. The survey also found that these businesses spent £1,497 on average per annum seeking advice from law firms or other organisations.
53. On the basis that 20% of essential suppliers to businesses that avoid liquidation seek legal advice at a cost of £1,497, a best estimate of **£585,028** for legal costs is indicated in Table 6 below.

**Table 6: Range of familiarisation and legal costs to business**

Estimate	
Number of suppliers impacted	1,954
Familiarisation cost to business at £23.07 per hour (£)	45,079
Legal costs at £1,497 in 20% of cases (£)	585,028
<b>Total transitional costs (£)</b>	<b>630,106</b>

### **Non-monetised benefits**

#### *Increased job preservation and reduction in social costs*

54. In addition to the monetised benefits arising from the expected increase in the proportion of business rescues, there are also expected to be indirect economic benefits. The extent of these benefits are difficult to quantify, but a successful business rescue will generally result in the preservation of the whole, or a part, of the insolvent business, meaning that more jobs will be preserved in comparison to a liquidation where businesses will be closed and jobs lost. This not only benefits individual employees, but means that they are less likely to experience a period of temporary or permanent unemployment, reducing the burden on the state through a consequential reduction in social costs.
55. A survey conducted by ComRes into the Value of the Insolvency Industry<sup>18</sup> on behalf of the Association of Business Recovery Professionals (R3), indicates that on average insolvency practitioners estimate that they save 33.69 jobs per business rescued. Applying this figure to the range of liquidations which may be avoided (see Table 2), would give a number of jobs saved in the range 21,764 to 54,443, with a best estimate of 38,103. Whilst the economic impact of this is difficult to estimate accurately, it is likely to be significant in terms of benefits to the individual and the state.

<sup>17</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/206442/bis-13-914-iff-report-consumer-rights-and-business-practices.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/206442/bis-13-914-iff-report-consumer-rights-and-business-practices.pdf)

<sup>18</sup> [http://www.r3.org.uk/media/documents/policy/policy\\_papers/insolvency\\_industry/R3\\_Value\\_of\\_Industry\\_FINAL\\_VERSION\\_01May2013.pdf](http://www.r3.org.uk/media/documents/policy/policy_papers/insolvency_industry/R3_Value_of_Industry_FINAL_VERSION_01May2013.pdf)

56. There will also be some further benefit for those suppliers who are required to continue supplying – as they will receive earlier notice of the onset of the administration. Responses to the consultation and anecdotal evidence through discussions with stakeholders alluded to the fact that often suppliers are not aware that the administration has started until weeks into the process. This delay in informing the supplier can result in weeks of the businesses receiving the benefit of the supply without the supplier having any knowledge of the insolvency, which can result in difficulty for the supplier to plan their next steps. This was an issue raised in particular amongst the utilities sector. Early notification will enable suppliers to better plan and manage their supply and client accounts.

#### *Enhanced value preservation for secured creditors*

57. In addition to the expected monetised benefits accruing to unsecured creditors, any increase in the proportion of business rescues is also likely to lead to greater returns to secured creditors through enhanced value preservation. A business which is rescued is likely to retain greater value through the preservation of goodwill on the part of customers, suppliers and employees. Secured lenders may not need to crystallise losses incurred on loans or will receive a better return than they otherwise would were the business to enter liquidation. The impact of this is difficult to quantify, but if secured creditors (e.g. banks and other lenders) retrieve more money from insolvency, they will have more money to lend to other businesses which can be expected to contribute to economic growth.

#### *Increased business rescue in individual insolvency*

58. The analysis throughout this impact assessment has focused on business rescue in corporate insolvency procedures, as it is in that context that the vast majority of business rescues are undertaken and consequently where the economic impact is greatest. The ERR Act powers also provide for analogous amendments to be made to insolvency law affecting the insolvency of individuals, and will affect cases where the individual has been carrying on a trade and essential suppliers seek to rely on a contractual termination clause or demand 'ransom' payments.

59. It is proposed that equivalent changes will be made preventing essential suppliers from relying on contractual termination clauses or from demanding 'ransom' payments in individual insolvency law, which can be expected to lead to a small reduction in the number of bankruptcies. It is expected that the number of such cases will be negligible so the impact has not been quantified, but any reduction in the number of bankruptcies where the individual has been carrying on a trade can be expected to lead to an improved outcome for creditors and enhanced job preservation.

### **Micro/Small Businesses Assessment (SMBA)**

60. We do not propose to exempt essential suppliers who are micro or small businesses from the new provisions, as this would be detrimental to other micro and small businesses who as creditors of insolvent businesses are expected to derive greater benefits from the increased proportion of business rescues. An analysis of why a full, temporary or partial exemption for small or micro businesses would be significantly detrimental to achieving the wider policy objectives is considered below.

61. According to the BIS Business Population Estimate 2014<sup>19</sup> small and medium (SME) businesses accounted for over 99% of all private sector businesses in the UK (employing 0-249 people). Of the SME population, 95% of businesses are micro (0-9 employees), and 4% are small (10-49 employees). The creditor profile of most insolvent businesses is reflected by the general business population meaning that the vast majority of unsecured creditors can be expected to be small or micro businesses. The primary benefit of the changes is the increased return that will accrue to unsecured creditors by virtue of the increased proportion of business rescues.

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<sup>19</sup> <https://www.gov.uk/government/statistics/business-population-estimates-2014>

62. The R3 Membership Survey on termination clauses indicates that 60% (IT), 46% (telecoms) and 41% (utility) of essential suppliers seeking to withdraw their supply or extract 'ransom' payments from insolvent businesses are SME businesses. As outlined above, small and micro businesses account for a large proportion of the SME population. These are lower proportions than the general business population, reflecting the prevalence of larger businesses in these sectors. This indicates that the policy would often impact on larger businesses whilst delivering benefits to unsecured creditors who can ordinarily be expected to reflect the profile of the general business population, being predominantly small and micro businesses. Notwithstanding this, it remains the case that many essential suppliers to insolvent businesses are micro and small businesses (applying the BIS Population Estimates of 95% and 4% respectively to the SME population). If such suppliers were excluded from the scope of the policy there would likely be a significantly detrimental effect on the quantum of the overall benefits accruing from increased business rescue, as well as a disproportionate negative impact on micro and small suppliers, as demonstrated below.
63. When insolvency practitioners are appointed in a formal insolvency, they will often have only a very limited time in which to make crucial decisions about the potential viability of a business. One of the factors taken into consideration will be the ability of the business to retain key suppliers, such as those providing utility, telecoms and IT services, so that it may continue to trade. Continuing to trade may be the most effective way of preserving goodwill in the business and securing a sale in the interests of the creditors.
64. What constitutes an essential supply, or supplies, to an insolvent business will vary. There may be a number of factors that are relevant, such as the availability of alternative suppliers or whether the nature of the services provided is of a unique or specialist nature. Such services may be provided by a range of different suppliers of varying size, for example a large business may be providing utility services whilst a micro business may be providing an essential bespoke IT system. In such circumstances the insolvency practitioner will require certainty that all essential suppliers to the insolvent business, whatever their size, will be required to continue their supply in order ensure the greatest prospects of a rescue. It is therefore crucial that small and micro businesses are included within the scope of the policy, as in a substantial proportion of cases it is withdrawal of supply or extraction of a ransom payment by this group that is harming the prospects of a business rescue and thereby reducing the amount returned to creditors including other small and micro businesses.

*Quantification of overall benefits attributable to small and micro business essential suppliers*

65. R3 have advised that 'very many' essential IT suppliers are likely to be small and micro businesses. They further advise that such suppliers will often be niche and can hold a position of strength where they hold the key to source codes or cloud technology. In addition, R3 have indicated that in the telecoms sector many 'on-sellers' of services are likely to be small and micro businesses. If such suppliers were not within scope the effectiveness of the policy in these sectors would therefore be greatly reduced and could become un-workable. There is also a risk that suppliers would seek to arrange their supply through an on-seller or other intermediary not within scope of the provisions.
66. On the basis of the advice received from R3, it is reasonable to assume that the proportion of essential SME business suppliers that are small and micro businesses reflects that of the wider business population (4% and 95% respectively as outlined in paragraph 50 above). Applying these proportions to those SME essential suppliers in the IT, telecoms and utility sectors that seek to withdraw their supply or extract 'ransom' payments on insolvency will reduce the overall benefits of the policy that will accrue from the enhanced likelihood of business rescue, as indicated below.

**Table 7: Indicative estimates of the size of the reduction in quantified benefits from exclusion of small and micro suppliers across sectors**

<b>Sector</b>	<b>IT</b>	<b>Telecoms</b>	<b>Utility</b>
% of SME suppliers	60	46	41
% of SME suppliers that are small (4%)	2.4	1.8	1,6
<b>Reduction in overall benefits (£46.69m x % small suppliers)</b>	<b>£1.12m</b>	<b>£0.86m</b>	<b>£0.75m</b>
% of SME suppliers that are micro (95%)	57	43.7	39
<b>Reduction in overall benefits (£46.69m x % micro suppliers)</b>	<b>£26.61m</b>	<b>£20.40m</b>	<b>£18.21m</b>

67. The table indicates a possible reduction in overall benefits resulting from the exclusion of small and micro business suppliers across different sectors, with an **overall range of reduction of £0.75m to £26.61m**, depending on the size and nature of the supplier. This demonstrates a potentially significant detrimental impact on the wider quantified benefit of £51.88m outlined in paragraphs 30 and 31 above. The greatest loss of benefit would be likely to result from the exclusion of micro business IT suppliers from the scope of the policy, which reflects the advice received from R3 about the nature of supplies made in this sector.

#### *Benefits to small and micro businesses*

68. Small and micro businesses who are required to continue their supply to insolvent businesses or who will be prevented from extracting ransom payments are expected to benefit from the policy in three ways. These benefits are difficult to quantify as no qualitative data is available but are summarised below.

69. The requirement for essential suppliers to continue their supply will only be exercised by insolvency practitioners in circumstances where on-going trading is expected to lead to a rescue of the business or otherwise achieve a better outcome for creditors. A rescue of the insolvent business will mean that a small or micro business supplier will continue to have a customer with whom to trade – this may be of greater proportionate benefit to a small or micro business supplier that may depend on a single or few customers. In some cases, this could be crucial in ensuring the preservation of the small or micro suppliers' business.

70. The requirement to continue supply will be subject to a number of safeguards as regards security for the payment of supplies made during formal insolvency. These safeguards include the ability to request a personal guarantee from the insolvency practitioner, and in practice it is therefore assumed that the risk of any supplier remaining unpaid for supplies made during formal insolvency is negligible. This ability to request a personal guarantee from the insolvency practitioner, and to effectively obtain a form of security for payment of supplies made during insolvency, is likely to be of proportionally greater benefit to small and micro businesses. Such businesses may have only a single or few customers and may not ordinarily seek security for payment in the course of transacting, effectively placing them at an advantage to other small and micro business suppliers facing a general credit risk of customer insolvency.

71. The improved prospects for a business rescue will mean that those essential small and micro suppliers who are required to supply, and who are also creditors in respect of supplies provided prior to insolvency, can be expected to receive a greater return on their debt than would otherwise have

been the case. Again, this may be of proportionally greater benefit to a small and micro business with a single or few customers where the effects of a bad debt may be more keenly felt.

*Costs to small and micro businesses*

72. Businesses are expected to receive full payment for supplies made during formal insolvency. Any debt incurred by suppliers prior to insolvency will remain outstanding and will have occurred irrespective of this policy which will only have affect at the onset of formal insolvency, although there will be a likelihood of improved returns on pre-insolvency debt as a result of the enhanced prospect of a business rescue.
73. Businesses that will no longer be able to obtain a ‘ransom’ payment as a condition for continuing their supply will lose this benefit. A proportion of these businesses will be small and micro businesses as outlined above. However, the effect of obtaining a ‘ransom’ payment is that those suppliers effectively receive ‘preferential’ payments at the expense of other creditors, obviating the basic insolvency principle of *pari passu* (i.e. that all creditors in the same class should be treated equally) and potentially resulting in lower returns to other creditors. This benefit therefore represents an economic transfer from the general body of creditors (constituted primarily of small and micro businesses) to essential suppliers, whose constitution reflects generally lower proportions of small and micro businesses.
74. Additionally the cost to essential supplies from preventing the use of termination clauses at the point of insolvency causes a further economic transfer from essential suppliers to insolvent business/creditors.
75. Paragraph 38 and paragraph 41 estimates the total value of the economic transfer on business resulting from ransom payments as £2.43m and from the removal of termination clauses as £23.99m. The value of this transfer to small and micro business suppliers, using the proportion of SME suppliers outlined above from the R3 survey, is indicated below.

**Table 7: Indicative estimates of the value of economic transfer to small and micro suppliers**

<b>Sector</b>	<b>IT</b>	<b>Telecoms</b>	<b>Utility</b>
% of SME suppliers	60	46	41
% of SME suppliers that are small (4%)	2.4	1.8	1.6
<b>Value of transfer to small suppliers (£26.42m x % small suppliers)</b>	<b>£0.63m</b>	<b>£0.48m</b>	<b>£0.42m</b>
% of SME suppliers that are micro (95%)	57	43.7	39
<b>Value of transfer to micro suppliers (£26.42m x % micro suppliers)</b>	<b>£15.06m</b>	<b>£11.55m</b>	<b>£10.30m</b>

76. The table indicates that the possible value of the economic transfer to small and micro business suppliers is in the **range of £0.42m to £15.06m**, depending on the size of supplier and sector. This is a significantly lower range than the estimated negative impact to the overall benefits of the policy were small and micro business suppliers to be excluded from scope. It is important to recognise that this transfer benefit results from opportunistic behaviour on the part of essential suppliers, and is not a benefit that small or micro businesses would expect to derive in the ordinary course of their business.



## *Summary of small and micro business impact*

77. A full exemption for small or micro businesses who are essential suppliers would therefore disproportionately harm the wider small and micro business community which accounts for over 99% of the business population, as reflected in the creditor profile of insolvent businesses who are expected to benefit from the changes. A full exemption would reduce the effectiveness of the changes, leading to a smaller increase in the number of business rescues and reduced returns for unsecured creditors (other small and micro businesses). This would significantly undermine the rationale for the policy. A partial or temporary exemption for small or micro businesses has also been considered and discounted on the basis that the benefits of the policy are expected to accrue primarily to the small and micro business populations. Any delay in implementation for particular business sectors would therefore lead to delayed and/or reduced benefits, and not be in the interests of the wider small and micro business communities.
78. In addition, any partial or temporary exemption would also create an even more complex legal regime, with different obligations to supply varying according to the size of the supplier. This would deprive the changes of most, if not all, of their desired clarity and may cause a disproportionate increase in legal costs. For example, small and micro businesses, and insolvency practitioners (some of whom will also be small and micro businesses) would be required to assess whether or not a particular essential supplier was subject to the new provisions by reference to the size of the supplier. This may not always be easy or practicable for the insolvency practitioner to determine in circumstances where urgent action will often need to be taken if a business is to be rescued. In this context, any dispute surrounding the scope of the provisions is likely to lead to a detrimental impact on the likelihood of a business rescue and cause small and micro businesses to incur unnecessary costs.
79. Furthermore, the nature of the provisions is such that they override certain contractual terms. The potential impact of this has been recognised in the provisions by providing for a range of statutory safeguards, of which all essential suppliers, including small and micro businesses, will be able to take advantage. For example, the ability of essential suppliers to obtain a personal guarantee from the insolvency office-holder as a condition of continuing their supply. Overriding contractual terms is a significant step and providing certainty of outcome, for both essential suppliers and insolvency practitioners, is an important aim of the provisions. In seeking to achieve this aim, the impacts on the small, micro and wider business community have been considered, which is reflected in the range of safeguards incorporated into the provisions.
80. In summary, small and micro businesses can be expected to benefit from the policy at both a macro and micro level, through the following impacts:
- Improved returns to unsecured creditors generally (99% of which are small or micro businesses) of £46.69m. This benefit could be reduced by up to £26.61m in the event that small and micro business suppliers were excluded from the scope of the policy.
  - Enhanced prospect of business rescue where small and micro businesses are required to supply preserves trading relationship on which small and micro businesses may be particularly reliant
  - Ability to obtain a form of security for payment of supplies made during insolvency may reduce the credit risk for small and micro businesses affected in comparison to other suppliers in the sector facing general risk of customer insolvency
  - Where a small or micro business has been required to supply an insolvent business which is subsequently rescued improved returns can be expected in relation to any debt incurred for pre-insolvency supply which is likely to be of proportionally greater benefit to small and micro businesses
81. To mitigate the familiarisation burden on small and micro businesses, specific guidance and information will be made available and tailored to their needs, in order to mitigate any

disproportionate demands in respect of understanding the potential impact of the changes. We will also engage with representative bodies of suppliers affected, so that they can effectively advise their members.

82. As a part of the post implementation review, the impact on small and micro business will be monitored and reported on, to assess whether the policy has led to any unforeseen impacts on this sector.

### **Risks and assumptions**

83. The main assumptions in this assessment concern the proportion of liquidations that will be avoided, and the quantum of 'ransom' payments currently paid by insolvent businesses in order to continue operating. Both variables were tested in the ComRes survey of insolvency practitioners undertaken in August 2013. It is assumed that where liquidation is avoided businesses will instead enter administration – the main corporate rescue procedure, resulting in an improved outcome for creditors.
84. The risk of the policy is that those essential suppliers who will no longer be able to rely on contractual termination clauses, or demand 'ransom' payments from insolvent businesses, will perceive that the risk of supply has increased. Suppliers may perceive that the risk of being required to supply an insolvent business is greater than the risk of supplying a business not subject to an insolvency procedure. This could result in an increase in the general cost of supply or encourage essential suppliers to take earlier precipitate action in order to avoid becoming subject to the provisions.
85. In reality, essential suppliers who are required to supply an insolvent business will be protected by a number of safeguards. Essential suppliers that are required to supply a business in administration will rank as an administration expense, which means that they have priority over other creditors including the remuneration of the administrator. Essential suppliers will also be able to obtain a personal guarantee from the insolvency office-holder as a condition of continuing their supply. Essential suppliers will in addition be able to withdraw their supply when payment for charges remains unpaid 28 days after payment is due. In practical terms it is therefore assumed that the actual risk of essential suppliers remaining unpaid for any supply made under the new provisions is negligible.
86. Whilst there may be a period of initial uncertainty surrounding the impact of the changes and of the risks associated with being required to supply an insolvent business, it is expected that the extent of the safeguards that will be provided and nature of the creditor hierarchy governing the payment of supplies made during an insolvency will ultimately offset any negative impact on the perception of risk.

### **One-in, Two-out**

87. The legislation increases regulation on businesses supplying IT and utilities to businesses in administration. The continuation of supply increases the chance of survival for many businesses that enter administration who otherwise would have gone in to liquidation and so will increase returns to creditors. The benefits of business survival exceed the costs to essential suppliers and so the legislation is net beneficial to business and in accordance with the better regulation framework has been scored as a 'Zero Net Cost IN'.
88. The Equivalent Annual Net Cost to Business has been estimated to be -£36.6m.

### **89. Wider Specific Impact Tests:**

- a. Competition Assessment – the proposed policy will have no impact on competition as the regulations represent a clarification as opposed to a change to the substance of current law.

- b. Justice - there may be a minor impact on courts as occasionally a supplier bound to supply the insolvent company may make an application to be released from that obligation on hardship grounds.
- c. The proposed system will not have an adverse or disproportionate effect on any protected characteristics.

### **Sunset and Review**

- 90. The Government will conduct a non-statutory review on the effectiveness of the changes within five years of implementation. The review will be required to consider whether the changes have had a positive impact on business rescue and delivered the benefits identified in this assessment.

## Annex: Estimation of per insolvent business cost of energy supply

Estimated £ per MWH per business size			Assumed consumption of Gas MWH		Assumed consumption of Electricity MWH		Annual per firm cost (Gas plus Elect) (£)	
	Gas	Electric	Lower bound	Upper bound	Lower bound	Upper bound	Lower bound	Upper bound
Very small/Micro	41	127	1	277	1	19	168	13,761
Small	31	109	278	2,777	20	499	10,849	140,898
Medium	29	89	2,778	27,777	500	1,999	124,539	978,758
Large	26	89	27,778	277,777	1,999	69,999	891,250	13,382,625