The Insolvency Service

Summary of Responses:

Consultation on the Continuity of Essential Supplies

February 2015

A BIS SERVICE

1. Introduction

1.1 When a company or individual running a business enters an insolvency procedure, some suppliers may have contractual rights entitling them to terminate the supply contract on account of the insolvency. Where those supplies are essential to the continuation of the business, termination may have an adverse impact on the prospects of a successful rescue of the business and thereby on the amount of money available for creditors.

1.2 Insolvency practitioners have also told Government that essential suppliers to an insolvent business may seek to withhold supplies or services unless further payments are made or the pre-insolvency contract is re-negotiated. That too can undermine the likelihood of a business rescue.

1.3 Existing provisions in the Insolvency Act dating back to 1986 were intended to protect essential utility supplies during formal insolvency. However, deregulation of the utility sectors since 1986 requires existing legilsation to be updated if all providers of utility supplies are to be brought within scope of the legislation.

1.4 In 2013 the Government took a power in the Enterprise and Regulatory Reform (ERR) Act to prevent essential utility and IT suppliers from withdrawing their supply to businesses in insolvency rescue procedures. IT supplies have been added as essential supplies on the basis that IT supplies and support services are invariably essential for the operation of modern businseses.

1.5 To ensure suppliers impacted by the regulations get paid for the ongoing supply during the insolvency, the power taken in the ERR Act 2013 requires safeguards to be provided for suppliers left unable to exercise their contractual rights.

1.6 In July 2014 the Government published a consultation document, together with a draft order and impact assessment, inviting views on the adequacy of the safeguards for essential suppliers. Thirty-one responses were received from utility, IT and card payment service providers as well as rescue professionals, creditor groups and lawyers. This document provides a summary of responses to that consultation.

2. Summary of responses

2.1 The following organisations responded to the consultation:

Organisation	Category
Institute of Credit Management	Creditor Group
Atradius	Credit Insurer
Haven Power	Energy Supplier
Smartest Energy Ltd	Energy Supplier
Industrial and Commercial Shippers and Suppliers (ICoSS) Group	Energy Supplier
EDF Energy	Energy Supplier
E.ON Energy UK	Energy Supplier
Energy UK	Energy Supplier
Npower	Energy Supplier
Company A	Energy Supplier
GDF SUEZ Energy UK-Turkey	Energy Supplier
Scottish Power	Energy Supplier
British Gas	Energy Supplier
Web Applications UK Ltd	IT Supplier
Virgin Media	IT Supplier
City of London Law Society	Lawyers
Insolvency Lawyers' Association	Lawyers
The UK Cards Association	Card payment services
First Data	Card payment services
Worldpay (UK) Ltd.	Card payment services
Barclays	Card payment services
Elavon Financial Services Ltd	Card payment services
OFWAT	Regulator
Water UK	Water suppliers
Ofgem	Regulator
Deloitte LLP	Restructuring Services
KPMG Restructuring	Restructuring Services
R3	Restructuring Services
PriceWaterhouseCoopers	Restructuring Services
Chartered Accountants of Ireland	Restructuring Services
ICAS	Restructuring Services

2.2 Most respondents expressed their support for the broad objectives of the proposals, with some commenting on how they considered the safeguards could be strengthened. Many welcomed the inclusion of intermediate suppliers of utility and IT services being brought into the scope of existing legislation.

2.3 The full responses can be found below. Some respondents asked that their responses be kept confidential. Their responses have been published but parts of their responses have been redacted and /or anonymised in an effort to accommodate their requests.

2.4 The main themes that emerged from the consultation can be grouped according to the interests of the stakeholders as follows:

Energy suppliers and their regulators

2.5 Respondents in this category were concerned that the inability of energy suppliers to terminate or vary their contacts may result in losses to the supplier due to the way gas and electricity is bought and sold on the market. Respondents in their responses and during discussions with Government commented that these losses could be mitigated if there was greater office-holder engagement with the suppliers early in the process as to the future energy requirements for the business.

Card payment services

2.6 Providers of debit and credit card services, particularly those within the Merchant Acquiring sector, expressed concern about their inclusion within the scope of the regulations.

2.7 Due to the nature of the card payment system, Merchant Acquirers could bear a high financial risk through facilitating payments where the retailer may breach their contract by failing to provide the goods or service or providing faulty goods or service. The obligation to honour the transaction remains with the Merchant Acquirer through refunds and the chargeback claim process which can remain for a considerable period of time including after the insolvency procedure has come to an end. Concern was expressed that the safeguards proposed did not appear to be adequate due to the longer term contingent liabilities acquirers are potentially exposed to.

Legal Advisors and larger energy providers

2.8 As well as requests to clarify some of the legislative drafting in the statutory instrument (the Order), lawyers and larger energy providers raised concerns that the test a court must apply to override the provision on 'undue hardship' grounds is too high a threshold, particularly for larger suppliers.

Rescue professionals and rescue practitioners

2.9 For insolvency practitioners in particular, the proposals did not go far enough to include other insolvency procedures such as liquidations and provisional liquidations. Insolvency practitioners believed other 'essential services' could also have been captured and the ability of the supplier to seek personal guarantees was considered 'inappropriate' and 'unnecessary'.

Suppliers in general

2.10 A general concern was the time restrictions suggested for an essential supplier to request a personal guarantee from the insolvency practitioner for ongoing charges for the supply. The time limit of 14 days to request a personal guarantee was considered restrictive. For suppliers this creates uncertainty and imposes a greater burden on the supplier.

3. The Government response

3.1 Government has considered these issues that have been raised in the consultation responses and Government officials have met with a number of stakeholders to discuss how best to address these concerns.

3.2 The Government's response can be found at www.parliament.uk by way of a Written Ministerial Statement.

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6 October 2014

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Dear Sir/Madam

RESPONSE OF THE INSTITUTE OF CREDIT MANAGEMENT TO: THE INSOLVENCY SERVICE – CONTINUITY OF SUPPLY OF ESSENTIAL SERVICES TO INSOLVENT BUSINESSES

The Institute of Credit Management is the largest professional credit management organisation in Europe. Its members hold important, credit-related appointments throughout industry and commerce, and we feel it appropriate to comment on this consultation.

The Institute is broadly supportive of the proposals recognising the need for continuity of supply of essential services in attempts to save struggling businesses. Our only request is to ask that the complexity of the supply chain has been adequately considered in the measures proposed. With on-sellers and agency agreements, multiple parties can be involved and it is vital that any measures take account of the various interactions that can arise to ensure all parties are fully engaged.

If we can help in any further way please do not hesitate to contact us.

Yours faithfully

Glen Bullivant FICM
Chair of Technical Committee

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Policy.Unit

From: THOMAS Michael <Michael.Thomas@atradius.com>
Sent: 06 October 2014 13:29
To: Policy.Unit
Subject: Response to Continuity of Supply of essential services to insolvent businesses

Atradius is a leading credit insurer in the UK and indeed globally. The brief below is based upon existing experience of energy/ utility policyholders and how this may be applied to potentially policyholders in the IT market.

Atradius is familiar with the obligation to continue to supply through a number of policies held by energy clients. Indeed Atradius builds its respective policies around the legal obligation of our clients to continue to supply. In practice Atradius and its clients will be aware of a deterioration of the credit profile of a given company where this obligation stands. In order to safeguard its position in such cases, our experience of the energy clients which Atradius insures, is that a Material Adverse Change (MAC) will be used to adjust terms for those companies that exhibit a high credit risk. As such whilst the obligation to continue to supply remains, the energy/ utility company has the option/ opportunity within its standard terms and conditions to adjust its payment terms thus reducing/ removing its credit exposure to a given company. Atradius experience of this process has proven to be successful with its energy clients in protecting receivables in a deteriorating risk environment. Should this obligation be extended to other providers of services or goods then such protection should be incorporated in to the additional suppliers contracts.

The provision of energy/ utilities is clear, however what will be covered under the IT critical suppliers requires greater clarity. IT supply comes in a variety of forms from hardware supplies, largely commodity style supplies that may be provided directly from OEM's or from a number IT distributors, to service provision of cloud services without access to which the company may not function. The definition and application of critical suppliers needs to be absolutely clear. In the case of IT distributors, the requirement to continue to supply may be difficult as by definition IT distributors act as middlemen so to continue to supply they will need to source additional hardware and potential software from vendors who may not wish to supply, possibly due to brand image/ harm, being associated with a failed company.

The supply post administration is generally secured by obtaining the reassurance of the insolvency practitioner, however in the case of IT providers, the incumbent supplier of IT may be placed at a disadvantage by having to trade on terms that applied to prior to the insolvency when a competing IT provider may be able to adjust its terms to provide a more competitive quote, placing the incumbent at a disadvantage. This brings us back to the definition of critical supply, this should only apply to a circumstance where it is not possible to obtain the supply from any other provider of IT.

In summary, the obligation to continue to supply cannot be divorced from the terms of the payment in order to secure the continuity of supply. Whilst accepting that in certain cases critical suppliers are essential to ensure a company's survival, this should not prevent the supplier from adjusting the nature of its supply and may thus be reflected in the contract between supplier and end user. Without this the problem may be compounded by placing obligations on suppliers that may indeed damage their health, should they subsequently suffer a bad debt or an onerous obligation to supply.

Regards

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The operating companies affiliated with Atradius N.V. (Atradius Group) conduct insurance, debt collection and information services business through their registered (branch) offices in many countries. For information about the main registration details of Atradius Group offices in your country please visit http://global.atradius.com/general-content/legal/legallist.html

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7th September 2014

Dear Sir,

Continuity of Supply of Essential Services to Insolvent Businesses Consultation July 2014

I am writing in response to the above consultation with particular emphasis on the proposals for delivering continuity of electricity supplies to insolvent businesses.

I understand that these provisions are being introduced to prevent Insolvency Practitioners from "being held to ransom" by suppliers with the objective of being able to rescue more businesses. The proposals as drafted however will expose electricity suppliers to huge financial risks out of all proportion to the normal profitability of business electricity supply contracts. The whole concept of "ransom" is wrong from an Electricity perspective. For the reasons set out below electricity suppliers' costs can increase dramatically when a business enters administration. The higher charges are simply to cover higher costs and are not a ransom.

We note that these proposals also cover certain IT licences. We would point out that the supply of electricity is fundamentally different to IT licensing, yet you seem to be applying the same general principles without any regard to this difference. IT businesses face few if any ongoing costs to provide a licence for an insolvent business. Electricity suppliers face direct costs that can be a multiple of the normal costs of supply and are accordingly much more reliant on being able to terminate their contracts in order to manage these risks. We are fully supportive that the rescue of insolvent businesses should not be held to ransom (in the proper sense of the word) by suppliers but suppliers must be able to ensure that they can at the very least recover the costs of providing the supplies to such businesses and the proposals prevent this. In many cases suppliers would be making these supplies at a loss if your proposals were implemented as set out.

Haven Power is an independent electricity supplier to large and small businesses. Our margins are small (typically 0.5%) and as a result we need to manage our costs of supply and cash carefully. As an example if we were to default on payment for the power or other services that we buy by even one day, the consequences for our business would be severe, letters of credit would be called and this could lead to failure. We are concerned that the sort of arrangements that are envisaged by the new Act could seriously threaten our business. The additional costs that we experience when a customer enters administration are often more than **100 times** our normal margin.

The consultation has paid little or no attention to the Suppliers' perspective. Electricity suppliers do not appear to have been part of the process so far. I note that the proposals envisage some safeguards for Suppliers but these will not be effective and in many cases suppliers will lose money on supplies to insolvent businesses for the period of administrations if these proposals are implemented. Safeguards are normally meant to provide protection for exceptional cases but these proposals would damage suppliers' businesses in the majority of cases.

I thought it would be helpful to summarise the background from the point of view of a Supplier rather than an Insolvency Practitioner.

There are several reasons why it is often not reasonable to continue to provide supply to businesses in administration on the same terms as supply was made prior to administration. In summary these include:

1. There is normally great uncertainty over the amount of electricity that a business in administration will require. This makes it very difficult for a Supplier to forecast and buy the right amount of power. Power is bought and sold on a half hour by half hour basis and suppliers are required to balance purchases and sales every half hour. Any imbalance is penalised by the system operator. Ofgem is introducing new rules to increase the incentives to balance and thus the (already high) costs of imbalance are expected to increase dramatically. Administrators are normally very reluctant to give any commitment or indication of how much power will be required or for how long they will require it. This means that excess must be bought (or shortfalls sold) in the short term spot markets which can trade at very different prices exposing the Supplier to significant losses. As an example in a recent administration our costs of supply for the relevant premises were almost **doubled** due to the need to purchase on the short term and balancing markets to meet the needs of the business. This doubling of costs was equivalent to **more than 100 times** our normal margin. We had to follow this course of action because the Administrator refused to even discuss their plans for the business and its power requirements (this is quite normal). If we were required to continue supply at pre-administration prices it would threaten our business. These additional costs could be partially mitigated if Administrators were required to provide information and forecasts on a regular basis and to bear some consequences of errors. We currently offer lower prices to administrators who cooperate in this way. These variances in electricity consumption occur at the margin and so feed directly into suppliers' out of balance purchases and sales.
2. The fact that we had power sourcing arrangements in place for the customer prior to the administration does not mitigate these risks; it merely establishes a different baseline and exposes us to market price risk on the power. Often power usage falls on administration and this means that the supplier can be left with stranded power that has to be sold at distressed prices. These prices can be lower than the original wholesale purchase price (and sometimes can even be negative) if this is not planned and the sale occurs on balancing. Administrators rarely give a supplier any guidance about the volumes of power that the business in administration will take which means that the

problem inevitably ends up in the expensive balancing market whilst a pattern is established. Suppliers can face these risks for a long period including the exit from administration.

3. Administrators are often reluctant to give any undertaking to pay bills and yet the business in administration continues to 'take' electricity. They often refuse to enter any sensible dialogue with suppliers because they do not have to persuade the supplier to deliver the product. They simply continue to use it. We have little control over this and in practice are powerless to prevent it. There are provisions where we can ask for personal guarantees but in practice these are often ineffective. We deal with this by including a premium in our rates to cover those cases where we are not paid and to cover the costs of the very long periods that we have to wait for our money. If we were required to continue to provide supply at pre-administration rates this exposure could quickly damage our business. In addition, normal payment terms in electricity are 14 days from date of invoice – these proposals envisage a much longer timescale. I appreciate that proposals have a 28 day window for agreement but it could take two or three times that time again to cut off supplies during which time our exposure would be constantly growing.
4. Finally, when a business fails we have a claim against that business for losses under our original contract. Advice provided to us is that if the original contract is not terminated and we continue to supply on the same terms then the legal basis for our claim for losses against the failed business (for the pre-administration period) is greatly damaged. The proposals do not seem to have considered this point and I am concerned that perfectly valid claims against the pre-administration failed business might be struck out as an unintended consequence of the new legislation. This issue arises because we can face a mark to market loss on the power that we had purchased to supply to the business prior to its becoming insolvent for the period after the insolvency. The proposals mean that it is not possible to achieve a clean break between the pre and post administration supplies and unreasonably limit our ability to crystallise our power position and any associated mark to mark loss.

In addition we currently apply careful credit processes before taking on new customers. If we had to provide continuity of contract to all failing customers we would be forced to significantly tighten our credit criteria denying a significant number of customers lower prices. This cannot be in the interests of businesses generally.

Insolvency Practitioners are already of course free to change to change supplier if they are unhappy with the terms on offer from the incumbent. In many cases where there are good prospects of rescuing the business then competitive offers will be freely available in the market negating the need for the measures proposed. In this respect electricity is quite different from e.g. software licenses where short term change is not possible. In our experience this option is rarely considered but it is a perfectly viable one. We have held contingency discussions on exactly this subject with an administrator in the past. At the very least administrators should be required to seek alternative suppliers in these situations. If administrators took advantage of this there would be no need for the proposals as far as electricity was concerned.

We have included answers your consultation questions in the annex to this letter.

We believe that these proposals need a fundamental rethink before they can be reasonably applied to electricity.

I hope you will understand some of the practical (and unintended) difficulties that could arise from the proposals. I would be happy to meet either you or your officials if you would find it helpful.

Yours faithfully

Peter Bennell
CEO

Annex: Answers to Consultation questions

Q6 Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

For the reasons set out above we do not believe that the proposals are workable for electricity. They will result in electricity suppliers losing money on such supplies and will lead to both a sharp increase in demands for administrators to provide personal guarantees and in applications to the courts for permission to terminate the contracts. You have made much of the need for a strong case to interfere with these private law contracts but **the consultation has only really considered things from the insolvency practitioners' point of view and due regard has not been taken of the impact on suppliers.** This is clear from the impact statement and the absence of any arguments reconciling why the same arrangements can be applied to IT and electricity businesses despite their different nature and cost and risk bases.

Your impact assessment shows the total downside cost to suppliers as £3M pa. This is huge underestimate of the likely costs in todays' markets. This position will get worse when the full effects of Ofgem's Code Review on system balancing come into effect. We are a smaller supplier but we estimate that the insolvency of one of our Industrial customers could quite easily cost us several million pounds if we are unable to terminate the contract and the consumption becomes unpredictable (which it often does) and we are required to continue to supply at the pre-insolvency rate. Across the whole market the likely cost must run into hundreds of millions of pounds depending on the rate and nature of business failures. Your impact assessment has omitted this burden.

Q7 Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

The proposals will place suppliers in the position where they have to use every means at their disposal to avoid having to supply at the same price for the majority of insolvencies. Suppliers will also seek to avoid supplying any business that looks as if it might become insolvent. This will create work and uncertainty for the courts, for administrators and for suppliers and is unlikely to be conducive to good working relationships. We would also expect a large increase in requirements for personal guarantees from administrators and this may render the proposals ineffective if these are not forthcoming. In addition we would expect the higher charges that would be applied to marginally solvent businesses would result in a significant increase in insolvencies.

As set out above the whole concept of ransom is wrong from an Electricity perspective. Whilst significant increases in costs may appear as ransom there are good reasons why the costs are higher. It is surprising that little or no effort seems to have been made to investigate the basis for the ransom label and this may leave the proposals open to challenge if they are implemented without proper consideration of these factors.

Q8 Do you believe that the safeguards provided for suppliers are adequate?

For the reasons set out above the safeguards are both inadequate and unworkable and will lead to much higher power prices being charged to those businesses that suppliers feel may tip over into insolvency.

Q9 What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

There should be no exceptions, personal guarantees are at the core of insolvency law and there can be no justification for limiting their use. Without this lever administrators will simply ignore suppliers because the law will say that the supplier has to continue to supply.

What impact, if any, do you believe the changes would have on the pricing of contracts in relation to;

a) **utility supplies**
b) **IT goods or services**

As set out above the proposals will result in significantly increased electricity costs for businesses that suppliers believe may become insolvent. These costs could be considerable and it may make it very difficult for some businesses to get power contracts.

We do not have sufficient knowledge to comment on the impact on prices for IT goods and services.

Q11 Can you foresee any practical difficulties arising from the proposed changes?

Yes, there are a host of difficulties. A large number of cases will be taken to the courts because of the impacts on suppliers; there will be a huge increase in the absolute requirements for administrators to provide personal guarantees; some suppliers may incur exceptional electricity balancing costs as a result of these proposals which in extreme cases could lead to failure of the supplier; it will reduce the incentives for administrators to work with suppliers to provide forecasts of likely power requirements and this itself will lead to much higher costs for suppliers so suppliers face a double blow of higher costs and lower revenues; and, it will make the provision of supply contracts to marginally solvent businesses much more risky and expensive which will hasten their demise in some cases.

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06 October 2014

Continuity of Supply of Essential Services to Insolvent Businesses Consultation July 2014

Dear Sirs,

SmartestEnergy welcomes the opportunity to respond to your consultation on the Continuity of Supply of Essential Services to Insolvent Businesses

SmartestEnergy is an aggregator of embedded generation and a supplier in the electricity retail market serving large corporate and group organisations.

Please note that our response is not confidential.

SmartestEnergy's view

We recognise the issues associated with administrators trying to make a going concern of a failed business. However, as an electricity supply company it is absolutely imperative that we are able to recover the costs of electricity supplied in all circumstances because the vast majority of the make-up of a bill is for expenses for which we ourselves are liable; to generators, distributors and National Grid. We operate in a very low margin business (i.e. non-domestic supply); our profit after tax as a proportion of turnover is a mere 0.5%. We simply cannot afford not to be paid.

When a company enters into administration we end the contract with the company and attempt to enter into a contract with the administrators. Part of this process involves asking the administrator to provide the information needed to provide a contract i.e. start and end date, profile of usage and total estimated consumption. In most cases the administrator is unable, understandably, to provide this information as they do not know how long they will continue to trade, how quickly the business will sell or if they will receive any offers. Some administrations are as short as a month whereas some continue for a year or more with court extensions. However, we need to know this information to hedge forward and keep the costs of supplying the customer down.

We are not able to obtain Credit Insurance on a company in administration as the insurers will not provide cover for companies in this situation (and administrators will not accept personal liability clauses in the contracts.) This increases the risk to us. Unlike contracted customers where insurance is not available, we do not request alternative forms of collateral from administrators. Our deemed rates are reflective of the risk of not being able to forward hedge a power contract as the termination date by definition is unknown. In addition, the electricity use is often unstable and we are exposed to large volume fluctuations.

If deemed rates are considered to be unfair, this is a matter for Ofgem. Indeed, we are aware that enquiries were made industry-wide by Ofgem into the level of deemed rates some years ago but this did not result in a formal investigation or consultation.

We also believe it would be legally difficult to make a claim on debt if the contract with the old company has not been broken and supply is still being taken on the same terms by the administrators. Our understanding has always been that once a company enters administration all contacts held by the company are terminated. It is then down to each supplier to negotiate a contract although they are obliged by the administration (court) order to continue supplies.

It should be noted that a supplier cannot “lose” a customer; the process of transfer is initiated by a new supplier. However, we have never disconnected on the basis of debt. In any event, industry rules prevent us from disconnecting a customer who is on deemed rates.

We cannot countenance arrangements where there is no incentive on administrators to engage with us. Implementing the proposals as currently designed would also increase the costs of supplying businesses with lower credit ratings due to the increased risk that administration would bring. Therefore, in the interests of small businesses generally, we believe that any solution should ensure administrators guarantee payment for electricity during the administration period or allow suppliers to terminate the supply if they are not happy with what the administrator offers.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich

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07 October 2014

ICoSS response to consultation on Continuity of supply of essential services to insolvent businesses

The Industrial and Commercial Shippers and Suppliers (ICoSS) group is the trade body representing non-domestic industrial and commercial (I&C) suppliers in the GB energy market. Members collectively supply three-quarters of the gas needs of the non-domestic sector as well as half of the electricity provided by non-domestic independent suppliers.[1]

Please note that we have only responded to the questions relevant to our members. Our responses are as follows:

Q1: Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?
Yes.

Q2: Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?
Yes.

Q6: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?
Yes.

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[1] :

our members

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Q7: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding "ransom" payments as a condition of continuing supply?
Yes.

Q8: Do you believe that the safeguards provided for suppliers are adequate?
We note that a distinction is made between when a supplier can terminate the **supply** and when it can terminate the **contract**. If a supplier does not receive a guarantee within the timeframe specified, it is only able to terminate the supply, not the contract. We are uncertain why this distinction has been made. If a supplier does not receive a guarantee when it has asked for a guarantee, the supplier should be able to terminate the contract. This would enable the supplier to charge higher out of contract rates. The possibility of being charged out of contract rates is much more likely to influence an administrator to give a guarantee than is the threat of discontinuance of supply. Disconnecting a supply takes at least a month. In many cases the administrator is only on site for a few weeks and is therefore not overly concerned whether the supply is disconnected once (s)he has left site.

We are therefore of the view that in relation to obtaining a personal guarantee from the administrator, the safeguard provided is not adequate. It is our view that there should not be a distinction between terminating the supply and terminating the contract, and that in the event that the insolvency holder fails to give the guarantee in the specified timeframe the supplier may terminate the contract.

We further note that suppliers are able to terminate the contract if any charges in respect of the supply are not paid within 28 days beginning on the day that payment is due. It is unclear whether this is 28 days from the date of the demand or 28 days after the supplier's standard payment terms have expired. The draft legislation needs to be clearer in this regard. It is our view that termination can take place if payment is not made within 28 days of the demand, as otherwise this puts suppliers in a worse position than they are currently. It is also important that suppliers have both the option to terminate and the option to disconnect open to them in this scenario.

The draft statutory instrument proposes to insert section 233A(4)(a) stating that (where an insolvency-related term of a contract ceases to have effect under this section) the supplier may terminate the supply, if *within a period of 14 days beginning with the day the company entered administration or the voluntary arrangement took effect*, the supplier gives written notice to the insolvency office-holder that the supply will be terminated unless the office-holder personally guarantees the payment of any charges in respect of the continuation of the supply after that

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date (and (b) the insolvency office-holder does not give that guarantee within the period of 14 days beginning with the day the notice is received).

The effect of including the words shown above in italics is that any failure by the office-holder to notify the supplier promptly that the company has entered into administration (or of the existence of the voluntary arrangement) could mean that the supplier is unfairly prevented from seeking the personal guarantee, because the supplier has not done so within 14 days of the company entering into administration (or of the voluntary arrangement taking effect).

We therefore propose deletion from the draft section 233A(4)(a) of the following:
the words *"within a period of 14 days beginning with the day the company entered administration or the voluntary arrangement took effect*,"; and
the words *"after that day"*

The same amendments should be made to the draft section 372A(4)(a).

Q9: What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?
We do not consider there should be any exceptions. We should also be grateful for further clarification of what is meant by "personal guarantee". It is not our experience of dealing with administrators that they guarantee, in their personal capacity, payment of our charges. What we usually obtain from the administrators is a request to continue supply and confirmation that our charges will be treated as an expense. This is usually known as an "undertaking". An example of a "personal guarantee" would be helpful.

Q10: What impact, if any, do you believe the changes would have on the pricing of contracts in relation to; a) utility supplies; and b) IT good and services.
In relation to a), we are of the view that the changes reflect our current processes. As such, we do not consider there will be an impact on pricing.

Q11: Can you foresee any practical difficulties arising from the proposed changes?
We would need to revise our current insolvency processes to reflect the changes.

Yours sincerely

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Email to: Policy.Unit@insolvency.gsi.gov.uk

8 October 2014

Continuity of supply of essential services to insolvent businesses

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy understands the principle behind the Insolvency Service's attempts to provide greater protection to organisations that enter into administration or insolvency procedures. However, we have concerns that the proposed approach and its safeguards may leave suppliers of electricity and gas exposed to greater financial risk through the accrual of debts during insolvency due to continued supply.

The consultation does not take account of the key issue in the supply of electricity and gas, namely that terminating a contract and terminating supply of energy are two very different things and there can be a very significant time lag between the two. We therefore believe that the provisions should be strengthened to provide suppliers with greater safeguards in this regard.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Claire Antill on 07875 117554, or myself.

We would request that this letter is not published by Insolvency Service due to the commercially sensitive nature of some of the information within our response.

Yours sincerely,

Paul Delamare

Paul Delamare
Head of Downstream Policy and Regulation

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Attachment

Continuity of supply of essential services to insolvent businesses

EDF Energy's response to your questions

Q1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

EDF Energy has no comment to make on this question.

Q2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

Yes, EDF Energy agrees the wording of the amendments would not impact on wholesale electricity and gas provisions.

Q3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

EDF Energy has no comment to make on this question.

Q4. Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

EDF Energy has no comment to make on this question.

Q5. Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)

EDF Energy has no comment to make on this question.

Q6. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes, we agree that they will prevent suppliers from relying on insolvency termination clauses. However, as we have outlined in our response to Question 8 we do not believe the current proposals provide sufficient safeguards against the accrual of debt during insolvency due to the continued supply of electricity or gas.

Q7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

Yes, we agree that they will prevent suppliers from demanding payment against existing debt as a condition of continuing supply. However, as we have outlined in our response to Question 8 we do not believe the current proposals provide sufficient safeguard against the accrual of debt during insolvency due to the continued supply of electricity or gas.

Q8. Do you believe that the safeguards provided for suppliers are adequate?

No, EDF Energy does not believe the safeguards provided are adequate to protect the suppliers of electricity and gas from increased exposure to unrecoverable debts.

We believe that the consultation and the proposals do not sufficiently recognise the difference between termination of a supply contract for electricity and/or gas and termination of the supply of energy itself. There is often a significant time lag between the two, particularly in administration, where consent of the administrators or leave of the court is required to commence proceedings, including the issue of a warrant for de-energisation of the supply. This can often result in a period of several months passing following the failure of the company to pay and/or provide a s233 guarantee and de-energisation, during which supply will continue with no certainty as to who is liable for the accruing debt.

Our experience is that administrators are often reluctant to provide personal guarantees and the proposed amendments do not currently give sufficient comfort that this will change. Therefore, we believe the provisions would be strengthened if they provided suppliers with greater leverage to ensure a personal guarantee and to prevent the delays mentioned above. This could be achieved by an amendment to require any administrator who refuses to provide a s233 guarantee within 14 days to allow a utility company immediate access to all relevant premises to de-energise without the need for a warrant. Alternatively, an amendment might be sought allowing suppliers express powers to apply for a warrant without the need to obtain the consent of the administrators or leave of the Court.

Equally, we believe that an amendment should be added to the Act providing a form of wording or guidance as to the content for the personal guarantee that must be provided by administrators. This will provide clarity and greater certainty as to what needs to be covered by the personal guarantee and make it difficult for administrators to deviate from the required content.

EDF Energy also notes that the provision of the14 day window for a supplier to notify the administrator starting from the onset of the insolvency, as set out in paragraph 43, does not recognise the fact that in many cases suppliers are not immediately made aware that such proceedings have begun. It is our experience that in some circumstances (especially where an administrator may not be able to readily identify the supplier of electricity or gas) we may not be notified until after 14 days has passed. We therefore believe that the 14 day window should not begin until written notice has been provided to the supplier.

Finally, it is also our view that the provision set out in paragraph 38 that termination of supply may begin if payment is not received by the supplier within 28 days, should be shortened to 14 days. This would guard against the significant debts unnecessarily accruing during this time, particularly on major administrations where there may be a number of supply sites with a significant overall consumption.

Q9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

Given the reasons we have already outlined on the significant delays often experienced before a supplier can actually terminate a supply, EDF Energy believes that there should be no exceptions from the ability to seek a personal guarantee.

Q10. What impact, if any, do you believe the changes would have on the pricing of contracts in relation to;

a) utility supplies
b) IT goods and services

a) As a supplier of electricity and gas our prices are set to be cost-reflective which includes an element of risk to hedge against credit issues and outstanding debt. We believe that the provisions as they stand do not adequately safeguard against a potentially significant increase in debt accrued during administration or insolvency. This will over time have an adverse impact on the overall cost to the supply of electricity and gas to the non-domestic market.

b) EDF Energy has no comment to make on this question.

Q11 Can you foresee any practical difficulties arising from the proposed changes?

Yes, please see our response to Question 8.

EDF Energy
October 2014

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Policy Unit
The Insolvency Service
4 Abbey Orchard Street
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SW1P 2HT

08 October 2014

Dear Sirs

Continuity of supply of essential services to insolvent businesses

Please find attached our response to the above consultation.

The response is non-confidential.

If you wish to discuss any aspects of this response please contact myself or Alan Kemp, Alan.Kemp@eonenergy.com.

Yours sincerely

Steve Russell
Business Regulation Manager
Commercial Regulation

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Continuity of supply of essential services to insolvent businesses

Response by E.ON

Background

1) E.ON operates two business units providing electricity and gas supplies to business customers. Our Corporates business is largely focussed on the higher consuming Industrial and Commercial businesses whilst our SME business services mainly smaller businesses.

Policy objectives

2) We support the policy objectives of the changes to legislation proposed. It is our practice to work in both of our businesses to work with insolvency practitioners to assist them to rescue viable businesses. We do not charge "ransom" payments or terminate existing contracts to apply more detrimental rates[1] in the event of insolvency.

Supplier Safeguards

3) We believe that the proposed supplier safeguards could be adequate with a couple of additional steps.

   i. The insolvency office holder serves prompt notice that the business has entered into administration or that a voluntary arrangement has taken effect. This will limit a supplier's exposure to additional unpaid for services.
   Ideally the insolvency office holder should have fourteen (14) days from the point of formally taking the office to advise and extend an undertaking as a matter of fact rather than request, or give clear indication and consent that they have successfully handed the keys back to the landlord who has accepted them, moved it into liquidation and evidence that they are disclaiming the lease or advise how the property is disposed of in their market approach.
   Without this process suppliers are going to be drawn into conflicts as a third party, which have the potential to be protracted. Whilst we accept that the government may not want to formally legislate for

[1] Currently our standard terms and conditions for small and medium enterprises including micro businesses includes a right for us to terminate a contract in the event of insolvency but this right is never exercised and will be removed at the next terms and conditions re-write.

this procedure we would propose that the industry is encouraged to develop a code of practice to cover this situation.

ii. The government consults on guidance to be provided to the courts on what constitutes "undue hardship" for a large company applying to the courts to terminate a supply contact.

Exceptions to personal guarantees

4) There are a few exceptions to personal guarantees that have not been completely worked through that need clarity: i.e. the administrator is no longer the occupant on site but wishes to "market" the business as a "prepack" to a prospective buyer. Potentially they could have several entrepreneurs in over a period of several months who are now the occupiers who are seeing if the business is viable before making offers, would the administration remain responsible for the service provision until the point of sale?

Impact on pricing of contracts

5) It is possible that the government proposals will increase the generality of pricing of services however if insolvency practitioners act responsibly and act promptly with suppliers any potential increase in price levels will be minimised.

The voice of the energy industry

Anne Wilcox
External Affairs
Policy Unit
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London
SW1P 2HT

Sent via e-mail: policy.unit@insolvency.gsi.gov.uk

8 October 2014

Consultation response: Continuity of supply of essential services to insolvent businesses

Dear Anne,

Energy UK is the trade association for the energy industry. Energy UK has over 80 companies as members that together cover the broad range of energy providers and supplies and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested £10billion in the British economy.

Energy UK welcomes the opportunity to respond to The Insolvency Service's consultation. Energy UK has a number of new and smaller energy suppliers among its membership, and likewise wishes businesses to be able to enter and be successful in the market.

Some Energy UK members are concerned that Government's proposed changes around the exercise of powers taken in the Enterprise and Regulatory Reform Act 2013 will move disproportionate levels of risk and cost from insolvent businesses to energy suppliers, contradicting with Government's principles of better regulation[1].

It is common that companies which are saved from going into administration subsequently fall into another insolvency procedure. We wonder whether the impact assessment has taken this into consideration and suggest that further research into this area would be beneficial.

Forecasting

Suppliers work on small profit margins. Their profit rests on their ability to buy effectively and design sophisticated risk management strategies.

Suppliers are not able to accurately forecast how much electricity or gas a customer will use after it goes into administration. Removing the ability to terminate a contract will make it increasingly difficult for suppliers to hedge and balance. If they mistakenly over-buy contracts as a result of this, suppliers may be forced to sell back their surplus to the market at a negative price. Suppliers will be exposed to high costs as a result.

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[1] http://www.legislation.gov.uk/ukpga/2006/51/pdfs/ukpga_20060051_en.pdf

Having to manage these high costs will lead to unintended consequences. Customers could suffer from higher prices. Also, businesses with bad credit ratings - or those that are new start-ups and statistically more likely to go into administration - may be less able to procure a contract in the market.

With regards to personal guarantees from insolvency practitioners, we have had reports from members that, in practice, these are rarely offered. Where they are offered, it is reported that guarantees can entail protracted negotiations. One member suggests that personal guarantees would be more robust if the personal guarantee must (i.e. not voluntarily) be provided by the Insolvency Practitioner, in the name of insolvent company and with the financial backing of the wider firm (which would have to hold an acceptable credit rating). One member, however, welcomes the proposed amendment's codification of suppliers' ability to terminate supply where a guarantee is not provided by the Insolvency Practitioner.

Varying payment terms to manage debt

Some members have expressed concern that under the proposed changes they would no longer be able to manage the amount of debt accruing. Unlike services such as IT, energy is usually billed in arrears on a quarterly basis. Currently a supplier may vary terms of supply by asking for more frequent or upfront payments as appropriate, helping keep debt to manageable amounts.

If, under these proposals, suppliers are unable to change payment terms to monthly, or weekly, or to pre-payment, a customer could consume energy for months before it becomes apparent to both the customer and the supplier that the customer is unable to afford to pay for it. The fact that suppliers need to secure court warrants to disconnect may in many cases further increase the length of time energy can be consumed without payment.

Notification that a business has gone into administration

When a company enters into administration, the contract with the customer will move to the administrator. It is important that suppliers are informed immediately when one of their customers has gone into administration.

In general the provisions and the consultation do not appear to recognise that in practice there can be a significant delay between the beginning of insolvency and the ability of the supplier to terminate the supply itself, during which there is often further accrual of debt due to the continued supply. Therefore the safeguards do not currently provide suppliers with adequate protection against the scenarios where a personal guarantee of continued supply is not provided and payment is not received.

If you have any questions, please do not hesitate to contact me on 020 7747 2963 or daisy.cross@energy-uk.org.uk

Yours sincerely

Daisy Cross
Policy and External Relations Executive

BY EMAIL
The Policy Unit
The Insolvency Unit
4 Abbey Orchard Street
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Your ref Continuity of supply of essential services to insolvent businesses
Our ref BIS081014
Name Kate Garth
Phone 07989 490 747
E-Mail kate.garth@npower.com

8th October 2014

Consultation into the Continuity of Supply of Essential Services to Insolvent Businesses

Dear Sir / Madam

Thank you for providing RWE npower the opportunity to respond to the above consultation. RWE npower supplies electricity, gas and energy services solutions to businesses of all sizes. We currently supply ca 238,000 small to medium sized enterprises (SMEs) and around 17,000 industrial and commercial customers (I&C) across more than 100,000 sites.

Utility suppliers are already prevented from demanding payment of outstanding charges as a condition of continuing supply under the Insolvency Act 1986, and we can confirm that RWE npower does not and would never threaten to withhold supply or demand any sort of “ransom” payment in respect of debt accrued prior to insolvency as a condition to continue to supply. We would note that the use of the term “ransom” payment as used by the Department of Business and Innovation (BIS) is both unclear and unnecessarily emotive.

We support the policy objective of bringing on-sellers of utility supplies and IT suppliers within the list of suppliers of essential services within the scope of Insolvency Act. We believe this should address the biggest concerns regarding the withholding of supply and requests for “ransom” payments by these companies.

Gas and electricity suppliers are prevented from disconnecting customers (irrespective of whether they are insolvent or not) unless a sum is outstanding for 28 days. Even once that date has passed, energy suppliers cannot simply withdraw their supplies. Suppliers are required to provide written notice to the customer that they intend to disconnect the energy supply and then apply to a court for a warrant to disconnect. Assuming that there are no delays with the court process, it can still take (as a minimum) six to seven weeks for the disconnection to be effected.

This is fundamentally different to the situation of an IT supplier or even a telecoms company, who may be able to immediately withdraw supply of services, should any owed sums not be paid within 28 days. Furthermore, unless the energy supply has been physically disconnected, the registered licensed energy supplier to the meter will always require a customer to be responsible for the cost of supply (both for the cost of any units of energy used and any associated standing charges). This is a very different situation to suppliers of IT equipment or services, which can be both removed (and reinstated) very quickly.

RWE npower

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The third proposal contained within this consultation; ensuring continuity of utility and IT supplies by preventing reliance on insolvency termination clauses, will significantly increase the risk and cost that suppliers will be required to bear. This will result in higher levels of debt write off and ultimately higher costs for businesses.

RWE npower considers the proposed safeguards are inadequate and will not provide sufficient protection for suppliers, who will have lost their right to contract freely, as is the case at present. The proposed safeguards are predicated on the basis that a court grants permission for the termination of the contract, but this would only be on the basis that the supplier had requested a personal guarantee from the Insolvency Practitioner within 14 days of the administration or CVA or IVA taking place, and that the Insolvency Practitioner does not provide this assurance within 14 days of receiving the order. In reality, suppliers will not (and often do not) know that the administration process has begun, or who the appointed Administrator is until after the proposed 14 day window has passed. RWE npower believes that the onus should be on Insolvency Practitioners to inform key suppliers of an Administration (or on the customer to inform key suppliers of an IVA / CVA).

In addition, the provision of a personal guarantee from the appointed Insolvency Practitioner may not be sufficient to cover the likely cost of the energy likely to be consumed. Without confirmation of the level of assets available or the existence of an appropriate credit insurance scheme, such a personal guarantee, particularly for those larger industrial and commercial sites, may simply not be sufficient to cover the ongoing costs – and therefore can not be considered a safeguard.

We are very concerned regarding the proposals within this consultation that would apply to energy suppliers. We note that the original Com Res research, which forms a significant source for evidence for the accompanying Impact Assessment notes that:

“Few insolvency practitioners believe that many liquidations or bankruptcies could be avoided if key utility, telecoms and IT suppliers had been forced to supply on the same terms as they did pre-insolvency”.

We also note that the rate of liquidations used to determine the likely costs / benefits of these proposals is based on 2012 data, whereas the most data from 2013 shows a 7.3% decrease compared to the 2012 data, and the most recent quarterly statistics (for Quarter 2 2014) show an 18.1% reduction in the rate of liquidations compared to the same period in 2013.

Given that the estimated number of avoided liquidations resulting from this policy is very low and that the rate of liquidations is also reducing, we believe the imposition of the proposal to restrict the right of utility companies to terminate on the basis of insolvency to be disproportionate and that it will penalise energy suppliers in particular (due to the time required to disconnect a supply following non-payment) and increase the costs of all businesses in the future.

Please find attached our detailed response to the consultation questions.

If you have any questions, or require further details, please let me know.

Yours faithfully

Kate Garth.

Kate Garth
RWE npower

RWE npower response to the detailed consultation questions:

Q1) Do you agree that the proposed amendments to sections 223 and 372 will be effective in bringing on sellers of utility and IT services within the scope of the existing provisions?

We agree that the proposed amendments to sections 223 and 372 should bring on sellers of utility and IT services within the scope of the existing provisions. However, we would note that energy suppliers face additional requirements, including regulations under the Electricity Act and Gas Act that preclude the disconnection of a customer unless a sum remains unpaid after 28 days.

Q2) Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

No, we do not believe the proposed amendments are sufficient to ensure that any supplies made for wholesale purposes would be prevented from becoming subject to these provisions. Given the potential changes within the energy market, such as the potential of Licence Lite arrangements, a shift towards Community Energy arrangements as well as the provision of power for “White Label supplies”, the intention that wholesale supplies would not be impacted by these proposals, should be made explicit.

Q3) Do you agree that the proposed changes will be effective in bringing the suppliers of IT goods or services within the scope of sections 233 and 372?

Yes, we agree.

Q4) Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

RWE npower has no views on this question.

Q5) Are there other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible).

RWE npower has no views on this question.

Q6) Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

We fundamentally do not agree with the inclusion of the proposed new sections 233A and 372A and believe these interfere with our right to contract freely and to manage the risk that our counterparties are unable to meet their obligations under the contract.

We are particularly concerned that much of the evidence submitted within the Impact Assessment relates to an online survey of members of the R3 Trade Association, undertaken last year by ComRes. We note that the executive summary states that:

“Few insolvency practitioners believe that many liquidations of bankruptcies could be avoided if key utility, telecoms and IT suppliers had been forced to supply on the same terms as they did pre-insolvency”

We also note that the research indicates that in those situations where suppliers withdrew their supply due to formal insolvency, 41% relate to key trade suppliers (compared to 46% of IT suppliers) and the incidence of “ransom” payments or attempts to renegotiate contract terms as a precondition of continuing supply is 49% for key trade suppliers (compared to 55% of IT suppliers).

The proposed changes will not prevent key trade suppliers from withdrawing or re-negotiating their contractual terms and therefore it appears unlikely that making the proposed changes would significantly alter the rate of liquidations.

RWE npower supplies all types of non-domestic customers with energy. We segment customers on the basis of volume of energy supplied; our Industrial & Commercial (I&C) customer segment contains companies spending as a minimum ca £20k of energy spend pa up to companies consuming ca. £1m+ energy spend p.a.

Our range of products and services available to I&C customers is broader than those offered to customers within our Small and Medium Enterprise (SME) sector, given their relative low volumes of energy consumed, and the relative lack of importance energy has for these customers given their other business priorities.

The current provision of insolvency termination clauses provides npower with a range of options (many of which would not be utilised) in order to both promote the best outcome for the customer, as well as ensuring that our business is not unnecessarily exposed to additional (and avoidable) risk.

Some of the current tools at our disposal for our larger I&C customers include:

- For those larger customers on a flexible purchasing contract (typically those with an energy bill of >£1m); they may be moved on to a new fixed price deal or have advance purchasing restrictions imposed
- Require security cover (in the event of a new contractual rate being agreed with the customer) – this could not; under any circumstances, be used to offset previously agreed debt from the company prior to going into insolvency; although any security held prior to an insolvency could and most likely would be used to offset against debt before any claims are submitted to the IP, or
- Terminating the contract and moving the customers on to deemed rates (these are regulated through the supply licence).

By removing the right to rely upon an insolvency termination clause, these proposals would significantly reduce npower’s ability to manage or offset the risk exposure associated with continuing to supply a higher risk customer.

For our SME customers who enter administration, npower always (once we become aware that the company is in administration and has appointed an Insolvency Practitioner (IP)) requests that the IP sign a form of undertaking regarding the supply for the business in administration, which confirms that in the event they do not return the form of undertaking, the ongoing supply at the site will be disconnected. If they opt to not take out a new contract, then any energy consumed will be charged on our published deemed rates up until such point that the supply is either transferred to a new supplier or disconnected.

Please also see our response to question 10.

Q7) Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding “ransom” payments as a precondition of continuing supply?

As per our response to question 6, we do not agree with the proposals contained in sections 233A or 372A with regards to energy suppliers, given the existing rules that govern energy suppliers under the Electricity Act 1989 and the Gas Act 1986 which preclude suppliers from disconnecting insolvent customers unless (and until) debt is outstanding on the account for more than 28 days, and that specific steps have been taken (as outlined within Paragraph 2 of Schedule 6 of the Electricity Act 1989 and in Paragraph 7 of Schedule 2B in the Gas Act 1986) in order to effect a disconnection (which includes providing at least 7 days written notice in advance of any action). Licensed energy suppliers cannot and do not demand "ransom" payments from companies in administration / CVA or IVA, therefore we do not accept the estimated benefits that these proposals could deliver, as outlined in the Impact Assessment, even though these amounts are still very low; (£136,500), compared to the total estimated cost of "ransom" payments of £3,136,893[1]

We would also note that the aforementioned Com Res survey, whose results (as quoted in the Impact Assessment) suggested that 25% of utility suppliers sought a "ransom" payment or renegotiated contract terms as a condition of continuing supply. We are highly concerned that the issue of "ransom" payments and renegotiated contract terms are being conflated within this question (and indeed, there appears to be no specific question regarding renegotiated contract rates within the published Com Res research). The term "ransom" payment as used in both the Com Res survey and also within the BIS consultation is a little unclear and unnecessarily emotive.

Licensed electricity and gas suppliers cannot demand "ransom" payments and cannot threaten immediate cessation of the energy supplies, given the existing requirements. However, it is possible that those members of the Insolvency Practitioners Trade Association (R3) who responded to the survey may have misinterpreted or misunderstood the concept of a renegotiated contract rate.

For those customers (and their IPs) who do not wish to enter into another contract for a given period (and our experiences show that this is the case for the majority of SME customers in Administration), those customers will be supplied under the deemed contract rate. These energy rates are regulated through the supply licence, and are publicly available on our website.

Those IPs who responded to the survey and claimed that in 25% of all insolvency cases utility suppliers demanded a "ransom" payment or attempted to renegotiate contract terms may have confused a deemed contract rate with a "ransom" payment, as the costs of a deemed rate, are by their very nature, higher than agreed contract rates. This is because customers who are supplied with the gas and or electricity via a deemed rate are under no obligation to remain with the supplier and can leave as soon as they sign up with a new supplier and the customer switch has completed.

Following the industry changes due to be implemented by December 2014, a customer will be able to switch to another supplier within 16 working days. Suppliers are prevented from objecting to such a transfer, even if the customer has accrued debts for energy consumed since entering insolvency.

Within the I&C sector, our debt management specialists will seek to arrange new contractual rates with the company in administration, which would take into account any changes in circumstance (lower forecast consumption, shorter contractual periods), which would be benefit to the customer. Generally, this is generally the outcome that is achieved, and of the majority of those customers will continue to trade following administration.

Prior to any further steps to implement the proposal to remove the right to terminate due to insolvency, we would urge BIS to undertake more detailed research into this matter, taking into account information

[1] Information from the Impact Assessment Table 4 – Estimated total value of" ransom" payments paid in CVA's and administration (from utility suppliers)

from suppliers, as to the level of debt written off, the steps taken prior to the business going into administration, as our concern remains that these proposals are both disproportionate and unnecessary.

We are also concerned at the some of the information contained within the Com Res research, which suggests that those R3 members questioned may not have responded accurately or sufficiently clearly. For example, within the research, Com Res notes that the respondents were asked "*where suppliers have demanded a "ransom" payment, roughly how much was the "ransom" payment, and how much – if anything was paid out?"*

The research showed that the majority 74% of respondents didn't know the approximate demand made or payment given when a "ransom" payment was demanded. If the prohibition of these practices is expected to make such a difference to the rate of insolvencies ending in liquidation that would justify the changes, it appears very unusual that the respondents could not provide more data to back up their claims.

All of the evidence provided within Impact Assessment suggests that the majority of cost (and assumed harm done) is related to the activities of IT suppliers; Table 4 (on page 8 of the IA) shows the estimated levels of harm done by IT suppliers to be an order of magnitude higher than utility and telecoms providers combined (for those companies with a CVA, the value is assumed to be £2.3m for IT suppliers (versus £105k for utility companies and £302 for telecoms companies). For companies in administration, the size is assumed to be £695k for IT suppliers versus £31.5k for utility companies and £91 for telecoms companies.

We believe there is a significant discrepancy between the assumed levels of harm and the imposition of blanket rules that would impact on energy suppliers. Furthermore, with regards to the overall policy costs and benefits assumed within the Impact Assessment, we are unclear why BIS has opted to use the 7% estimate (Table 2) of avoidable liquidations as the medium benefits case. The Com Res 2013 research indicated that the majority of IPs interviewed (39%), did not believe **any** liquidations would be avoided due to the proposal to force those key suppliers to supply on the same terms as they did pre-insolvency.

It would therefore appear more proportionate for Government to consider enacting proposals 1 and 2 (to bring IT suppliers and on sellers of energy) into the same category of key supplies (as currently impacts water and energy companies) and to monitor the impact of the change, before making such significant changes to rights of companies to freely contract under English law. This is particularly important given that there is a difference between the ability of energy companies to disconnect their supplies, which are paid for in arrears, versus an IT supplier who could remotely disconnect or prevent the use of certain IT systems; such as point of sale terminals, services enabling the making of payments and computer hardware / software.

Finally we would question the use of the total number of liquidations in 2012 as the best available data. Whilst we note the Impact Assessment is dated 10/03/14, we note that the most recent data published by the Insolvency Service was dated 7th February 2014. That published data showed there were 14,982 compulsory and voluntary liquidations in 2013, a 7.3% decrease on 2012 figures.

Furthermore, we note that the latest quarterly statistics; those for Q2 2014, published on 29th July (3 weeks after the consultation was published) show an 18.1% reduction in the number of companies entering creditor's voluntary liquidation compared to the same quarter in 2013. That report confirms that

"The liquidation rate in the 12 months ending Q2 2014 was at its lowest level since data has been available to calculate the rate."[2]

Given that the rate of liquidation tends to be highest in the second quarter; if the reduction in the level of liquidations is indicative of the ongoing reduction, it would suggest that the benefits cause may be significantly overstated.

Q8) Do you believe the safeguards provided for suppliers are adequate?

No, we do not. The proposed safeguards are predicated on the basis that a court grants permission for the termination of the contract, but this is only on the basis that the supplier had requested a personal guarantee from the Insolvency practitioner within 14 days of the administration or CVA or IVA in order to prevent the termination of supply, and that the IP does not provide this guarantee within 14 days of receiving the order.

This process is fundamentally flawed, given that suppliers will not always know that the administration CVA / IVA has begun until after the 14 day window. In many cases it will take considerably longer than this. There is both a risk that the IP could be incentivised to not prioritise communication of the administration to those suppliers likely to be impacted by these new proposals, if it would prevent suppliers from providing the necessary notice within the 14 day time frame. RWE npower believes that the onus should be on Insolvency Practitioners to inform key suppliers of an Administration (or on the customer to inform key suppliers of an IVA / CVA).

Secondly, the provision of a personal guarantee may not meet our credit worthiness requirements, this is particularly important if a large consumer of energy was at risk, given the potential sums of money involved. Whilst this is less of an issue if the IP is working for a large practice, where there would be sufficient assets or insurance to underwrite such a guarantee, it is unclear that this would be the case for many smaller or high street IPs.

In order for the proposed legislation to provide sufficient safeguards, we recommend that the legislation place a legal requirement upon the appointed IP to inform the supplier within a fixed period (7 days or less) of the administration commencing, failure to do so would render the requirement upon suppliers to request the personal guarantee within 14 days void.

In addition, where the IP agrees to provide the personal undertaking to cover the charges, evidence of their ability to provide this underwriting function (either the provision of credit insurance or proof of asset ownership) should be required, particularly where the ongoing costs of the contracted supplies would be significant.

We would also note that there already exists; (as confirmed within the consultation document) the right to request a personal guarantee from the insolvency practitioner. However in the majority of cases that our debt management teams handle, whilst these personal guarantee requests are sent out, very few IPs agree to provide this guarantee.

Q9) What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office holder as a condition of continuing supply.

Suppliers must retain the option to decide for themselves (within the confines of existing legislation) what the most appropriate steps are or could be to maximise the likelihood of receiving payment for ongoing

[2] 29 July 2014, Insolvency Service, "**Insolvency Statistics – April to June 2014 (Q2 2014)"**

consumption costs, as well as supporting the ongoing commercial relationship with the company in administration, and those companies that emerge from administration.

There may be opportunities to request a guarantee from a third party (such as a parent company or from another party), however even if such a guarantee is provided, this should not exempt the IP from providing a personal guarantee as a condition of continuing supply.

As mentioned in our response to question 8, where the IP agrees to provide a personal undertaking to cover the charges, suppliers must be able to require evidence of the IP's ability to provide this underwriting function, particularly where the ongoing costs of the contracted supplies would be significant. Where the supplier reasonably believes that the IP will not be able to effectively underwrite the customer's ongoing consumption then the supplier must be able to either seek an alternative arrangement or seek to disconnect the supply.

Q10) What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

- **a) utility supplies**
- **b) IT goods and services**

We can not comment on any potential impacts or changes on the pricing of contracts of IT goods and services, however we can foresee that these proposals could have a significant impact on how suppliers (both direct and on-suppliers) price in the cost of credit risk or request mitigation (e.g. security deposits, third party guarantees etc) for businesses who have a poor credit record, or for those start up businesses, who do not have an established credit record.

Further to our response to questions 6 & 8, we believe there are significant issues with the proposal to remove the right of insolvency termination clause and the current safeguards proposed. As a consequence, we believe it highly likely that the levels of debt that will be written off will increase, raising costs for all other business customers.

Furthermore, impacted suppliers may start to act on credit issues earlier (i.e. before the company is in administration / CVA / IVA) in order to avoid the risk that certain parts of their contracts would be unenforceable after an administration / CVA / IVA has begun. This is unlikely to be in the best interest of customers.

Q11) Can you foresee any practical difficulties arising from the proposed changes?

RWE npower provides a range of services to businesses that extend beyond simply the provision of gas and electricity supplies. We are concerned that there is insufficient clarity as to which (if any other) services could be impacted by these proposals, such as the metering services, energy solutions / efficiency services would be included within the remit of the proposals. The legislation should be clarified to state whether it would apply to the provision of other ancillary services (such as metering and energy efficiency / solutions).

Please also see our response to question 8.

We do not believe the proposed safeguards will be effective unless there is a requirement placed upon insolvency practitioners to inform the relevant suppliers of an administration within a specific timescale. Otherwise, the 14 day window provided to suppliers to send a written request to the IP for a personal guarantee will likely be impossible to implement, given the current delays in receiving the information confirming that a business has gone into administration. The current requirement on the administrator to inform creditors "*as soon as reasonably practicable*", is inconsistent with the imposition of a specified timeframe to be placed upon suppliers of essential supplies to insolvent businesses in order to gain a personal guarantee from the IP.

In addition, without clarity as to the IP's ability to underwrite the ongoing costs of the services provided, it is likely that this would be factored into the assumed costs of credit risk at the outset of any new contract agreed. This could increase the costs for all businesses.

According to the Com Res research used within the Impact Assessment, both the withdrawal of supply and the demand for "ransom" payments is almost as high for key trade suppliers as it is IT suppliers, and has a significantly higher rate than for utilities. We are therefore very concerned as to whether the proposals will actually deliver the assumed 7% reduction in businesses avoiding liquidation, if key trade suppliers are also able to continue to withhold supply or demand "ransom" payments.

We recognise and understand the rationale of requiring suppliers of IT goods and supplies to be required to continue to supply businesses in administration, in the same way that utility companies are currently required. However, the proposal to change the right of only certain, specified companies to freely contract with one another, appears to be both disproportionate and an unjustified distortion of contractual law.

Finally, we note from the Com Res research suggested that 41% of utility suppliers who seek to withdraw supply or extract "ransom" payments are SMEs. If we assume that proportion is true, this would suggest that the issue of "ransom" payments (or suppliers seeking to withdraw supply) are most likely to be on-sellers, given that the business energy market[3], and the electricity market in particular remains dominated by large companies, either the large household energy suppliers for electricity (British Gas, Eon, EdF, Scottish & Southern, Scottish Power and npower) or within gas, multinational corporations, which include Gazprom, ENI, Statoil, Wingas and Total.

If this is the case, then we believe it would be more proportionate if the focus of these proposals were placed on those companies, (on-sellers of utilities). Further research should be commissioned by BIS to assess the types of companies that are attempting to withhold supply or charge "ransom" payments, and to then deliver regulation and legislation that would tackle those companies that bring the wider industry into disrepute.

Treating on-sellers of utility services and IT services as essential suppliers for the purposes of the Insolvency Act should be the focus of the legislation, with a further evaluation of that policy before any further steps are taken with regards to the removal of a company's right to freely contract with another company.

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[3] Cornwall Energy, April 2014, http://www.energy-uk.org.uk/publication/finish/5-research-and-reports/1099-cornwall-energy-competition-in-british-business-energy-supply-markets-report-april-2014.html

Table 4.2 Competition in Business Electricity Supply, household energy suppliers provided 80.8% of supply
Table 4.3 shows that within the SME electricity market, household energy suppliers provided 88.7% of supply
Table 4.4 shows that within the I&C electricity market, household energy suppliers provided 78.6% of supply

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RESPONSE of

To the Consultation

"Continuity of Supply of essential services to insolvent businesses."

Introduction

1. is a shipper and supplier of natural gas to the Industrial and Commercial market in GB.

   supports the aim of keeping businesses in operation through troubled times if they have a realistic prospect of survival (and has some experience of doing so with its customers), it is deeply concerned about the effect these proposals have on gas suppliers, as the draft regulation effectively loads additional credit risk on the gas supplier. notes that BIS paper takes no account of the 28 days' continued supply that are already required under the Gas Code before any action can be taken to stop debt increasing.

2. Figures for gas suppliers' gross margins vary across the market – for example, larger consumers can command tighter margins from suppliers – but for the I&C market, The balance is made up of the cost of gas and the cost of delivery. Since the transportation cost is regulated by Ofgem there is no competition between suppliers on that element of the cost. The cost of gas is transparent: buys most of its supplies from its shareholders, but these are which are generally visible to anyone with a desire to follow them. Competition is therefore almost entirely on the margin and intangible elements such as service.

3. By paragraph 7 (1) and (3) of the Gas Code (Schedule 2B Gas Act 1986), no steps may be taken to isolate a supply unless a demand has been made for outstanding charges and the demand remains unpaid for 28 days. From there, the process involves the transporter as the means of isolation is normally in or on its equipment. The transporter's contractor can only gain access to the equipment either with the (unlikely) consent of the occupier or with a court order giving him access against the owner's wishes. In a practical sense, this takes so long that either a new owner will have taken the premises with a new supply contract or the Administrator will have closed the business. **argues strongly that this process offers more than enough protection from isolation of the supply.**

4. The Gas Act 1986 was the Act that privatised British Gas. In 1986 transportation, shipping and supply were encompassed within the monopoly. The situation has developed with the introduction of a competitive market. The effect of the Gas Code provisions referred to above is that the shipper of gas acts as guarantor for the payment of the transporter's charges, because it (the shipper) can do nothing practical to curtail the transportation. This is not a fair distribution of risk in the event of insolvency. **argues strongly that in the event of an insolvency, the transporter should not be able to recover its charges from the shipper, but, like the shipper, should be a creditor in the insolvency.**

5. does not offer any view on how the IT supplier should be treated in the event of insolvency, but it does take the position generally that it is concerned about weakening of the disincentives for insolvency. It is, in view, a proper protection for risk taking that vehicles such as the limited liability corporation or partnership should be used, and prudent suppliers take into account the creditworthiness of their counterparties. However, increasing the risk to suppliers (whether gas, power, water or IT) is a transfer of risk from the imprudent to the prudent, and to the extent that this encourages imprudence, it is unwise. supports the objective of keeping employees in work, but in principle, if the value of their output exceeds the cost and their product can be placed in the market at competitive prices the business should have a positive value in the hands of the insolvency practitioner. Prudent directors will, of course, wish to avoid the wrongful trading provisions of S214 and should therefore start to wind down the commitments of the company while it is still solvent; has little sympathy with directors who fulfil their duties with insufficient care.

6. The proposals set out in the consultation rest on the propositions that
   - "when a business enters insolvency, such essential supplier may take a number of actions that can severely impede any chances of business rescue ...For example some essential suppliers ... may withdraw their services altogether ..." (Para 12). As explained above, the Gas Code and the practical process make this impossible for the gas supplier, without plenty of warning.
   - "Because they have the power to withdraw supplies, essential suppliers are able to demand additional 'ransom' payments before they agree to continue to provide services altogether ..." (para 13). Gas is continuously supplied by pipeline and cannot readily be stopped. Contracts may contain provisions permitting termination for insolvency: such clauses do not stop the flow of gas, but will result in a "deemed contract" with the new consumer (presumably the insolvency practitioner). Deemed contracts are required to be published on suppliers' websites. The terms are already subject to Condition 7 of the Gas Supply Licence, the relevant parts of which say:

     7.3 The licensee must take all reasonable steps to ensure that the terms of each of its Deemed Contracts are not unduly onerous.

     7.4 One way in which the terms of a Deemed Contract will be unduly onerous for any class of Domestic Customers or for any class of Non-Domestic Customers is if the revenue derived from supplying gas to the premises of the relevant class of customers on those terms:

     (a) significantly exceeds the licensee's costs of supplying gas to such premises; and

     (b) exceeds such costs of supplying gas by significantly more than the licensee's revenue exceeds its costs of supplying gas to the premises of the generality of its Domestic Customers or, as the case may be, to the premises of the generality of its

Non-Domestic Customers (in each case excluding from the calculation premises supplied in accordance with standard condition 8 (Obligations under Last Resort Supply Direction)).

As a consequence of these provisions, [redacted] does not believe that excessive demands are a feature of the I&C gas supply business.

- "Such payments may also result in certain creditors receiving 'preferential' treatment at the expense of other creditors". (Para 14) If so, such "preferential" payments should be considered under S213 Insolvency Act and if agreed by the incumbent insolvency practitioner they must, by definition, be in the interests of the creditors.

Therefore, insofar as it applies to the gas industry, none of these foundation propositions has merit; it is unlikely that there is evidence to support the propositions, and if, in a few cases, the evidence can be shown it should be dealt with under existing legislation/regulation.

<u>Answers to Questions</u>

Q1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

A1. Yes: however there is a potential overlap with subsection (a) which could be avoided by the following amendment:

2(1) Section 233 of the Insolvency Act 1986 is amended as follows.

(2)After subsection (3)(d) insert—

"(e) a supply of gas, electricity, water or communications services by a person who carries on a business which includes giving such supplies *and who does not fall within subsection (a)*,

(f) a supply of goods or services mentioned in subsection (3A) by a person who carries on a business which includes giving such supplies, where the supply is for the purpose of enabling or facilitating anything to be done by electronic means

Q2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

A2. "Wholesale" does not have a definition that readily fits with the supply of gas by pipeline to business. For the reasons set out in the introduction to this note, gas supplies to businesses are generally protected by the Gas Code, which is an argument for taking Licenced Gas Suppliers out of the ambit of the Insolvency Act, if HM Government wants to give effect to its intention that "any supplies made for wholesale purposes [not] be subject to the provisions." (para 26)

Q3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

A3. Yes

Q4. Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

A4. The Respondent does not wish to comment on any industry other than its own.

Q5. Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)

A5. The Respondent does not wish to comment on any industry other than its own.

Q6. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

A6. The Respondent does not wish to comment on any industry other than its own

Q7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

A7. No evidence has been presented of ransom payments in the I&C gas industry. The proposed additions to legislation are unnecessary in relation to Licenced Gas Suppliers who are subject to the Gas Code.

Q8. Do you believe that the safeguards provided for suppliers are adequate?

A8. The safeguards do not address the issue for gas, which is that the supplier's reward is a very low proportion of the costs which increase with every extra day of continued supply. If an insolvency practitioner wishes to keep the business running, he must give the personal guarantee to his gas supplier within 5 working days of the insolvency. The gas supplier is effectively the guarantor of the transporter's charges; it is unsustainable to leave the gas supplier with no or delayed relief.

Q9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

A9. None

Q10. What impact, if any, do you believe the changes would have on the pricing of contracts in relation to;

a) utility supplies
b) IT goods and services

A10. In relation to gas, they add risk (and therefore risk premium) to the price.

Q11. Can you foresee any practical difficulties arising from the proposed changes?

A11. As set out above.

Any questions on this response may be addressed to

Continuity of supply of essential services to insolvent businesses

Submission by GDF SUEZ Energy UK

(I) Background

GDF SUEZ Energy International is responsible for GDF SUEZ's energy activities in 32 countries across five regions worldwide. Together with power generation, we are also active in closely linked businesses including downstream LNG, gas distribution, desalination and retail. GDF SUEZ Energy International has a strong presence in its markets with 72.9 GW gross (37.4 GW net) capacity in operation and 8.4 GW gross (4.4 GW net) capacity of projects under construction as at 31 December 2013.

GDF SUEZ Energy in the UK is the country's largest independent power producer by capacity with approximately 5,085 MW of plant in operation in the UK market made up of a mixed portfolio of assets – coal, gas, CHP, wind, OCGT distillate, and the UK's foremost pumped storage facility. Several of these assets are owned and operated in partnership with Mitsui & Co. The generation assets represent approximately 6% of the UK's installed capacity. The company also has an established retail business which is currently the 6th largest supplier of electricity and the 9th largest supplier of gas to the industrial and commercial sector.

GDF SUEZ welcomes the opportunity to comment on Government's proposals in relation to the continuity of supply of essential services to insolvent businesses.

(II) Summary

- **GDF SUEZ welcomes the government's efforts to standardise the approach to energy supply arrangements in the event of business insolvency but we consider the proposals put additional risks on energy suppliers which are too great.**

- **The proposals should not be applied in all circumstances and to all customers. The standardised approach could be applied to smaller and medium sized businesses because the risks can be diversified more easily but that it would be inappropriate to apply the suggested approach to larger businesses because the risks are highly concentrated.**

- **We recommend that the government consider the introduction of a threshold which protect smaller and medium sized businesses but above which the existing rules of the insolvency act remain.**

(III) Answers to Questions

Question 1-5. We have no comments to make in relation to IT goods or services.

Question 6 – Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

No, it is critical for energy suppliers, to larger businesses at least, to maintain the right to activate a contract termination once a business enters administration. If not these proposals are likely to introduce undue risks and costs to energy suppliers which are simply unsustainable. The reliance of energy suppliers on insolvency termination clauses is valid due to the significant risks involved in the supply of wholesale products such as electricity and gas, particularly where contracted volumes are very large. Our explanation of these risks is set out below in response to question 7.

Additionally, we note that it seems commonplace for businesses entering insolvency to be sold on or for them to re-emerge quickly under a different trading name, this is commonly referred to as a "pre-pack acquisition". Under these circumstances energy suppliers are left exposed as a creditor to the previous indebtedness of the business concerned. It is not uncommon for this process to repeat itself within a short period of time leaving the energy supplier exposed to unpaid charges once again.

Question 7 – Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding "ransom" payments as a condition of continuing supply?

The term "ransom" payments in relation to out of contract rates is disingenuous, and we do not request any such payments. It should be noted that there are significant additional risks and costs arising and a supplier's out of contract rates simply reflect these costs. Additionally, electricity and gas suppliers are restricted by licence from making excessive profits arising from deemed contracts and out of contract rates.

The terms of deemed contracts are already governed under gas and electricity supply licence conditions and these are monitored and enforced by the energy regulator Ofgem. Specifically SLC 7[1] states that the terms of deemed contracts shall not be "unduly onerous", and, "the revenue derived from supplying to the premises on those terms" may be unduly onerous if it "significantly exceeds the licensee's costs of supplying to such premises".

1 https://epr.ofgem.gov.uk//Content/Documents/Electricity%20Supply%20Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf

The licence recognises that there may be valid cost drivers which necessitate suppliers to charge for the additional risks and uncertainties they face in circumstances such as business insolvency. Energy supply costs are largely driven by commodity costs which are in turn sensitive to; a) volume risk and b) price risk. It is legitimate for energy suppliers to have the ability to manage these risks by means of terminating contracts where there have been significant changes to the original agreement, for instance where a business enters administration. The proposed changes would remove the ability for energy suppliers to manage these risks on a case by case basis which may have the effect of increasing consumer prices overall (due to increased risk premiums) or may result in suppliers exiting the market because they perceive the ongoing risks are too high.

In the larger business market the contracted volumes are generally sufficient for the gas or electricity requirements to be bought in advance by the supplier (hedged) according to the individual requirements of the particular business consumer. Any significant variation in demand, usually a reduction in the case where a business enters administration, will mean that the supplier will have to sell-back gas or electricity via the wholesale markets or face punitive out of balance charges through the energy cash-out regimes. Exposure to these commodity markets is highly price sensitive and the costs which arise cannot be absorbed by energy suppliers, the potential losses are simply too large to be sustainable.

In our experience, where businesses have entered administration it is very rare to receive any meaningful forecast of energy requirements from the administrator. The ability for the energy supplier to terminate the original contract due to insolvency allows for these unforeseen risks to be taken into account, the proposal to roll the original terms and prices throughout the period of administration is unreasonable and not cost reflective. Retaining the ability for energy suppliers to terminate the contract is also key to determining a crystallised position in relation to the losses incurred under the original contract, this would be clouded where the original contract was allowed to run on, which may prejudice any settlement.

Question 8 – Do you believe that the safeguards provided for suppliers are adequate?

Currently there are no Supplier of Last Resort (SoLR) provisions in the non-domestic energy supply market but the introduction of these proposals would enforce a quasi (SoLR) arrangement, where existing contracts must be honoured despite a change in circumstances. We consider that the safeguards offered are not either sufficient or appropriate for energy suppliers to larger businesses but they may have some merit for application to energy supply contracts for small and medium sized businesses.

For example the personal guarantee from the insolvency office holder would need to be a very substantial sum of money; in the case of larger consumers this undertaking could amount to hundreds of thousands if not millions of pounds where an energy supplier has a contract with an energy intensive user for both gas and electricity. Further, the amount accrued under insolvency may typically cover a period of around three months; one month for energy (billed in arrears), plus 28 days for payment by the insolvency office holder plus a further month or so to arrange for disconnection of supply. Whilst the opportunity to request a personal guarantee from the insolvency office holder is welcome, it may be meaningless in reality where this becomes a very large requirement. In fact the extent of the underwriting may even restrict the market for insolvency practices (LLPs) to work on behalf of very large clients, but in any event, there should not be any exceptions to an energy supplier having the ability to make the request.

There should be a requirement for insolvency practitioners to provide energy suppliers with a notice of insolvency as soon as possible and certainly within the first week. Currently we rely mainly on our own checks (London Gazette etc.) and we have noticed a reluctance for insolvency practitioners to inform in a timely manner.

We require more clarity in relation to the proposed safeguard process as outlined in paragraph 43. It is not clear what happens when the energy supplier does not or is unable to request a guarantee from the insolvency practitioner within the prescribed 14 day window. Would the energy supplier have the discretion to choose whether to request either a personal guarantee or choose to terminate the supply? Further, is it correct to interpret "terminate the supply" as the right to both a) terminate the contract and b) to disconnect the supply? And when would the 14 day period start – the date of the insolvency? or the date the supplier becomes aware of the insolvency?

Question 9 – What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

If energy suppliers are forced to continue to supply under the existing contracts there should not be any exceptions to the ability for energy suppliers to make a request for a personal guarantee from the insolvency office holder.

Question 10 - What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

a) Utility supplies
b) IT goods and services

In relation to the supply of electricity and gas it is certain that the introduction of the proposed changes will increase the risk premium associated with such contracts. This will be true in most cases and in others it will require a higher security deposit from large consumers to cover the additional wholesale price and volume risks we have identified in our answer to question 7. The practical application will depend on the pricing policy employed by each energy supplier however it is likely that the non-payment risk premium will be increased to consumers overall and hence there will be an increased cross-subsidy between consumers. Where non-payment risk is assessed by energy companies on a case by case basis then at the very least, risk premiums will increase but it is also likely that some higher risk businesses will not be offered an energy supply contract at all by some suppliers; with the effect of diluting competition in the market.

Question 11 – Can you foresee any practical difficulties arising from the proposed changes?

It is likely that a large number of cases will be referred to the courts by virtue of causing the hardship to the energy supplier. This would be particularly true in the case of larger businesses where the risks are highly concentrated; the failure of a larger consumer, compared to a smaller consumer could more easily place an energy supplier into hardship.

In relation to the insolvency guarantee process (para. 43) we require more clarity:

It is not clear what happens when the energy supplier does not or is unable to request a guarantee from the insolvency practitioner within the prescribed 14 day window. Would the energy supplier have the discretion to choose whether to request either a personal guarantee or choose to terminate the supply? Further, is it correct to interpret “terminate the supply” as the right to both a) terminate the contract and b) to disconnect the supply? And when would the 14 day period start – the date of the insolvency? or the date the supplier becomes aware of the insolvency?

End of response.

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ANNEX

CONTINUITY OF SUPPLY OF ESSENTIAL SERVICES TO INSOLVENT BUSINESSES

SCOTTISHPOWER RESPONSE

<u>Question 1</u>

Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

The proposed amendments would appear to be effective in bringing supplies of electricity and gas other than by a licensed supplier within the scope of the existing provision. We would note that the changes in the electricity and gas markets (such as the growth of the small suppliers) have not affected the need for most types of supply to end users to be covered by a licence.

However there are some special cases such as landlord/tenant situations, and supply over a direct pipe or line, where there are exemptions from the need for a licence and we see no reason why the insolvency protections should not apply, subject to getting the wholesale issues right.

<u>Question 2</u>

Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

We think that more work is needed here. On the basis that "supply" means the transfer of a good or service from somebody who has it to somebody who wants it, for consideration, it is likely that somebody selling electricity or gas in the wholesale market is supplying it to the buyer.

The Electricity and Gas Acts contain special provision to deal with this. Supply of electricity is defined in section 4(4) of the Electricity Act 1989 as "supply of electricity conveyed by a distribution system to premises other than premises occupied by a licence holder for the purposes of carrying on the activities which he is authorised by his licence to carry on". This definition excludes wholesale transactions.

Similarly, while the Gas Act 1986 does not have a special definition of "supply", section 5(1) of that Act 1986 establishes the need for a licence for the "supply to premises of gas which has been conveyed to premises through pipes". Subsequent provisions define a "gas supplier" as a person with a supply licence performing the licensed activity.

The existing provisions in sections 233 and 372 of the Act correctly pick up these definitions; if they are to be extended to cover other supply to end users, care will be needed to avoid including wholesale. It is therefore likely that either the word "supply" needs to be defined as meaning the supply to premises of gas/electricity which has been conveyed through pipes/a distribution system or else there will need to be an explicit carve-out of the supply of energy to a person for the purpose of sale to another person.

Consideration should also be given to the supply of gas for use in power stations. There are elaborate insolvency procedures in place around electricity and gas wholesale markets and it may be perilous to apply the provisions set out in this consultation without thinking through the impacts, especially given the very large consumption of a gas fired power station. Similar issues may also apply for the small number of transmission connected electricity customers.

The current insolvency rules in these cases are intended to protect the integrity of the trading market in the event of default and the impact on the rest of the market of the disapplication of these terms to an insolvent supplier must be carefully considered. While the savings for existing contracts may help here, it is unclear what the position will be where a new party accedes to an existing multi-party contract after section 233A comes into force.

Question 3

Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

Other companies and organisations will be better placed to advise on this question.

Question 4

Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

Other companies and organisations will be better placed to advise on this question.

Question 5

Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)

Other companies and organisations will be better placed to advise on this question.

Question 6

Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes, although they would also prevent such suppliers from relying on other provisions relating to insolvency. This may lead to unintended consequences, depending on the nature of such provisions.

Generally, we think that more work needs to be done in relation to sections 233A and 372A in order to ensure that the interests of suppliers are protected as required by sections 93(5) and 94(6) of the Enterprise and Regulatory Reform Act 2013 (“the ERR Act”). We explore this further in our response to Question 8 below.

At ScottishPower, while our terms and conditions do allow us to terminate a contract in the event of insolvency, our primary objective in the event of insolvency of a customer is to obtain an undertaking from the insolvency practitioner which would allow us to continue to support the customer. We do not charge special prices for customers in insolvency procedures. As background information, we outline below the process that we aim to put in place when one of our customers becomes insolvent.

When we become aware that an insolvency event has occurred (whether that notice is received directly from an insolvency practitioner or from general news updates), we take the following steps immediately:

- Finalise the existing customer's electricity and/or gas account up to and including the date of the appointment of the insolvency practitioner and enter a claim in the administration/liquidation for the calculated amount.
- A new supply account is generally set up in the name of the customer 'Company name - (in administration)' or '…. (in liquidation)'.
- In many cases, this is on the same tariff, rates and payment terms as the original contractual account. However, where such a rate is no longer available as a standard rate for new contracts, the new account is opened at the published variable rate.
- Seek an undertaking from the insolvency practitioner (the consultation describes this as a personal guarantee) for payment of the ongoing utility supply throughout the insolvency period.

Whilst we attempt to follow the procedure set out above, each customer's insolvency is different and can have its own unique problems and outcomes. There are, however, a number of problems that we often encounter:

- Supply of utility energy is sometimes not a high priority to the insolvency practitioner (IP) or the insolvent company. This can result in the utility not being included in the schedule of debts or being given notice of the insolvency. It is not uncommon to become aware of the insolvency more than 14 days after it commences.
- It can be very difficult to obtain meter readings for each affected premises as at the date of the appointment of the insolvency practitioner. Indeed, often the insolvency practitioner will have very limited information available, and rely upon us providing it with details of lists of customer sites, accounts, etc.
- Without correct and up-to-date meter readings, we can only invoice on the basis of estimated meter readings - this can cause billing disputes, which can take a significant time to resolve.
- Considerable time may elapse before we are notified by the insolvency practitioner as to which supplies are required and/or provided with the undertaking.
- When an insolvency practitioner no longer requires a supply, an undertaking can be withdrawn with very limited notice. Further, once an undertaking is withdrawn, it is difficult to obtain assistance from an insolvency practitioner to find out who the owners/occupiers of the affected sites are, which would enable us to obtain a warrant to disconnect the supply.
- When an undertaking is withdrawn, sometimes on very short notice, insolvency practitioners will not pay for any debt accrued on the account after the withdrawal, and we are advised to submit the debt as a claim under the insolvency. This rarely leads to a recovery.
- It can take many weeks or months to obtain a signed warrant to allow us access to disconnect the supply to particular premises. In the intervening period of time, the supply continues to be accessible by the customer. This places a disproportionate risk on the supplier. There are also costs incurred in disconnecting the supply, and again when a supply is reconnected.

Question 7

Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

The protections for companies and individuals in an insolvency process set out in sections 233 and 372 of the Insolvency Act ("the Act") already apply to us as a licensed electricity and gas supplier. Accordingly, we are already forbidden from making settlement of any part of pre-insolvency debt a condition of future supply and we think these sections already have the effect of prohibiting 'ransom' payments in our case. Furthermore, as a matter of good practice, we have always been willing to continue to supply and support customers during insolvency processes, providing that we have the insolvency practitioner's undertaking.

As mentioned above in our response to Question 6, a new supply account is generally set up in the name of the customer in administration and in many cases the new account will be on the same tariff, rates and payment terms as the original contractual account. However, where such a rate is no longer available as a standard rate for new contracts, the new account is opened at the published variable rate. The requests for undertakings sent by ScottishPower would specify that a supply will continue in accordance with the existing contract and the applicable rates.

The proposal that suppliers in possession of an undertaking should not re-price as a result of insolvency seems appropriate in principle. However, there may be IT issues because of the need to close the customer's account on insolvency and open a new one (in order to segregate the before and after finances). It may be difficult to open a new account for a tariff that is no longer available to new customers. We suggest suppliers are allowed to switch the customer to the published tariff available to new customers corresponding most closely to the existing customer rate; alternatively, we would request six months' notice to implement the necessary IT changes.

We do, however, think that more work needs to be done in relation to sections 233A and 372A in order to ensure that the interests of suppliers are protected as required by sections 93(5) and 94(6) of the Enterprise and Regulatory Reform Act 2013 ("the ERR Act"). We explore this further in our response to Question 8 below.

Question 8

Do you believe that the safeguards provided for suppliers are adequate?

As mentioned above, we think that more work needs to be done in relation to sections 233A and 372A in order to ensure that the interests of suppliers are protected as required by sections 93(5) and 94(6) of the Enterprise and Regulatory Reform Act 2013 ("the ERR Act"). At present we do not consider that the proposed safeguards achieve the right balance of risk, specifically:

(a) The proposed deadline of 14 days for the supplier to request an undertaking from the insolvency practitioner does not seem reasonable. In many cases, the supplier will not be aware of the insolvency until after that period is over and we question whether this limitation is fully consistent with section 93(3) and 94(4) of the ERR Act. It is unclear to us why there needs to be any limitation on when a supplier can ask for an undertaking.

In any event, any time period would need to run from the date of effective notification of the supplier by the insolvency practitioner and not the insolvency event itself.

(b) The giving of 14 days for the insolvency practitioner to decide whether to give the undertaking seems to require suppliers to provide services to an unnecessary extent without any form of security. We think that a sufficient deadline to provide the undertaking would be 5 business days.

(c) It is unclear how the separate provisions relating to termination of the contract and termination of the supply interact. In particular, we think it would be helpful to be clearer that a right to terminate the supply (eg as a result of non-receipt of an undertaking) includes a right to terminate the contract which obliges the supplier to give that supply.

(d) The criterion for the court to decide on allowing for the termination of the contract is stated to be that continuation would cause the supplier undue hardship. This is an almost impossible test to meet for a large supplier and does not seem consistent with sections 93(2)(b) and 94(3)(a) of the ERR Act. We wonder whether it would be better to be silent on the criteria, so that the Court can address the question within the context of the objectives of the section and protecting the interests of suppliers.

(e) It is unclear what happens when the insolvency practitioner withdraws an undertaking. It is not sufficient to rely on the provision allowing for withdrawal of supply for non-payment 28 days after the payment terms are exhausted, as this could, combined with the meter reading cycle, leave energy suppliers exposed for 90 days or more. The order should provide that supplies can cease immediately on withdrawal of an undertaking. We also think that BIS should use the powers in sections 93(5) and 94(6) of the ERR Act to provide that the insolvency administrator should provide reasonable assistance to energy suppliers to identify and obtain access to premises affected by an undertaking and its withdrawal.

(f) The proposal that suppliers in possession of an undertaking should not re-price as a result of insolvency seems appropriate in principle. However, there may be IT issues because of the need to close the customer's account on insolvency and open a new one (in order to segregate the before and after finances). It may be difficult to open a new account on a tariff that is no longer available to new customers. We suggest suppliers are allowed to switch the customer to the published tariff available to new customers corresponding most closely to the existing customer rate; alternatively, we would request six months' notice to implement the necessary IT changes.

(g) The prohibition on shortening payment terms upon insolvency needs careful analysis. On the understanding that an undertaking by the insolvency practitioner covers energy consumed up to the date when it may be withdrawn, even if under credit terms which do not require payment for some long time later (in some cases, 60 days), this may be reasonable, subject to point (e) above.

(h) There are huge complications in relation to multi-site contracts, which may have differing billing cycles and may be held by differing legal entities within an insolvent group. It is also quite likely that an insolvency practitioner may wish to withdraw an undertaking in relation to some but not all sites – for example in retail chains where it is necessary to distinguish the viable stores from the others. Different but equally difficult issues arise in relation to very large consumers that buy in the energy wholesale markets. We do not think that the provisions as drafted properly cater for such cases. We would urge BIS to hold an early workshop where these issues can be thought through and solutions identified.

We think that it would be useful to consider whether criteria could be placed around what constitutes an adequate undertaking, such as minimum notice required to withdraw it

Question 9

What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

There should be no exceptions. We do not think that electricity or gas utilities should be required by insolvency law to give a supply in any circumstances if the insolvency practitioner is unwilling to give an undertaking.

Question 10

What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

a) utility supplies
b) IT goods and services

To the extent that the proposed changes increase the level of losses from insolvency risk (especially by increasing the period when a supply may need to be given without a clear route for payment), this is likely to be reflected in pricing.

The effect may either spread across all non-Government customers (and therefore be relatively small) or – to the extent that suppliers are able to predict insolvency risk – focussed on the more risky sectors. Where suppliers are able to identify sectors at risk, they may increase pricing in those sectors more significantly and some may choose not to supply that segment or particular companies,

Question 11

Can you foresee any practical difficulties arising from the proposed changes?

The structure of the proposed legislation, which operates by disapplying all insolvency-related terms, is potentially risky as it is unknown in relation to a particular contract which terms may be disapplied, what is the reason why they were in the contract in the first place and what is the effect of disapplying them.

We wonder whether, if the requirement is the continued provision of the essential service on substantially the same credit terms and pricing, whether a more targeted approach might carry less risk of unintended consequences.

If the final version of the changes exposes suppliers to significant post insolvency credit risk, it is likely to cause suppliers to have to take a more pro-active and robust approach in terms of monitoring potential insolvencies. This may lead to suppliers having to require security deposits, or to taking more aggressive recovery action at an earlier stage in order to avoid the negative consequences of the proposed changes following the insolvency event. Such an outcome may therefore have the unintended consequence of causing greater difficulties for businesses at risk of insolvency.

ScottishPower
October 2014

British Gas
Looking after your world

Continuity of supply of essential services to insolvent businesses

British Gas response to the Department for Business Innovation and Skills

October 2014

Executive Summary

British Gas is the country's largest energy supplier, providing gas and electricity to over 950,000 non-domestic customer sites, as well as providing a significant number with energy services. Our customers range from very small businesses to large corporates and also include a wide range of public sector organisations, such as local authorities.

At a time when many people are under increasing strain from the rising cost of living, British Gas' priority is to keep energy bills as low as possible for our customers. To do this we must keep a tight rein on our costs and manage bad debt, which impacts on all our customers and can lead to an increase in prices.

The UK is emerging from a severe recession and an improving economic climate should help UK business. However, previous recessions have shown that insolvencies tend to lag recessions by several years and insolvencies may therefore remain high, or even increase, before dropping. This consultation, therefore, is timely and we welcome the opportunity to respond to it.

The proposals, which are laid down in the Enterprise and Regulatory Reform Act 2012, prevent suppliers of essential services from terminating supply, demanding 'ransom payments', or varying the terms of supply on the event of insolvency. We fully support the intention of the proposals; to bolster the business rescue culture and ensure struggling businesses can be saved. However, insolvency can have a significant impact on creditors, including employees, small businesses and the taxpayer. It is important, therefore, that these measures do not lead to a situation where businesses without a viable future are rescued temporarily and debts across the creditor community increase as a result.

We have extensive experience of dealing with Insolvency Practitioners on business rescue procedures. Insolvency has a significant impact on our business and in the last year alone over 5,500 businesses, supplied by British Gas, entered an insolvency procedure. Over the last three years, these businesses have left over £50m in outstanding debts.

British Gas is supportive of the aim of the proposals, but we have several key concerns about the proposed safeguards for suppliers, which we do not believe will be wholly effective. In addition, the changes do not take into account complexities, which are specific to the energy industry, such as the Deemed Contract regime, which is a statutory contract between energy suppliers and consumers, which may interact with the proposals.

Our primary concern is that the ability to withdraw supply for non-payment, or if a personal guarantee is not provided, will be practically very difficult, lengthy and expensive. We will have to go to court to obtain a warrant to enter the premises, which takes time, and where a moratorium is in place we will also need to go to the Companies Court to ask for the moratorium to be lifted before we then apply to the Magistrates Court. In addition, the fact that energy is usually billed on a quarterly or monthly basis means that we could potentially be exposed to significant debts under these proposals.

Under our current framework we manage this issue by varying our terms of supply, asking for upfront or more frequent payments, or entering into short term contracts to support the business and manage the amount of debt involved. Under the proposed changes, this will no longer be possible.

Without some changes, we are concerned that this positive policy intervention could, in fact, have a negative impact on the business sector. Suppliers of essential services may need to consider additional upfront safeguards when taking on high risk customers, such as different payment terms, or security deposits, which may make it harder for businesses to operate. Alternatively, increased exposure to bad debt may impact prices across the entire customer base, or in extreme cases it might be considered too risky to supply certain customers.

However, we believe there are ways to ensure that the proposed legislation can be more effective. In particular, we suggest that energy providers should be allowed to vary the terms of payment, by requesting a more regular payment regime. This will balance the fact that withdrawing supply is, in practice, very difficult. This should reduce our exposure to debt, with little impact on the insolvent business.

We also believe the rules around personal guarantees should be strengthened to ensure they are fit for purpose. At the moment, very few Insolvency Practitioners will agree to provide a personal guarantee. In some cases, we suggest this should be a regulatory requirement, rather than an optional safeguard.

We also need to ensure that personal guarantees are robust and are not subject to protracted negotiations. In this context, we suggest that the personal guarantee should be provided by the Insolvency Practitioner, with the financial backing of the wider firm (which must be of an acceptable credit rating). The terms of the guarantee should also be provided on the basis of the original supply contract and for the full length of the administration.

We also have some doubts about the actual impact these changes will have on the business rescue culture, particularly where energy suppliers are concerned. As we have highlighted, energy supply is very rarely withdrawn because of the difficulties involved with doing so, and we will always try and work with the Insolvency Practitioner to find an arrangement that works for both the business and the supplier. We suspect that very few businesses fail to be saved for this reason alone.

Finally, in our experience, many companies that are ‘rescued’ fall into another insolvency procedure some time later and in some cases we do not believe it is in the best interests of the business, or its creditors, to facilitate a temporary rescue. Good examples of this in recent years are Blockbuster and La Senza, which went into numerous business rescue procedures before finally being wound up. We question whether the impact assessment has taken this into consideration and suggest that further research into this area would be beneficial.

Questions

Question 1 – Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

Yes, we believe the proposed amendments will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions.

Question 2 – Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

Yes, we believe the proposed amendments will be effective in preventing supplies made for wholesale purposes from being subject to the provisions.

Question 3 – Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of section 233 and 372?

British Gas agrees that IT goods and services now play a vital role in the everyday running of a modern business. In this context, it is right that they should be treated as essential suppliers and brought within the scope of this legislation. We believe the proposed changes will achieve this.

Question 4 – Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

No comment.

Question 5 – Are there any types of IT goods or services that you believe should be brought within the scope of sections 233 and 372?

No comment.

Question 6 – Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes, we believe the proposed amendments will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses.

Question 7 – Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

British Gas believes that the inclusion of the wording 'from doing any other thing because the business has entered a business rescue procedure' will be effective in preventing suppliers from demanding 'ransom payments'.

We recognise that the ability to demand 'ransom payments' could add greater pressure on businesses' finances, at a time when they are struggling and we agree that Insolvency Practitioners should be given the best chance possible to help facilitate a rescue if it is appropriate to do so. However, we would argue that reasonable upfront security deposits, which reflect the company's changing credit risk, are an important way for businesses to manage the debt risk appropriately. We believe a distinction should be drawn between this and 'ransom payments'.

We are concerned that the proposed changes will prevent some legitimate business practices, which we use to reduce our exposure to debt, but which we do not believe will have a significant impact on a business' ability to be rescued. As highlighted earlier, it is important we carefully manage our bad debt charge, as this ensures we are able to keep energy prices as low as possible for our customers.

When a business enters into insolvency, British Gas will continue to provide the business with energy and we will work with the Insolvency Practitioner to ensure this happens. We may, however take the decision to reduce the debt risk we are exposed to by increasing the frequency of payments, or asking for up-front payment. Energy suppliers tend to bill customers on a quarterly or monthly basis, so debts can quickly build up, particularly in large retail insolvencies with a number of different stores.

Given that insolvency debt has a considerable impact on our business and a knock-on effect on all our customers, we call on Government to give energy suppliers the ability to negotiate payment terms with Insolvency Practitioners and vary them where reasonably necessary. As highlighted above, significant debts can build up quickly in the non-domestic energy sector and it is very difficult for energy companies to withdraw supply if they are not paid throughout the insolvency. This change could enable us to manage the risk.

We believe this should be possible within the current wording of the Enterprise and Regulatory Reform Act.

Question 8 – Do you believe that the safeguards provided for suppliers are adequate?

British Gas does not believe the safeguards provided for suppliers are adequate and they do not take into account certain complexities in the energy supply industry, such as the Deemed Contact regime. We believe these should be strengthened and additional measures should be provided to protect against an increase in insolvency related debt.

Withdrawal of supply for non-payment

Unlike IT, or most other essential suppliers, energy companies are unable to withdraw supply easily, or remotely. If an Insolvency Practitioner does not make payments during the insolvency we would find it very difficult to withdraw supply, as we would need to go to court to get a warrant to enter the property, which takes time.

In the 28 day period the Insolvency Practitioner has to pay the outstanding debt, along with the time taken to get a warrant, significant debts could build up, particularly where an insolvent company has a number of different sites, high energy needs, or where they are on quarterly billing.

In addition, where an administration moratorium is in place, energy suppliers are unable to get a ‘rights of entry warrant’, without first issuing an application to the Companies Court to lift the moratorium. In the event the permission is granted, we will then need to apply to the Magistrates Court. Administrators are unlikely to agree to the lifting of the moratorium and the process is expensive, lengthy and uncertain.

To guard against this, we suggest that the period for non-payment is reduced and energy companies are given the ability to require more regular payments of outstanding sums, where necessary, so they can reduce what can often be a very substantial debt. We have outlined this further in question 7.

We would also like further information on whether energy suppliers will be entitled to terminate supply after 28 days of non-payment if the outstanding debt is disputed. This happens on a number of occasions, especially where estimated billing has been used and it would be useful to have clarity on this issue.

Application to the court

We envisage that this will be very difficult in practice. In the length of time it takes to go to court, the supplier will be exposed to significant debts. Again, where an administration moratorium is in place, this process is made even harder. We would welcome further information on this issue.

Personal guarantee

Despite our experience of dealing with insolvent companies, we can remember very few occasions where an Insolvency Practitioner has provided a personal guarantee. Where Insolvency Practitioners do show signs of being willing to provide a personal guarantee, there are often very difficult and protracted negotiations that follow and a solution that fits both parties is often not found.

We agree that if personal guarantees were forthcoming they would be a good form of security. However, for the personal guarantee to be robust, it would need to be given for the full duration of the administration and on acceptable terms.

A personal guarantee from an Insolvency Practitioner under the backing of just the insolvent company would be less robust, as would a personal guarantee backed only by the Insolvency Practitioner, as an individual’s wealth is hard to quantify and audit.

We are also concerned about the inclusion of the 14 day period the Insolvency Practitioner has to agree to provide a personal guarantee. As highlighted above, in our experience, Insolvency Practitioners do not willingly provide personal guarantees and we can envisage a situation where an Insolvency Practitioner is never likely to provide a guarantee, but waits 14 days before alerting the supplier, allowing additional debts to build up in this time.

Equally, we are worried that there are no timing requirements for Insolvency Practitioners to notify energy suppliers of the details of the administration, which will be needed to enable suppliers to request a personal guarantee. For example, in a recent large retail case that British Gas was involved in, it took 14 days for the Insolvency Practitioner to confirm which sites they had retained. We suggest there should be a regulatory penalty for an Insolvency Practitioner failing to unveil details of the sites it has retained within 14 days.

In its current form, we do not believe the personal guarantee will be particularly beneficial. However, we believe this safeguard would be more robust if the personal guarantee is in the name of the Insolvency Practitioner, with the financial backing of the wider firm (which must be of an acceptable credit rating). The terms of the guarantee should also be provided on the basis of the original supply contract.

Given how difficult it is for energy providers to withdraw supply, we also suggest the Government look at whether it would be sensible for a personal guarantee to be a regulatory requirement, rather than an optional safeguard.

We also suggest that the 14 day period is amended, to reduce the amount of debt the supplier is exposed to. We suggest five working days would be a more appropriate time period.

Question 9 – What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as condition of continuing supply?

We do not believe there should be any exemption from the ability to seek a personal guarantee from the office-holder. Instead, we think this safeguard should be strengthened, as detailed in question 8.

Question 10 – What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

Utility suppliers

Without a sufficiently robust personal guarantee, or the ability to manage debt through varying payment terms, we believe there could be fairly significant consequences on our non-domestic supply business. As a company, we need to ensure we protect all our customers and as far as possible prevent any knock-on consequences this may have.

In this context, some of the things we will need to consider include, whether we become more risk averse and stop contracting with higher risk customers, or whether we need to require increased security or risk premiums on acquisition of higher risk companies, which may make it more difficult for these companies to secure affordable energy.

We will also need to keep our bad debt charge under review. If this increases significantly there may be an impact on energy prices across all our non-domestic customers.

IT goods or services

No comment.

Question 11 – Can you foresee any practical difficulties arising from the proposed changes?

British Gas believes there are a number of practical difficulties arising from the proposed changes and a number of areas where it would be useful to have further clarity. We have covered these in our responses to earlier questions. However, in summary these include:

Failure on the part of the Insolvency Practitioner to provide a personal guarantee
The 14 days period for agreeing personal guarantees is too long

In addition, we would also like further information on how the proposals will interact with the deemed contract regime.

It would also be useful to have details on the process for personal guarantees where an administrator is changed mid-administration. Would, for example, the successor Insolvency Practitioner be required to provide a guarantee on the same terms as any guarantee provided by the administrator being replaced?

Policy.Unit

From: Craig Kennedy <Craig.Kennedy@webapplicationsuk.com>
Sent: 11 July 2014 15:03
To: Policy.Unit
Subject: Continuity of Supply of Essential Services to Insolvent Businesses - Consultation

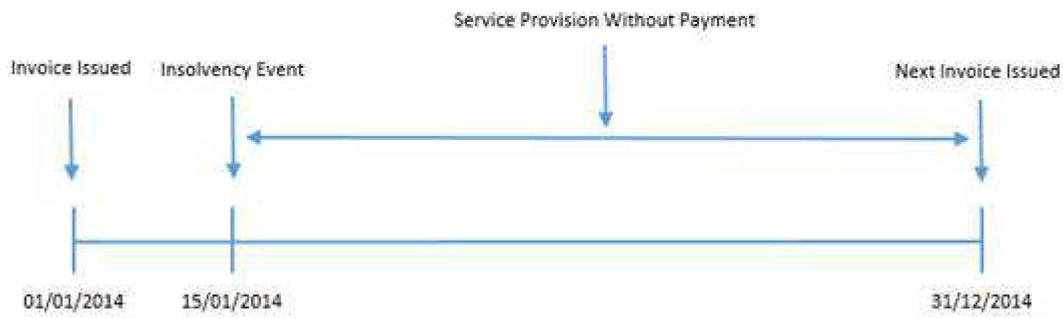
Web Applications UK Limited is a software development company based in Oldham, Greater Manchester, specialising in the provision of bespoke reservation systems for the travel industry. Currently we employ a workforce of ~70.

The comments in this email reflect the views of our Board. The concerns were highlighted in an informal conversation between myself as Finance Director and our Chief Executive.

This legislation will impact directly on our business so we would appreciate if the following could be taken into account.

Annual Invoicing

The 28 day non-payment safeguarding provisions appear to only cover post insolvency liabilities? In many circumstances we invoice for licence and support fees annually in advance. The legislation needs to ensure that the amounts owed to organisations such as ourselves cannot be ring-fenced within the insolvency process requiring us to effectively provide support services free of charge for the remainder of the term. In extreme circumstances, the remaining term could be a full year if the insolvency process commences on the day following the issue of the invoice. I have illustrated a scenario below.



One potential resolution would be to require payment from the Insolvency Practitioner on an accruals basis for services provided. The services could be paid on a pro-rata basis at the end of each calendar month following the commencement of the insolvency process. This would also help to reduce the creditors at the date of insolvency.

Although preferable to non-payment, the above suggestion would not address the impact on cash flow as we would have budgeted to receive payment in full within 30 days of issuing the invoice.

Domino Effect

In circumstances where the supplier is an SME, as is likely to be the case for many IT companies, the legislation needs to consider that the SME may not necessarily have the cash reserves or working capital to support the continued provision of services in the absence of payment. There is a risk that a domino effect may occur with the SME supplier entering into financial difficulty themselves. At present the legislation impacts mainly on large multinational corporations, the changes are likely to be far reaching, including owner-managed businesses and SME's.

If you have any queries or wish to discuss this further, please do not hesitate to contact me.

Kind regards

Craig Kennedy
Finance Director
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Policy.Unit

From: Kitchen, Andrew <Andrew.Kitchen@virginmedia.co.uk>
Sent: 07 October 2014 19:09
To: Policy.Unit
Subject: Continuity of supply of essential services to insolvent businesses

Dear Sirs,

Thank you for the opportunity to provide views on the detail of the exercise of powers set out in the Enterprise and Regulatory Reform Act 2013 pursuant to the Consultation Paper - Continuity of supply of essential services to insolvent businesses.

We have reviewed the Consultation Paper and set out below our comments in response to a number of the questions raised in the paper. References below to S233 of the Act equally apply to S372.

Q2- It is not clear to us that the current wording would be effective in preventing all supplies made for wholesale purposes from becoming subject to the provisions. For example, Company A makes a supply of essential supplies (covered by S233(3) of the Act) on a wholesale basis to Company B. Company B on sells those services to Company C the end user. If Company C enters into a process covered by Section 233(1) or S233A(1) then it is clear that only the supply from Company B to Company C is relevant and the supply by Company A to Company B is not affected by the provisions. If Company B is the company entering into the relevant process then it is not clear that the wholesale provision by Company A to Company B would be excluded from the provisions as there could on the face of the wording be a supply of essential services to Company B. This is because the supplies referenced in S233(3) are categorised by reference to the type of supply and do not distinguish whether the supply itself is made on a wholesale basis or directly to the end user. If the intent is to prevent the provisions applying in the event that Company B enters into a relevant process then wording should be added to S233 and S233A to make this clear.

Q8- We are unclear why it is necessary to have a 14 day period in S233A(4)(a)rather than allowing the Supplier to give such notice at any time during the period of the administration/voluntary arrangement. We are also unclear as to why a further period of 14 days is required in which to respond to the request for a guarantee as we consider that the office holder could respond to such requests in a much shorter time period.

Currently S233(2) of the Act provides that the insolvency office holder can make a request for continued supply, in which case, the supplier may require a personal guarantee. In practice the request for continued services is likely to come from the insolvency office holder when he/she first notifies the supplier of the insolvency or if no such request is initially made the supplier may ask the insolvency office holder whether he/she requires continued supply (and to provide the personal guarantee) once the supplier becomes aware of the insolvency event. The personal guarantee is normally provided fairly quickly by the insolvency office holder. If the guarantee were not forthcoming in a timely manner the supplier would currently have the right to terminate the supply of services so as to limit any potential exposure to ongoing costs post the date of administration/voluntary arrangement although we note that, in the case of administration, supplies made during the administration period would rank as an expense.

Under the proposed provisions in S233A(a), in order to be able to terminate the supply the supplier firstly has to have notified the office holder during the 14 day window from the date the company entered into administration/voluntary arrangement that it will terminate services if it does not receive a personal guarantee. If the supplier does not become aware of the administration until after that 14 day window it will only then be able to rely on the provisions relating to termination of the contract in S233A(2)(b) and (3)(a-c). Restricting the right in S233A(4)(a) to a 14 day window seems unnecessary and we consider that it should not disadvantage the insolvency office holder if the right to notify in sub clause (a) had no time restriction.

The Supplier is always likely to require the personal guarantee from the insolvency office-holder. It is our experience that the office holder will be able to respond to such requests in a much shorter time period than the 14 days set out in S233A(4)(b). Given that the list of essential services is narrow and well defined we think that the insolvency office holder should be able to assess which of those services it still requires (and whether it will give a personal guarantee) in a much shorter period than 14 days.

We assume that, in any event, any services used within the 14 day period would be paid as an expense of the administration even if a personal guarantee was not ultimately provided at the end of that period.

Q9- We do not think that any exceptions should be provided from the ability to seek a personal guarantee from the insolvency office holder as a condition of continuing supply. Even if a supplier had obtained a guarantee from a third party that third party could itself later become subject to insolvency proceedings, or the guarantor could default on the guarantee or otherwise challenge its enforceability meaning that the supplier may not recover the relevant sums from the third party.

Yours Faithfully

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City of London Law Society Insolvency Law Committee response to the Insolvency Service consultation on continuity of supply of essential services to insolvent businesses

1 INTRODUCTION

1. 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.

2. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response, in respect of the Insolvency Service consultation paper published on 8 July 2014 entitled "*Continuity of supply of essential services to insolvent businesses*" (the "**Consultation**") 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.

3. We have focussed in our response on matters of corporate insolvency, as this is the area where we have the greatest practical experience of issues relating to continuity of supply.

2 General Points

4. We welcome the proposal to extend the scope of Section 233 Insolvency Act 1986 ("**IA**") to "ordinary" businesses, so as to give them similar protections to those currently enjoyed (for example) by investment banks, as this removes a potential obstacle to successful business rescues. The proposed drafting of The Insolvency (Protection of Essential Supplies) Order 2014 (the "**Draft Order**") does, however, raise a number of concerns with the approach which appears to have been adopted in relation to the implementation of this proposal.

Conformity with similar legislation

5. Imposing a statutory restriction on the exercise of termination rights in contracts for the provision of essential IT and communications services is not a new concept. Similar provisions already exist in, for example, the Investment Bank Special Administration Regulations 2011 (SI 2011/245) (the "**SAR**") and the Financial Services (Banking Reform) Act 2013 (the "**FSBRA**").

6. Given this position, we believe that there is a strong argument that the wording of the Draft Order should be conformed as far as possible to the equivalent provisions contained in the

SAR and the FSBRA. We cannot see any obvious commercial or policy reason for applying different rules, or for offering different protections, depending on whether a supplier provides IT related services to a manufacturing company or to an investment bank. Inconsistencies between provisions intended to achieve the same objective may also persuade courts to infer a statutory intention which may not have been intended.

Priority of supplies made after the appointment of an administrator

7. One specific example of the general point made in the paragraph above relates to the treatment of supplies made immediately after the appointment of an administrator. The Consultation states that "*It is also important to recognise that supplies made to an insolvent business pursuant to these requirements will, in the case of administration, rank as an expense of the procedure.*"

8. Both the SAR and the FSBRA expressly provide that any expenses incurred by the relevant company in relation to the provision of a supply after the commencement of the administration should be treated as necessary disbursements under Insolvency Rule 2.67(1)(f). The Draft Order does not contain a similar provision, thereby potentially creating uncertainty as to whether supplies made immediately post administration would definitely constitute administration expenses, particularly where the administrator decides not to give the requested guarantee. In addition, it is not certain whether, assuming that payments in respect of that supply did constitute administration expenses, they would be treated as "*expenses properly incurred by the administrator*" under Insolvency Rule 2.67(1)(a) or "*necessary disbursements*" under Insolvency Rule 2.67(1)(f).

9. The inclusion of wording clarifying the position, using the precedents contained in the SAR and the FSBRA, would address both of these concerns.

Provision by the insolvency officeholder of a personal guarantee

10. While the proposed legislation must address the legitimate interests of suppliers, there are significant practical and commercial issues surrounding the proposal that the insolvency officeholder should, if required, provide a personal guarantee to the supplier in question within 14 days. We note in this respect that neither the SAR nor the FSBRA contains a requirement for the administrator to provide IT suppliers with a personal guarantee in such circumstances.

11. The existing Section 233 IA is comparatively limited in its scope, with the result that the insolvency officeholder would, at most, receive requests to provide guarantees to entities providing gas, electricity, water and communications services to the business. There is also no statutory deadline by which the form of such guarantees must be agreed.

12. The proposed new legislation would considerably extend the scope of Section 233. While a company will generally only have one water provider, it will often have a significant number of different IT suppliers, providing it with information technology, software, data storage and other IT related services.

13. Permitting a significant number of suppliers to demand a personal guarantee (the terms of which will vary from supplier to supplier) during the early days of an administration creates the risk that the administrators and their staff may be forced to spend a considerable amount of time and effort during the crucial initial days of the administration negotiating the terms of supplier guarantees.

14. This will, in turn, result in either (i) resources being diverted away from the performance of essential tasks which may determine the future of the business or (ii) the use of additional staff and advisers to deal with the negotiation of guarantees, which will, in turn, drive up the costs of the process. We believe that stakeholders would find both options unattractive.

15. Furthermore, once the form of guarantee is agreed, we have experienced a number of occasions on which an officeholder was required, given the restrictions imposed on them by the rules of their partnership, LLP or company, to go through a time-consuming internal approval process before a personal guarantee could be executed. This could prove problematic in the context of a 14 day deadline for the negotiation and execution of a guarantee.

16. Given the practical and logistical issues surrounding the proposed extension of the personal guarantee regime, we strongly believe that it would be appropriate, at this stage, to reconsider the question of whether an insolvency practitioner should be required to provide the personal guarantees contemplated by the Draft Order.

17. To put this point into context, Section 233 IA contemplated the insolvency practitioner being required to provide a personal guarantee because, at time when this provision was drafted, the relevant supplier would only have had an unsecured claim if it continued to make supplies to a company in receivership. Until the introduction of the current rules relating to administration expenses, there was a concern that this could also have been the case, had the company gone into administration instead.

18. Looking at the position today, the supplier's legitimate concerns should be satisfactorily addressed by the fact that it is made clear in the Draft Order that any post-administration supplies would automatically be treated as administration expenses, ranking in priority ahead of the administrator's own remuneration.

19. There may be exceptional cases in which the supplier's position would not be adequately protected by having the relevant liabilities treated as expenses of the administration (for example if it had reasonable grounds to believe that there would be insufficient realisations to pay even administration expenses), but we would anticipate that the supplier could, if such circumstances did arise, properly apply to court for permission to terminate the relevant contract under Section 233A(3).

20. We are aware that Section 93(3) of the Enterprise and Regulatory Reform Act 2013 requires the giving of a personal guarantee, but consider that this requirement is, for the reasons outlined above, unnecessary and that it could hinder the rescue process. We would therefore strongly encourage you to reconsider the approach and, if at all possible, to amend Section 93(3), so that the ability to request a personal guarantee is restricted to the utilities currently covered by Section 233 IA.

21. If, however, it is not possible to alter the requirement in Section 93(3), we would suggest that the Draft Order should make it clear that this requirement would be satisfied where the administrator provides a guarantee in the standard form which they or their firm customarily use in such circumstances. Alternatively, we would suggest that there may be merit in either:-

- providing a simple, short form, template guarantee for the purposes of Section 233A(4) (which we would be happy to assist, with other professional bodies, in developing), so that everyone knows what they will receive; or

- including a statutory guarantee mechanism, whereby the guarantee obligation could be satisfied by the administrator simply confirming in writing to the relevant supplier that he or she would treat themselves as bound by Section 233A(4).

22. This would, at least, minimise the time spent negotiating guarantees, particularly where the form proposed by the supplier contains provisions which an administrator would find unacceptable, given their role, or the proposed guarantee is not governed by English law, forcing the administrator to obtain advice from lawyers in the relevant jurisdiction. In any event, there should be no time restriction on when the administrators must give such a guarantee, given the number of things on which they have to focus in the early days of the administration.

3 Specific Questions

Question 1: Do you agree that the proposed amendments to Sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

23. The proposed changes should bring most on-sellers of utility and IT or services within the scope of Sections 233 and 372. There may, however, be some grey areas, where the question of whether or not the Draft Order applies depends on an analysis of whether the supply in question was part of the on-seller's business. Looking at the example cited in the Consultation of landlords who have the right to charge tenants for electricity, would it be part of the "business" of a member of a manufacturing group which owns a factory to provide electricity to another group member who has a sub-lease of part of that factory? The courts may have to adopt a purposive approach when considering, for these purposes, what amounts to the carrying on of a "*business.*"

Question 2 Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

24. We believe that the current wording should be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions contained in the Draft Order, but believe that there may some merit in including an express provision to this effect in the Draft Order, to remove any possible ambiguity on this point.

Question 3: Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of Sections 233 and 372?

25. The proposed changes should bring suppliers of IT goods or services within the scope of Sections 233 and 372. We are, however, concerned that the current wording of the Draft Order may limit the practical benefits of doing so, as it may be relatively easy for a supplier to work around the draft provision. Specifically:-

(i) A supplier which was concerned about operating under the new regime could simply provide for automatic termination of the relevant contract "*should any step be taken with a view to putting the company into administration",* thus pre-empting the "*enters administration*" wording currently in the new Section 233A(6)(a). One possible solution would be to include a provision in the Draft Order similar to that contained in the current SAR, which states that "*any provision in a contract between the investment bank and the supplier that purports to terminate the* *agreement if any action is taken to put the investment bank into special administration is void*."

(ii) The words "*or to do any other thing*" appear in Section 233A(6)(b) but do not appear in Section 233A(6)(c), with the result that a supplier could (for example) include a provision in a contract giving it the right to increase the cost of supply, at its discretion, or to require the delivery of collateral, at any time after the company becomes insolvent. Increasing prices by reference to an event other than the company's entry into administration or a CVA, and then terminating the contract if the revised terms are not complied with by the administrator, would seem to be permitted under the current wording of the Draft Order.

(iii) Some suppliers have flexible tariffs and our members have experienced situations where suppliers have selected a high tariff within a permissible contractual range simply because the company was in administration. The words "*or to do any other thing*" are clearly intended to prevent such behaviour, but it may be worth making this point absolutely clear by the inclusion of words along the lines of "*including charging more than it would have done, had the company not entered administration*."

(iv) Under some IT agreements, the provision of supplies is discretionary. A framework agreement may, for example, permit the customer to make orders which the supplier "may" accept. If the customer went into administration, the supplier might simply decide not to supply. We do not consider that there is an easy drafting amendment to address this issue, as any attempt to regulate the manner in which a counterparty exercises a contractual discretion is, even if considered desirable in policy terms, likely to prove almost impossible to police.

Question 4 Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of Sections 233 and 372? If not, would a more generic definition of IT services be preferable?

26. We consider that the proposed approach of specifying types of IT goods and services that should be brought within the scope of Sections 233 and 372 is helpful, but are concerned that there could be arguments about whether a particular supply is caught by Section 233(3A), particularly if the supply in question is of an innovative new product or solution.

27. Given this position, there may be an argument for supplementing the current list of different types of IT related goods and services with a final, more purposive, sweep-up category such as "*agreements relating to the supply of information technology, the continued availability of which is essential for the continuation of the company's business*".

Question 5: Are there any other types of IT goods or services that you believe should be brought within the scope of Sections 233 and 372? (Please be as specific as possible

28. Please see our answer to Question 4 above.

Question 6: Do you consider that new Sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

29. Please see our answer to Question 3 above.

Question 7: Do you consider that new Sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

30. Please see our answer to Question 3 above.

Question 8: Do you believe that the safeguards provided for suppliers are adequate?

31. Please see our general comments in relation to both the priority of supplies made after the appointment of an administrator and the provision by the insolvency officeholder of a personal guarantee. For the reasons stated, we believe that the supplier's position should be sufficiently protected where any post-administration supplies are treated as administration expenses, ranking in priority ahead of the administrator's own remuneration.

Question 9: What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

32. Please see our general comments in relation to the provision by the insolvency officeholder of a personal guarantee.

Question 10: What impact, if any, do you believe the changes would have on the pricing of contracts in relation to utility supplies/IT goods or services?

33. We are not in a position to make an informed judgment on this point, as it will depend on the commercial importance which individual suppliers attribute to insolvency related termination rights.

Question 11: Can you foresee any practical difficulties arising from the proposed changes?

34. **Nature of breach**: The Draft Order effectively removes the right to terminate in respect of <u>any</u> event of default (whether or not insolvency related) that occurred before the company entered into administration. This is clearly intended to ensure that a counterparty cannot rely on a pre-administration payment default to exert leverage, but it does mean that a company which has fundamentally abused the terms of (say) a computer software licence can carry on using that software. We would therefore propose that Section 233(6)(c) should be amended, by replacing the words "*an event*" with the words "*payment default*", so as to distinguish other defaults.

35. **Multiparty contracts**: The Draft Order appears to assume that a contract for essential services, such as IT, will be between the supplier and the company in administration. In practice, IT services may be supplied under one contract to a number of different group companies. The relevance of this point is that Section 233A(6)(c), as currently drafted, prevents a supplier from terminating a contract where a termination right has arisen pre-administration as a consequence of the conduct of an entity other than the company in administration. It would seem an odd result if a customer who had fundamentally breached a multiparty contract was able to require a supplier to continue performing that contract, simply because another customer had gone into administration. One potential solution would be to provide in the Draft Order that it does not restrict the supplier's right to terminate the supply to any entity other than the company in administration.

36. **Mixed contracts**: Larger IT agreements may relate to a large range of services, including software maintenance, software development and hosting. Section 233, as currently drafted, would appear to catch any such contract, as long as one of the services provided under it was listed in Section 233(3A). One potential solution would be to provide in the Draft Order that, where both essential and non-essential supplies were provided under the same contract, the supplier would not be prevented from terminating the supply of those goods and services which are not listed in Section 233(3A).

4 Other Points

Relationship with existing legislation

37. As Section 233 IA was incorporated into the SAR, it would follow that, if the Draft Order were adopted, there would be two separate (and contradictory) provisions dealing with the continuity of essential IT services to investment banks, namely the bespoke provisions currently contained in the SAR and those being incorporated as a result of the proposed amendment to Section 233. We would suggest, in the interests of clarity, that it be made clear which rules would apply to an investment bank, our preference being that the existing provisions contained in the SAR should remain in place.

Bank payment systems:

38. Section 233(3A)(c) of the Draft Order could be read as requiring a bank to continue processing BACs payments requested by the company before it went into administration. We believe that there should be a clear carve-out for BACs payments which have not been expressly authorised by, or on behalf of, the administrator, as it is not in the interests of any stakeholder for a bank's standard procedural protections to be overridden in such circumstances.

Impact of the Draft Order on swap termination and netting provisions:

39. While it is not immediately apparent how any of the essential services covered by the Draft Order could fall under an ISDA Master Agreement, it may be worth confirming with ISDA that a netting safe harbour would not be required in this case.

Foreign law contracts:

40. The territorial scope of the Draft Order is unclear, particularly where the relevant contract for the supply of services is not governed by English law and the party exercising any termination right was located outside the United Kingdom. The Draft Order provides that an insolvency related termination right "*would cease to have effect*", but what would happen where a contract governed by New York law, and subject to the exclusive jurisdiction of the New York courts, was terminated by a counterparty located in New York because of a pre-insolvency payment default? The company in administration might potentially be able to sue the supplier in the New York courts for breach of contract, but this would seem an unattractive option for a company which urgently required the provision of essential supplies.

Extension to CVAs.

41. The Draft Order extends the scope of Section 233 to termination rights linked to CVAs. While understanding the logic underlying this proposal, we question how often it would be relevant in practice, as the restriction is on termination rights linked to the approval of the CVA. In our experience termination rights are generally exercisable by reference to a company proposing a CVA, given that the obligation to pay for any ongoing supplies would not have statutory priority and could be written off under the terms of the CVA in question.

6 October 2014

THE CITY OF LONDON LAW SOCIETY
INSOLVENCY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Hamish Anderson (Norton Rose Fulbright LLP) (Chairman)

C. Balmond (Freshfields Bruckhaus Deringer LLP)
J. Bannister (Hogan Lovells International LLP)
G. Boothman (Ashurst LLP)
T. Bugg (Linklaters LLP)
A. Cohen (Clifford Chance LLP)
L. Elliott (Herbert Smith Freehills LLP)
S. Frith (Stephenson Harwood)
I. Johnson (Slaughter and May)
B. Klinger (Sidley Austin LLP)
B. Larkin (Jones Day)
D. McCahill (Skadden Arps Slate Meagher & Flom (UK) LLP)
Ms J. Marshall (Allen & Overy LLP) (Deputy Chairman)
B. Nurse (Dentons UKMEA LLP)
J.H.D. Roome (Bingham McCutchen LLP)
P. Wiltshire (CMS Cameron McKenna LLP)
M. Woollard (King & Wood Mallesons SJ Berwin)

Working party members for this consultation:

Jo Windsor (Linklaters LLP)
Jennifer Marshall (Allen & Overy LLP)
Hamish Anderson (Norton Rose Fulbright LLP)

Continuity of supply of essential services to insolvent businesses Consultation (the Consultation)

This is the response of the Insolvency Lawyer's Association (the **ILA**) to the Consultation. By way of background the ILA provides a forum for c 450 full, associate, overseas and academic members who practice insolvency law. The membership comprises a broad representation of regional and City solicitors, barristers and academics and overseas lawyers. The Technical Committee of the ILA (the **Committee**) is responsible for identifying and reporting to members on key developments in case law and legislative reform in the insolvency and restructuring market place and is often consulted by the UK Government in relation to insolvency law reform.

The Committee is supportive of the policy behind the proposed new statutory provisions and welcomes the opportunity to comment on draft legislation which aims to support the rescue of UK businesses.

Question 1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

Generally, yes, although to make the position clearer, it may be preferable simply to refer to there being an agreement for the supply of relevant services, rather than refer to the supplier "carrying on a business" which includes giving such supplies. On the example given in the Consultation document, a landlord supplying electricity, for example to one of only twenty premises owned by that landlord, it might be arguable that does not amount to the landlord "carrying on a business" which (generally) includes the supply of electricity.

Question 2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

We do not feel that as drafted the exclusion of wholesale supply from the scope of the provisions is clear. This should be clearly expressed and defined.

Question 3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

Subject to our response to the next two questions, yes.

Question 4. Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

We agree that a specific list of the types of goods and services intended to be caught by the new provisions is preferable to a more generic approach. We query however whether the drafting could where applicable be made consistent with the existing provisions (particularly para 14 (4)(b) and (c)) in The Investment Bank Special Administration Regulations 2011 (the Regulations) , although we recognise that the ambit of the draft SI is wider and needs to capture a wide diversity of businesses.

Question 5. Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)

Please see our response to the previous question.

Question 6. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Generally, yes (although see our response to question 11).

There is however a potential loophole in the proposed new ss 233A and 372A which would allow suppliers to terminate before an administration or CVA on the basis of an early insolvency event of default (e.g. a notice of intention to appoint an administrator) if the contract so provided. This contrasts with the equivalent provisions for investment banks in special administration (para 14(4) of the Regulations), but we appreciate that the two situations are not necessarily equivalent and there may be policy reasons for the different treatment.

Question 7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

The legislation should expressly provide that the supplier is not entitled to impose increased payment conditions as a condition of continued supply. We believe however that thought should be given to introducing an express provision that the continued supply as required by the office holder constitutes an expense of the procedure (both under s 233 as amended and under the new s 233A). It will often be the case in a trading insolvency process that trading will need to be limited to a smaller number of premises (for example, retail stores) or that functions previously carried on at a number of offices are restricted to a single location and as mentioned above, such decisions as to which services are required should be left to the officeholder to determine. We have reservations regarding the introduction of personal guarantees, especially if the post-appointment supply is treated as an expense, as the time and costs associated with the negotiation of such guarantees will be contrary to the purpose of the continuing of the business. If, notwithstanding our comments on this aspect of the proposal, the requirement of a personal guarantee is pursued, we advocate the production of a pro forma office holder guarantee, which should in any event be expressly limited to amounts not otherwise recoverable as an expense of the procedure. This is because whilst suppliers already subject to s 233 have developed standard procedures and documentation, and are used to dealing with office holders, the new provisions will affect a wide variety of suppliers, of various sizes and sophistication, who are unlikely to have the same appreciation of insolvency procedures and the role of the office holder.

Question 8. Do you believe that the safeguards provided for suppliers are adequate?

Generally, yes. We note however that under the Regulations, the supplier needs to demonstrate "hardship" whereas under the proposal here, the term used is "undue hardship". We would favour a consistent approach throughout the legislation where similar principles are at play.

Question 9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

See our comments above in response to question 7, against the introduction of a personal guarantee regime and in favour of clearer rules on the supply being treated as an expense. If, notwithstanding our comments in this regard, a personal guarantee regime is introduced, we would favour having no statutory exceptions. This would have the advantage of simplicity and would allow suppliers and office-holders alike to make decisions on a case by case basis.

Question 10. What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

a) utility supplies

b) IT goods and services

We are not in a position to comment on any impact on pricing decisions by suppliers.

Question 11. Can you foresee any practical difficulties arising from the proposed changes?

We note that the proposed new provisions are expressed not to apply to "contracts entered into before" their coming into force. We are unclear why this is the case, rather than limiting the application of the new provisions to insolvencies commencing after that date. In our experience, supplies of the type envisaged will often be made under "umbrella" or framework agreements, with periodic renewals/extensions/price adjustments etc. There may be instances where this practice leads to legal arguments as to when "the contract" arose. We have concerns that this may lead some suppliers, in the period between adoption of the new provisions and their coming into force, to adopt "umbrella" or framework agreements and that as a result, a number of arrangements might fall outside the scope of the new provisions, thus defeating the statutory and policy intention of the new provisions.

8 October 2014

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The Insolvency Service

CONSULTATION ON SUPPLY OF ESSENTIAL SERVICES TO INSOLVENT BUSINESSES

Response from The UK Cards Association

October 2014

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Introduction

The UK Cards Association is the trade body for the card payments industry. The Association represents the card issuers and acquirers that facilitate the use of the UK's 56 million credit cards and 88 million debit cards, spending on which accounts for 33% of GDP. We represent our members to policymakers, regulators, media and other stakeholders, helping to shape legal and regulatory developments; promote industry best practice; facilitate fraud prevention; and deliver collective innovation in ways which look to ensure improved outcomes for consumers and retailers.

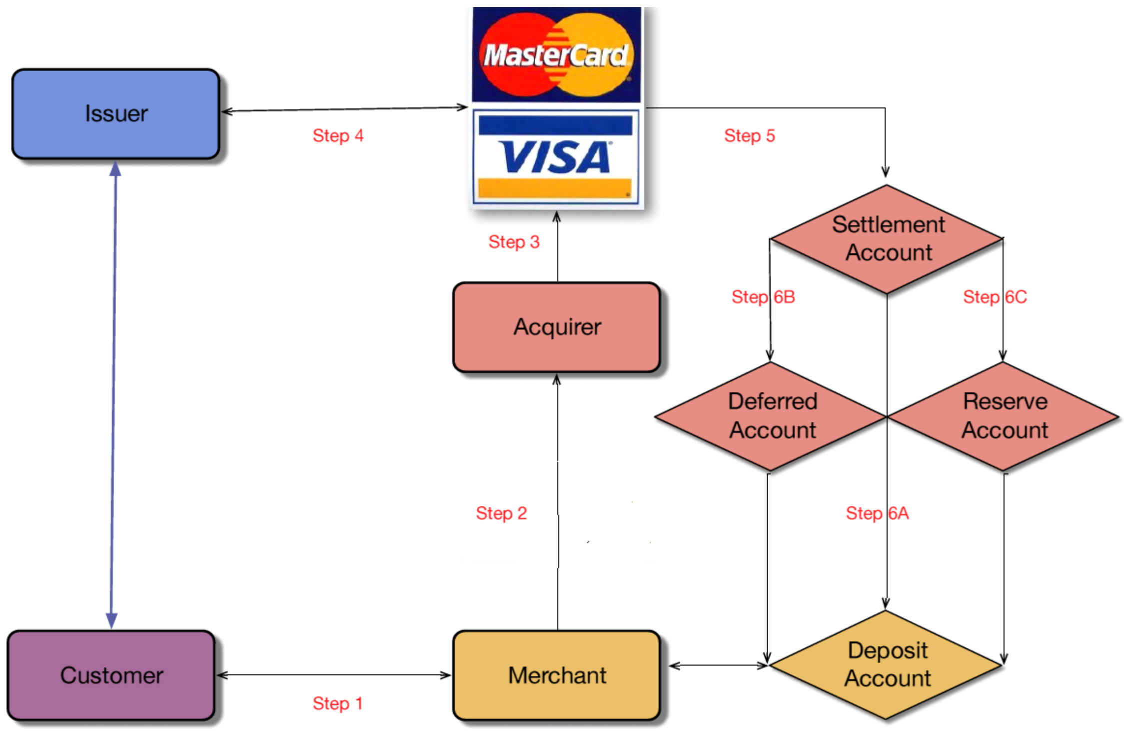
All of our merchant acquiring members are fully committed to helping those business customers facing trading difficulty and potential insolvency with appropriate support during the insolvency process and to work closely with the insolvency office-holder to provide the means to continue to accept card payments. This is usually essential to a viable business recovery plan. However, it is important for the Insolvency Service to understand how the role that card acquirers play in facilitating businesses accepting card payments differs quite fundamentally from a typical utility supplier, in that the acquirer is exposed to a significantly higher degree of risk because of their obligations to underwrite the risk of breach of contract, or failure to supply goods and services to the cardholder.

This differentiates merchant acquiring (the provision of card acceptance facilities) from the other "supplies" being considered within the context of the consultation. We believe that the inclusion of payment acquisition services within the scope of sections 233 and 372 will have a number of unintended consequences, restricting access to these services from high risk merchant sectors, or the termination of payment acceptance facilities at a much earlier stage, prior to the appointment of an insolvency practitioner. This would ultimately be counter-productive to the objectives of providing the insolvent business with the best chance of survival.

An explanation of the role that merchant acquirers play in a typical transaction

Businesses who accept card payments participate in payment card schemes, such as Visa or MasterCard, by virtue of the card acquirer's relationship with those schemes. Only regulated financial institutions can be members/licencees of these payment schemes, because settlement obligations exist between the members/licences of the scheme, which require them to have capital adequacy to meet their obligations. Card payments are unique in the sense that that the business accepting card payments can rely on the guarantee of payment at the point of sale, even though settlement of the transaction will only occur at a subsequent date. Confidence in the system has to be maintained by properly managing settlement risk.

We have set out in diagrammatic format the key steps in the transaction/settlement process for face-to-face immediate payment transactions, by debit or credit card, in the four party models.



Step 1 – Customer/Merchant

An individual with a credit or debit card (**Customer**) selects goods or services that they wish to purchase from a retailer (**Merchant**).

- At the checkout the Customer presents a debit or credit card (**Card**) branded by a payment scheme/network (**Scheme**), which the Merchant accepts (**Transaction**).
- As part of the Transaction process, the Merchant uses a terminal to transmit details of the Customer, extracted from the information on the Card and details of the Transaction through his merchant acquirer/processor (**Acquirer**) to the relevant Scheme and onwards to the issuer of the Customer's Card (**Issuer**) for authorisation of the Transaction.
- The Issuer authorises the Transaction on the basis that the Customer has sufficient funds, or credit, to cover the Transaction value. This authorisation is transmitted back to the Merchant via the Schemes and the Acquirer.
- Following authorisation, the Merchant will accept the Card as payment for the goods or services and the Customer will have purchased the goods or services that they have selected.

Step 2 – Merchant/Acquirer

- At the end of each business day, the Merchant will "batch up" all Transactions that have been effected during the day and transmit them to his Acquirer.

Step 3 – Acquirer/Scheme

- The Transactions will be processed and reconciled by the Acquirer and submitted into interchange with the Schemes.

Step 4 - Scheme/Issuer

- The submission of the Transactions into interchange effectively submits a payment order to the Issuers. The Schemes then manage the Transaction value settlement process with the Issuers, such that Issuers settle an amount representing the Transaction value with the Schemes.

Step 5 – Scheme/Acquirer

- Funds representing the Transaction value are then paid by the Schemes into a designated settlement account with the Acquirer in accordance with Scheme Rules.

Step 6 – Acquirer/Merchant

- On a daily basis, funds in the Settlement Account will be reconciled on a Merchant by Merchant basis and relevant funds utilised to "settle" the obligations that the Acquirer has to its Merchants, pursuant to the terms of each Merchant's Merchant Service Agreement (MSA) and also to provide collateral and security for contingent liabilities that the Merchant may owe the Acquirer.

The application of funds from the *Settlement* Account is usually some variant of the following:

- ***Step 6A – Daily Settlement*** - each day, same day funds due to a Merchant in accordance with their MSA will be paid out to their Deposit Account. Merchants are either settled "gross", i.e. gross of interchange, assessments and the merchant service charge due to the Acquirer, and then billed monthly for these amounts; or, are "net" settled in which case fees etc. are deducted before payment.

- ***Step 6B – Deferred/Suspense Accounts*** – we understand that in relation to some Merchants the overall risk assessment requires that settlement should take place sometime after funds are received from the Schemes – this is generally to take account of seasonal or other peculiarities in the Merchant's trading patterns. These funds are therefore transferred to a separate deferred/suspense account in the name of the Acquirer and are held until the agreed time period has passed.

- ***Step 6C – Reserve/Collateral Accounts*** – to provide security to the Acquirer in respect of its ultimate liability for chargebacks and other credit losses, a Merchant may agree (in its MSA) to divert in-flight settlement funds to a reserve account, or to provide cash collateral to secure these liabilities. Again, to the extent that settlement funds are diverted to a reserve account we assume that these are held in the name of the Acquirer and are released as the liability reduces or is extinguished.

Acquirer risks and obligations

As noted above, the Acquirer will require deferred settlement, or other collateral, to mitigate its exposure to risk. These risks arise out of the obligations to the card schemes, which are contained in the card schemes' rules and that are in place to protect the interests of all participants within the scheme. These can be categorised as follows:

Scheme fines and penalties: The scheme rules allow for fines to be levied on the Acquirer if a Merchant breaches the card scheme rules and operating regulations. In normal circumstances, the card acquirer will usually seek to recover such fines and/or penalties from the Merchant pursuant to their contract and the risk remains contingent. However, in the event a merchant becomes insolvent, this risk may materialise to the detriment of the card acquirer.

Chargeback liability: Chargebacks can arise where a Merchant fails to comply with card scheme rules, or where a Merchant breaches its contact with the cardholder, e.g. fails to deliver goods/services or the goods are faulty or not as described. In these circumstances the cardholder has the right to reimbursement of the full transaction amount. In normal circumstances the card acquirer will usually seek to recover chargebacks from the Merchant pursuant to their contract and the risk remains contingent. However, in the event a merchant becomes insolvent, this risk may materialise to the detriment of the card acquirer. Insolvency practitioners are aware that in the case of administration those customers who have paid by card rather than by other means will normally have a claim through their card issuer rather than being ranked as an ordinary creditor. In these cases, the card Acquirer effectively carries the obligations to meet these claims. Chargeback liability typically exists from 120 days from the date on which the supply of goods or services were expected, up to a maximum of 18 months.

Typically the charges for card acquiring services are based on a very a small percentage of the card transaction value, despite the fact that the Acquirer is assuming liability for the whole value of the transaction as described above. Card Acquirers are acutely aware the risks posed by insolvency and will necessarily manage this risk contractually through their underwriting processes as well as the use of reserves and collateral as described above. There may be certain provisions within the MSA that would apply in the event an Acquirer suspects the Merchant may become insolvent in the near future, so that the card Acquirer is able mitigate exposure to future losses. In reality, the complexity of the risks involved means that the Acquirer and insolvency practitioner usually need a detailed and properly considered framework to support the insolvent business that is not unduly onerous on the Acquirer.

The impact of the proposed changes

As currently drafted, the Statutory Instrument provides that insolvency related term(s) of a contract for the supply of any of the services covered by the amended s233 "ceases to have effect" if the company enters administration or CVA, but the supplier may nevertheless:

- exercise its right to terminate *the contract* if it obtains the consent of the office holder or permission of the court or if charges that are incurred post administration or CVA remain unpaid for 28 days after falling due;
- exercise its right to terminate *supplies* if the office holder fails to respond to a notice (to be served within 14 days of admin/CVA) by providing (within 14 days of receipt of the notice) a personal guarantee for future supplies.

The amendment potentially provides a 14 day lock-in of Acquirers in the event of an insolvency. There is little guidance on the meaning of 'supply'. It almost certainly extends to providing the data collection, but is silent as to whether or not there is any obligation on the payment service provider to remit the value of transactions. The provisions only relate to contracts entered into after the date that the SI comes into effect.
The contemplated provisions may effectively make it impossible for an Acquirer to use the traditional means of mitigating the risks through contractual arrangements with the merchant, given that these can be terminated.

The inadvertent consequences of the proposed changes

Having the contractual protections that Acquirers have carefully incorporated into MSA rendered of no effect would significantly increase the risks posed to Acquirers. It is very possible that this would impact on Acquirers' pricing of services to high risk Merchants or, in some cases, to provide card acceptance facilities at all. At present MSC is only paid for the provision of a technical service and not as a rule to accrue for the contingent risk. If the traditional means to mitigate that risk is removed , the MSC is likely to significantly rise.
It is very likely to lead to card Acquirers withdrawing facilities earlier in the pathway to insolvency to mitigate risks in order to avoid being subject to a lock-in period or having to seek approval to terminate the MSA. This would ultimately be counter-productive to the objectives that the Insolvency Service is trying to achieve, namely providing the insolvent business with the best chance of survival.

Answers to specific consultation questions:

Our comments are limited to the following questions:

4. ***Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?***

Yes, we believe that a specific list of types of IT goods and services would be helpful to avoid ambiguity. For the reasons set out above, we strongly recommend that card payment acquisition services is specifically excluded from the scope of s 233 and 327.

6. ***Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?***

We have concerns that the drafting of s.233A(6)(c) and the equivalent wording in s.372A(6)(c) is too broad. Inclusion of the phrase "because of an event that occurred before the company enters administration or voluntary arrangement takes effect" is problematic. It does not require that the "event" be linked to the onset of administration/voluntary arrangement (such as a notice of intention to appoint administrators). In our view this might inadvertently preclude termination that was not insolvency-related, e.g. a data breach.

In addition, there is no specified timeframe between the onset of administration or voluntary arrangement and the "event" in which the provision will be effective. Consequently, any historic event pre-dating by years the onset of an administration arrangement would be captured.

8. ***Do you believe that the safeguards provided for suppliers are adequate?***

No. The 28 day payment terms set out in the draft s.233A(3)(c) and s.372A(3)(c) are too long. The scope for Acquirers to incur further chargeback liabilities during this time is significant. Indeed, the draft legislation refers to unpaid "charges", which does not even necessarily include the range of other liabilities, as described above, which may arise under Acquiring contracts.

10. ***What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:***

    a. utility supplies;

No comment.

    b. IT goods or services?

For the reasons set out in the body of our response, we anticipate that the proposed changes will generally result in businesses facing increased pricing to accept card payments resulting from the increased risk to card acquirers. It is very likely to also lead to earlier termination of facilities.

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7 October 2014

Re: Response to consultation on Continuity of Supply of Essential Services to Insolvent Businesses
The Insolvency (Protection of Essential Supplies) Order 2014 and proposed amendments to the Insolvency Act 1986

Dear Sirs

This response is filed on behalf of First Data, including First Data Europe Limited trading as First Data Merchant Solutions, which is a significant provider of merchant acquiring services to the UK market.

Before dealing with the substantive questions that have been raised, we believe that it will be helpful to make some general observations. On the face of it, the legislation is aimed at preventing providers of key services to insolvent merchants demanding ransom payments from office holders before agreeing to continue to provide a service. In order to offset against any risk of losses to the provider, the proposed legislation provides safeguards in respect of fees either in the form of either: i) a personal guarantee from the office holder; or ii) the ability to turn off the supply if the fees are not paid.

For service providers where the only risk is their fees, that appears to us to be a workable solution. However a merchant acquirer assumes a variety of financial risks over and above fees alone, when it provides services to a merchant. In fact, fees are only a small part of the financial risk that a merchant acquirer assumes when processing card payments for a merchant. These transactions are governed by the Visa and MasterCard Scheme rules which provide a variety of financial risks arising out of the operation of a card facility. These risks include:-

- Chargebacks: where a card holder challenges a card transaction and can obtain a refund of the value of the card transaction if, for example, they do not receive any goods. Chargeback risk can run for a period of either 120 days from the date that the goods / services were due to be provided or 540 days from the date of the contract;
- Refunds: where a merchant refunds a card holder in respect of a transaction;
- Card Scheme Fines: arising out of a breach of a Scheme Rule obligation such as exceeding prescribed chargeback levels; or
- PCI DSS losses: arising where a merchant's IT systems are compromised and card holder data (such as credit card numbers) is stolen.

These risks mean that at the very minimum, when an acquirer provides services to a merchant then the acquirer has a contingent financial risk of a sum equal to the value of the transactions that have been processed, however that sum can, and is, on occasion exceeded when combined with losses in relation to fees and Card Scheme fines in particular. It should be noted that Card Scheme fines are effectively unlimited and are levied at the discretion of VISA and MasterCard.

We settle to a merchant in one of the following ways:

- Daily Settlement – a merchant is paid on a daily basis in respect of the previous day's trading;
- Deferred/Suspense Accounts – with some merchants, depending upon the type of business, funds are withheld for a period of time to reflect the risk to ourselves, either because the merchant is new, or sells goods or services to be delivered at some point in the future, or is type of seasonal business.
- Reserve/Collateral Accounts – sometimes we will build up a cash reserve over a period of time from a merchant's trading through the acquiring facility.

As such, we believe that the current approach taken, which envisages an acquirer being forced to provide merchant facilities to an insolvent merchant whilst suspending any power to effectively manage the acquirer's risk, creates a significant financial risk position for an acquirer, and represents a substantial limitation on the acquirer's freedom to contract on commercially acceptable terms.

If the legislation is passed in its current form it will have a huge impact upon the acquiring industry. We believe that all acquirers, including ourselves, will have to look at:

1. The commerciality of certain industry sectors such as ecommerce business, travel businesses and deferred delivery businesses such as furniture;
2. A significant re-pricing of the provision of merchant facilities generally, which would inevitably increase prices for consumers as merchants seek to pass on the increases;
3. A revision of the manner in which businesses in difficulty will be dealt with before they enter any form of insolvency;
4. Requiring increased security provisions at the outset of any commercial relationship, which may be difficult for some merchants to provide.

A detailed explanation of how acquiring works will be provided at the proposed meeting of 13 October 2014, and this response should be read in conjunction with that document.

Question 6: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes.

However our contract's termination clauses are linked to a variety of events, not purely insolvency events, and we believe that there may well be disputes arising from the operation of the merchant agreement termination clauses because of this.

Question 7: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding "ransom" payments as a condition of continuing supply?

We do not demand 'ransom' payment from office holders on an insolvency.

Our insolvency and risk teams work closely with Insolvency Practitioners in an insolvency situation. Whilst it is correct to say that from time to time the acquirer may have to assume a strong position in respect of an insolvent merchant this is not by virtue of seeking a 'ransom payment' or looking to take advantage of an insolvent business in any way. An acquirer's position is purely reflective of the financial risks that it faces by continuing to provide merchant acquiring services, and the commercial requirement to mitigate its losses.

In many insolvencies, there are two issues that need to be addressed at an early stage.

1. Where we have retained funds as a form of security, the office holder will often want to negotiate the release of part or all of those funds; and
2. In relation to the ongoing trading position post insolvency, whether and when funds will be paid in respect of that ongoing trading position.

Although fees are an issue, they are rarely, if ever, the focus of the discussion.

There is no 'one cap fits all' approach, our risk teams deal with this on a case by case basis. In a number of cases, provided that the pre-insolvency funds are going to be used to meet outstanding orders (reducing the risk of chargebacks) then those funds can be released based upon a properly worded agreement with the office holder. In other cases, the office holder will provide an indemnity in relation to future trading, but unless and until such indemnity is given, no funds are released to the office holder, to safeguard against the financial risks that the processing represents. In some cases funds are released upon receiving proof that the goods or services have been delivered. In some very limited cases, it has been commercially sensible to release funds to the office holder to keep the business going as a liquidation would result in an increased risk of chargebacks.

However it is important to understand that we have a history of working closely with insolvency practitioners, not one of attempting to hold them to ransom. Whilst any office holder would welcome the chance to trade for a fixed period of time and compel the acquirer to release funds without security, that it entirely inequitable and uncommercial in the circumstances due to the financial risks that it would create for the acquirer.

Question 8: Do you believe that the safeguards provided for suppliers are adequate?

No. The safeguards do not reflect the commercial and financial risks that we face as merchant acquirers.

There are two safeguards, which state that:

1. We cannot terminate a merchant agreement until charges incurred are outstanding for 28 days or more.

Linking a termination right to non-payment of fees is the wrong test, because fees represent only a small percentage of the financial risk for an acquirer. This clause provides no material protection to an acquirer at all.

2. We can terminate if the office holder does not give a personal guarantee in respect of our fees within 14 days of being asked for such a personal guarantee.

The problem that this creates is best described by looking at an example of a merchant agreement for one of our larger merchants. On any given day, such a merchant might process over 100,000 transactions per day, with an average value of £140 per transaction. In theory therefore, we might incur a contingent liability in respect of chargebacks alone in the sum of £196 million during the 14 day period before a personal guarantee is provided. In reality this provides no safeguard at all for a merchant acquirer and in respect of that 14 day period, there will only ever be 'security' if a personal guarantee is actually provided (and we are not sure to what extent a personal guarantee would provide security for this type of trading figure) and given the sums involved that can by no means be taken as being inevitable. Being able to terminate at that stage gives a merchant acquirer no comfort at all.

Question 9: What, if any, exception should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

There should be no exception but for the reasons stated above a solution based purely upon the provision of a personal guarantee does not address the financial risk issues for an acquirer.

Question 10: What impact, if any, do you believe the changes would have on the pricing of contracts in relation to (a) utility supplies (b) IT goods or services

It is highly likely that costs will increase across the industry generally, and also perhaps with a particular focus on certain industries where the financial risks will be greater for an acquirer.

Without disclosing commercially sensitive information, at present a typical merchant might process £1,000,000 of transactions per annum, against total fees of something in the region of £20,000 (the pricing and associated risk for larger merchants varies on a case by case commercial basis). The current average fees of 2% do not reflect the level of risk that would be faced under the new legislation. In order to make accepting the risk of processing for such a merchant unsecured in the event of an insolvency, even for just a 14 day period, that pricing model will be difficult, if not impossible to sustain.

Question 11: Can you foresee any practical difficulties arising from the proposed changes?

There will be a number of practical difficulties arising from the proposed changes:

- Pricing may increase
- Merchant contracts may be terminated earlier, rather than face an unsecured insolvency trading risk, leading to more insolvencies
- There will be an increase in court applications, to assess whether we ought to be compelled to provide services on an ongoing basis
- We may require more security from new and existing merchants placing pressure upon that merchant's balance sheet
- There may be less competition available for merchants in sectors perceived as high risk under the new changes
- The proposed changes may not work at all where the merchant is, for an example, an e-wallet or a payment facilitator
- At present we are experiencing situations where insolvency practitioners are unable to give personal guarantees in respect of an ongoing merchant facility
- It is by no means certain that an Insolvency Practitioner could give a personal guarantee that would provide adequate security for the risks involved, given the possible levels of trading through a merchant facility.

We realise that this is an issue for Insolvency Practitioners, however, we are a very different business to utility suppliers and the legislation would have a disproportionate impact on the acquiring industry given the level of risk faced. We remain committed and willing to work with the Insolvency Service to reach a commercially viable solution for all parties, however, as currently drafted, the legislation creates significant issues for the acquiring industry that would impact on the industry and consumers alike. We do not believe that the negative implications outlined above are the intention of the draft legislation.

Yours sincerely

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PRIVATE AND CONFIDENTIAL

8 October 2014

Dear Sir

Consultation - Continuity of Supply of Essential Services to Insolvent Businesses

Introduction

Worldpay welcomes the opportunity to engage with the Insolvency Service and the Department for Business Innovation and Skills in relation to its Consultation concerning Continuity of Supply of Essential Services to Insolvent Businesses. While Worldpay fully supports the principle of ensuring the continuity of essential supplies to insolvent businesses in order to help such businesses to be rescued from insolvency, we have significant concerns about the impact of the amendments currently proposed. This is due to the particular nature and extent of the risk that card processing service providers (Acquirers) assume in respect of all card transactions they process that has no equivalent with other providers of essential services such as water, gas and electricity.

For the reasons set out in this response, the proposed amendments will have a significant and damaging impact upon the acquiring industry, upon Merchants and upon the manner in which insolvencies are dealt with. This includes Acquirers like Worldpay and may result in Acquirers:

- withdrawing from some sectors altogether;
- requiring security (or additional security) from some businesses;
- terminating Merchants prior to insolvency; and/or
- re-pricing to reflect increased risk and costs.

Worldpay has invested in a specific team to work closely with insolvent Merchants and their office-holders to ensure that insolvent Merchants do continue trading wherever possible and that Worldpay is protected from significant financial losses. By way of example:

[redacted]

[redacted] This document should be read in conjunction with the presentation being submitted by Eversheds LLP.

About Worldpay

Worldpay (comprising Worldpay (UK) Limited; Worldpay AP Limited, Worldpay Limited and Payment Trust Limited) is a leading financial technology company specialising in payment processing around the globe. With offices in the UK, Europe, America and Asia, Worldpay authorises payments in 118 currencies. The bulk of these payments are made via credit and debit cards and in this respect Worldpay acts as the "Acquirer".

Worldpay is the largest acquirer in Europe, with over 250,000 customers in the UK, and the sixth largest acquirer globally.[1] We process over 9 billion transactions annually worth well over £300 billion. In 2013, 44% of all UK card transactions were processed by Worldpay.[2] Our customers range from large leading brand-name firms to small one-person businesses.

Definitions

Throughout this response we use the following definitions:

Acquirer – a member of a Card Scheme that processes Card transactions for Merchants. Worldpay is an Acquirer

Merchant – the customer of the Acquirer using payment processing services provided by the Acquirer and paying fees to the Acquirer for those services

Card Schemes – primarily Visa and MasterCard in the UK

Cardholder - the customer of the Merchant who uses her card to make payment for goods or services being purchased from the Merchant

Issuing Bank - the bank that has issued the card with which the payment is being made

The role of the Acquirer

It is important to view this response in the context of the Acquirer's role in the payments chain and the risk that the Acquirer assumes in respect of the card transactions that its Merchants process.

The Acquirer acts as the link between the Merchant and the Issuing Bank of the Cardholder in question, through the Card Scheme:

- The Acquirer "captures" the transaction at its Merchant's business (for example a high street retailer or an online website);

[1] Nilsen Report dated June 2013

[2] Based on market data provided by the UK Payments Administration

- The Acquirer passes the transaction data to the Card Scheme and on to the Issuing Bank;
- The Issuing Bank checks whether (1) the card has been lost or stolen; and (2) whether there are sufficient funds available in the account (or sufficient credit available), and sends an authorisation message or a decline message back through the Card Scheme to the Acquirer;
- The Acquirer receives the authorisation or decline message and passes that on to the Merchant; and
- The Acquirer receives funds from the Issuing Bank through the Card Scheme and the Acquirer remits funds to the Merchant in respect of the authorised transactions.

Looked at through the eyes of the Cardholder, she presents her card at the Merchant's checkout and keys her pin into the terminal machine and the terminal then displays a message stating whether the transaction is authorised or declined. This data flow from the Merchant to the Acquirer through the Card Scheme, to the Issuing Bank and back again through the Card Scheme to the Acquirer and on to the Merchant happens instantaneously. Funds in the amount of the transaction are "ear-marked" within the Cardholder's bank account (for debit cards) or unused credit limit (for credit cards) for transfer from the Issuing Bank through the Card Scheme to the Acquirer.

The relationship between the Acquirer and the Merchant is governed by the terms of a Merchant Services Agreement ("**MSA**"). Under the terms of the MSA, the Acquirer is responsible for remitting funds to the Merchant in the amount of the authorised transactions. This obligation on the Acquirer to remit funds to the Merchant is conditional/contingent upon all of the other rights and obligations set out in the MSA.

The role of the Acquirer is illustrated within the diagram at Appendix 1.

Card Scheme Rules and Acquiring Risk

To operate as an Acquirer, it is necessary to have the appropriate regulatory licences and also to sign up to and agree to be bound by the Card Scheme Rules. The card payments system is governed by the Card Scheme Rules which are set by the Card Schemes and which operate as the contract between the Acquirer and the Card Scheme and also between the Issuing Bank and the Card Scheme. It is important to note that there is no direct contractual or legal relationship between the Merchant and either the Card Scheme or the Issuing Bank. The Scheme Rules impose obligations on the Acquirer which the Acquirer must ensure are imposed on the Merchant under the MSA.

An Acquirer faces a variety of financial risks arising out of the operation of a MSA. These include chargebacks (which tend to represent the most significant risk with an insolvent Merchant); refunds; card scheme fines; and potential Merchant data compromise events.

Chargebacks

The Card Scheme Rules set out various bases on which a card transaction which was previously authorised can be challenged by the Cardholder and potentially reversed (known as a "chargeback"). Two of the most common reasons for chargebacks being raised are, (1) the Cardholder has not received the goods or services for which she has paid; and (2) the goods are defective or not as described.

The process for raising chargebacks and the time periods available to Cardholders to do so are prescribed by the Card Scheme Rules and the Card Scheme itself acts as the ultimate arbiter of such issues. The rules are complex and depend upon various factors, including the reason for the chargeback. Broadly speaking, where a Cardholder wishes to raise a chargeback, for example on the basis either (1) that it has not received the goods or services for which it paid; or (2) that the goods were defective or not as described, it may do so for 120 days after the date on which the Cardholder expected receipt of the goods and services.

By way of example – A Cardholder makes a payment by card for the purchase of a suite of furniture on 1 April which the Merchant promises will be delivered in 2 months' time, i.e. 1 June. If the Merchant fails to fulfil this order and does not deliver the goods, the Cardholder has the right to raise a chargeback under Card Scheme Rules for 120 days from 1 June i.e. the Cardholder may raise a chargeback at any time up until approximately 1 October.

This means that a chargeback may be raised at the end of September in respect of a card transaction taken at the beginning of April. This represents a significant potential liability period for the Acquirer for the reasons given below.

Under Card Scheme Rules, where a chargeback is raised on the basis that the goods or services have not been provided, and the chargeback cannot be defended with the provision of evidence demonstrating delivery, the liability for the chargeback rests firmly with the Acquirer. Each day, the Card Schemes debit the total value of all chargebacks levied that day from the total pot of funds otherwise due to be settled to the Acquirer. In this way, the Acquirer suffers the loss in the amount of the chargeback immediately and must then attempt to recover that loss from the Merchant.

Under the terms of the MSA between the Acquirer and the Merchant, the Merchant is liable for all chargebacks which are raised in respect of card transactions and the Acquirer is therefore contractually entitled to recover such chargebacks from the Merchant. In the event that the Acquirer is unable to recover the value of the chargebacks from the Merchant, for example because the Merchant is insolvent and without sufficient funds to pay the liability, then the Acquirer suffers a loss in the amount of the chargeback. If a transaction is charged back then the value of the chargeback far outweighs the value of the fees the Acquirer has charged for processing the transaction.

The chargeback process is illustrated within the diagram at Appendix 2.

Refunds

Under the terms of the MSA, a Merchant has the ability to process a refund to a Cardholder's account. Responsibility for the payment of that refund to the Cardholder rests with the Acquirer who must then try to recover the value of the refund from the Merchant. In the event that Merchant is unable to pay the value of the refund, this represents a loss to the Acquirer.

Card Scheme Fines

The Card Schemes set out a variety of circumstances in which breaches of the Scheme Rules by a Merchant can lead to a fine or financial assessment being levied by the Card Scheme on the Acquirer. The Merchant indemnifies the Acquirer in respect of such potential fines (assessments) under the terms of the MSA. In the event that the Merchant is unable to pay the value of the fine or assessment, this represents a loss to the Acquirer.

Data Compromise Event

Data privacy is taken extremely seriously by the card payments industry and in the event that there is a data compromise whereby Cardholder data is stolen, this can lead to fines or assessments as well as financial losses through fraudulent transactions. The Merchant is liable for all such liabilities under the terms of the MSA. In the event that the Merchant is unable to meet this liability, this represents a loss to the Acquirer.

Current methods for dealing with Acquiring Risk

Exercising right to withhold remittance

MSAs between Acquirer and Merchant routinely contain clauses entitling the Acquirer to withhold remittance of funds if it is concerned that losses may arise that the Merchant will be unable to pay. An Acquirer will routinely withhold remittance of funds where a Merchant enters insolvency in order to protect itself with respect to the potential significant liabilities described above.

Where funds are withheld prior to or upon the Merchant entering into administration, then the Acquirer works with the administrator to agree an orderly release of funds so as to allow the administrator to continue trading the business and to allow the Acquirer to protect its risk. The release of funds may be agreed in tandem with the administrator entering into an appropriate indemnity (see below).

Worldpay takes the position of supporting the insolvent business wherever and however possible. It is in the Acquirer's interests for the administration to succeed as this will in turn mean that Cardholders receive the goods or services for which they have made payment and therefore that there is a reduced risk of chargebacks arising and a reduced risk of losses for the Acquirer.

Security

In order to mitigate this significant acquiring risk, Worldpay sometimes asks a Merchant to provide security. This security takes different forms, but can include cash on account, or a standby letter of credit from an accepted bank. In some cases, Worldpay defers remittance of funds to the Merchant by an agreed period in order to provide a cushion of funds in the event of insolvency of the Merchant.

Administrator's Indemnity

Where a Merchant enters administration and the office-holder wishes to continue using Worldpay's services, Worldpay manages its acquiring risk and primarily its chargeback risk by obtaining an indemnity from the administrator in favour of Worldpay.

Under the terms of the indemnity:

1. the Merchant in administration indemnifies Worldpay in respect of all chargebacks arising, both in respect of pre and post administration transactions ; and
2. the administrator agrees that any liability of the Merchant arising under the indemnity will be paid to the Acquirer "*as if payable in respect of a debt or liability arising out of a contract entered into by the Administrator charged on property, payable out of property and afforded priority in accordance with paragraph 99(4) of Schedule B1 of the Insolvency Act*".

In this way, the Acquirer is protected with respect to the liability for potential chargebacks which will be met as a cost of the administration and the Acquirer is therefore able to continue providing its services to the Merchant and is able to release any held funds.

Worldpay will always request that an administrator enter into an appropriate indemnity and will continue providing services on that basis. If the administrator were to refuse to provide such an indemnity and there is no other security available, then Worldpay might take steps to terminate the account, however this is not a routine event.

Response to the Consultation

In our response we have focused on responding to Questions 6 to 11 as these are the areas we feel we can contribute to for the purpose of this Consultation. Our responses to these questions are below.

Question 6: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes, we believe that the proposed new sections will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses i.e. clauses that entitle the service provider to terminate immediately specifically in the event of insolvency.

However, it should be noted that various other immediate termination rights routinely exist in MSAs. Whilst such rights are not insolvency-related or dependent, the basis of the termination right may be more likely to arise in an insolvency situation. We assume that sections 233A and 372A are not intended to interfere with or impact upon the exercise of those termination rights that are not specifically insolvency related and this point should be clarified.

By way of example, the Acquirer may have a contractual right to terminate in the event that chargebacks exceed a certain ratio to transactions taken. This termination right may be more likely to arise in the event of insolvency, but it could equally arise with a solvent company. We do not consider that the proposed amendments would prevent Worldpay from relying upon such a termination right in the event of a Merchant administration.

Question 7: Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding "ransom" payments as a condition of continuing supply?

Worldpay does not demand ransom payments to continue the provision of services on a Merchant administration. Worldpay does take other steps, including (1) withholding remittance to protect itself against the acquiring risk described above; and (2) agreeing an administration fee with the insolvency practitioner to reflect the significant time incurred in managing the administration (see below).

The new section 233A(6)(b) appears to state that any clause in a supply contract which allows the supplier to do anything because the customer enters administration would cease to have effect. Worldpay considers that where the MSA provides for an additional payment to be made upon administration, the new sections would be effective in preventing that charging taking place.

The reality for an Acquirer when one of its Merchants enters into administration is that there is a significant amount of additional administrative work, both initially after the administrator is appointed and then on an ongoing basis. As a result, it is normal for Worldpay to agree an additional fee with the administrator. This is by agreement with the administrator and is outside the terms of the MSA, but the ongoing provision of services may ultimately be dependent upon this fee being agreed.

By way of example, within Worldpay's systems, each Merchant is allocated a separate Merchant Identification number ("**MID**") for each individual outlet that it operates. Merchants range from having just one outlet (and therefore just one MID) to having several hundreds or even more. When a Merchant enters into administration, it is necessary to change the registration details (including the bank account for remittance) against each and every MID individually. For Worldpay this is a manual process that requires time and cost to process. Worldpay therefore seeks agreement from the administrator to make a payment to Worldpay in order to continue operating the Merchant's account with all the necessary changes being effected. The purpose of this payment is to cover the administrative expense attached to processing card payments for a company in administration.

<u>Question 8: Do you believe that the safeguards provided for suppliers are adequate?</u>

No, Worldpay does not consider that the safeguards provided for suppliers are adequate for Acquirers due to the specific nature of the risk assumed by Acquirers in respect of card transactions under Scheme Rules.

The safeguards provided are as follows:

1. The Acquirer may terminate the MSA if:
    a. The Insolvency Practitioner consents
    b. The Court grants permission; or
    c. Any charges in respect of the supply incurred after the Merchant entered administration are not paid within the 28 day period beginning with the day on which payment was due.

2. The Acquirer may terminate the supply of services if:
    a. The Acquirer gives notice to the insolvency office-holder that the supply will be terminated unless the office-holder personally guarantees the payment of any charges in respect of the continuation of the supply after that day; and the insolvency office-holder does not given the guarantee within 14 days of receipt of the notice.

The definition of "charges" within the Statutory Instrument is unclear and inadequate in relation to the specific requirements of the acquiring industry but we assume that this is intended to cover fees for supply only, and not the other significant liabilities arising as a result of acquiring risk detailed above. Of far greater concern for Acquirers is the potential for chargebacks which liability routinely dwarfs that of any unpaid fees.

Any legislation which forces an Acquirer to process payments for an insolvent Merchant without allowing the Acquirer to rely upon its contractual rights creates an unacceptable financial risk for the Acquirer.

Termination after 28 days of non-payment of charges

This safeguard would be inadequate because:

1. If fees were paid, an Acquirer would have to continue to provide its services without any financial protection in respect of acquiring risk (in particular chargebacks) until the conclusion of the insolvency; and
2. Even where a right to terminate arises for non-payment, an Acquirer would still be forced to process transactions without financial protection for an insolvent merchant for a significant period of time (possibly more than 2 months, depending upon timing of invoicing and standard payment terms) during which time the potential chargeback risk will increase significantly.

It would not be financially viable for an Acquirer to be forced to increase its risk exposure to an insolvent Merchant in this manner. The only way the Acquirer would be permitted to limit this exposure would be by obtaining the office-holder's consent to terminate or by application to the Court. Either route would take time during which the risk exposure will be increasing. It is unclear who would bear the costs of a successful court application, but presumably this would have to be borne as a cost in the administration.

Termination for non-provision of a personal guarantee for payment of charges

A guarantee from the office-holder which relates only to the payment of charges with respect to the continuation of supply does not provide the Acquirer with any security in relation to the acquiring risks. Even if charges were to include all acquiring risk losses, it is unlikely that an office-holder would be prepared to provide such a personal guarantee, which in a large administration could amount to many millions of pounds.

Worldpay, in relation to a large Merchant, may be faced with the position that it is forced to continue processing hundreds of thousands of pounds of transactions a day without any security whatsoever and would effectively be in the position of indemnifying and funding an insolvent business in the hope that the administration will be a success and that no chargebacks will arise, two factors entirely outside the Acquirer's control.

We must emphasise that it is not uncommon for Acquirers to suffer losses that are many multiples of the profit made from a Merchant over its entire lifecycle due to chargebacks arising as a result of insolvency.

[redacted]

<u>Question 9: What, if any, exception should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?</u>

Worldpay does not consider that any exception should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply. However, as explained above, such a personal guarantee would not protect an Acquirer from its most significant financial risks.

<u>Question 10: What impact, if any, do you believe the changes would have on the pricing of contracts in relation to (a) utility supplies (b) IT goods or services</u>

The proposed changes will have a significant effect on pricing for the following reasons.

1. Worldpay's cost base will increase as we will need to introduce more due diligence procedures into the Merchant onboarding process and increase monitoring activities to identify Merchants who are at risk of insolvency. As the cost base increases, Worldpay will need to increase fees across its Merchant customer base to recover the increased cost. It is unclear by what degree pricing would be affected.

2. The risk involved in providing payment processing services will increase and therefore pricing will have to increase to reflect such additional risk.

In addition to this general increase in pricing, certain industries (in particular those operating on deferred delivery such as travel, e-commerce and furniture) may suffer greater price increases due to the increased risk profile.

<u>Question 11: Can you foresee any practical difficulties arising from the proposed changes?</u>

Worldpay foresees that numerous practical difficulties would arise from the proposed changes as follows:

- In circumstances where even a medium sized Merchant may process transactions worth in excess of £1 million per day, a personal guarantee (even if one were to be given) does not in fact provide any actual security in relation to the potential losses that an Acquirer may face. We further query whether any office-holder would be willing to give a personal guarantee against such a risk.

- More requests for security from new and existing Merchants. Acquirers would have to mitigate the potential losses that might accrue on an insolvency event by asking for security cover, and would have to undertake a wholesale review of its existing book in that regard.

- Greater levels of security from new and existing Merchants. Where Merchants are already providing security, that will have to be reviewed in relation to the increased risks related to an insolvency event.

- Impact on Merchant cash flow and balance sheet. There will be an inevitable impact upon all businesses that require card processing services in terms of pricing, security and in particular cash flow, with more Merchants being required to operate on deferred settlement terms.

- Greater remittance periods as standard. Acquirers will have to look at the standard settlement terms offered to Merchants at present, and it is likely that the industry will be forced to move to a new model where the standard remittance terms are extended to counter the higher risk of losses arising from an insolvency.

- Rejection of certain high risk sectors. Certain industry sectors, such as e-commerce businesses and the travel industry, provide their services or goods some time after the date of the transaction. Those industries historically represent the highest commercial risk to Acquirers, due to the contingent liability that the Acquirer carries until such time as the goods or services are delivered. Pricing and deferred settlement / security issues already strike a very fine balance under the current regime, however in circumstances where that deferred delivery time is linked to a period where the Acquirer is on risk (without any security), this will place immense pressure on those industries to find any viable solution that affords an Acquirer security when set against the risk reward of the Merchant contract.

- Longer boarding time and process and increase in documents requested at onboarding. It is inevitable that the process of recruiting new Merchants will take longer due to the enhanced security requirements as well as the commercial discussions that will need to take place.

- Increase in instances of the Acquirer wanting to audit the Merchant. At any given time, in order to protect its position, an Acquirer may look to exercise its contractual rights to audit a Merchant. Acquirers will need to recruit new staff to meet this increased demand, which will of itself increase standard pricing to offset the additional costs.

- Increase in demand for financial information from Merchant. At present, although acquirers have the power under the MSA to request financial information this is a power that is normally only used once issues of solvency have been raised. It is likely that this power will be used far more often, as Acquirers look to manage their risk more dynamically, placing a (under the current regime unnecessary) burden on both the Acquirers and the Merchants.

- Implementation of new 'at risk' Merchant policies. The Acquirer will have to look at reviewing the way in which it deals with Merchants where there are concerns about the Merchant's solvency, but no actual insolvency process is underway. Instead of the current position where these situations are often managed through with a Merchant, an Acquirer may have to withhold funds and / or terminate an MSA far earlier to protect its position.

- Increased risk of court applications. With large Merchants it is highly likely that Acquirers will be unable to accept a position where they are expected to continue processing for a Merchant that is creating a daily additional risk that can run to hundreds of thousands of pounds, indeed millions of pounds in some circumstances. In those circumstances, it is anticipated that Acquirers would regularly seek injunctive relief to prevent the payment of funds to an insolvent Merchant, until the date of a full hearing to request that the court allow the Acquirer to terminate the MSA. Costs would be significant, and the end result would be that, at the very least, an insolvent Merchant would be engaged in significant litigation at the onset of an insolvency rather than dealing with the key issues arising from the running of the business.

- Less co-operation between Acquirers and insolvency practitioners. Worldpay strongly believes that there is a high level of co-operation between office-holders and Worldpay under the current regime. There is a significant risk that this relationship will suffer in circumstances where an office-holder can compel an Acquirer to take on significant financial risk without security.

Conclusion and Proposals

Worldpay understands the reasons why it is desirable to ensure that on an insolvency event, key supplies are maintained without the office-holder being held to ransom and Worldpay fully supports this position. However Worldpay and, to its knowledge, the acquiring industry, does not engage in such a practice in any event.

There is a significant difference between the acquiring industry and other utility and IT providers, in that the acquiring industry carries a significant contingent risk of financial losses over and above the cost of providing the service. It is those financial losses that drive any insolvency strategy for an Acquirer, as opposed to issues concerning the payment of the acquiring fees / charges.

To remove the contractual powers that protect Worldpay from significant financial risk in relation to the on-going trading of an insolvent Merchant is inequitable, unnecessary and likely to have severe ramifications for any Merchant that requires payment facilities, in terms of pricing, security and the manner in which the Merchant account is managed. The fees made from a typical acquiring relationship bear no relation to the amounts that would be at risk under the proposed new legislation. Worldpay suspects that this is an unintended consequence of the proposed legislation.

Worldpay would propose:

1. That acquiring services and other payment services are excluded from the scope of the proposed legislation. Worldpay believes that the current contractual position and legislation provides an effective and positive environment for the Acquirer to work closely with office-holders to assist in meeting the objectives of an administration.

If the Insolvency Services still wishes to include Acquirers in the proposed legislation, then Worldpay would propose:

2. That there should be specific provisions entitling Acquirers to exercise certain contractual rights until a form of agreement is reached with the office-holder. The solution would vary depending on the particular circumstances of the case but one example is that the Acquirer would be able to exercise the right to withhold remittance subject to the provision of an appropriate indemnity by the office-holder.

If payment services are to be included in the proposed legislation then Worldpay would like to work with the Insolvency Service to find some form of solution that meets the Insolvency Service's objectives whilst acknowledging and meeting the acquiring industry's legitimate concerns.

This is an immensely important issue for the acquiring industry and we are very keen to work with the Insolvency Service to achieve a workable position for Merchants, office-holders and Acquirers. We look forward to discussing these submissions with you in more detail on the 13th October. Should you require any information in the meantime then please contact Sharon Gerbi on sharon.gerbi@worldpay.com or [redacted]

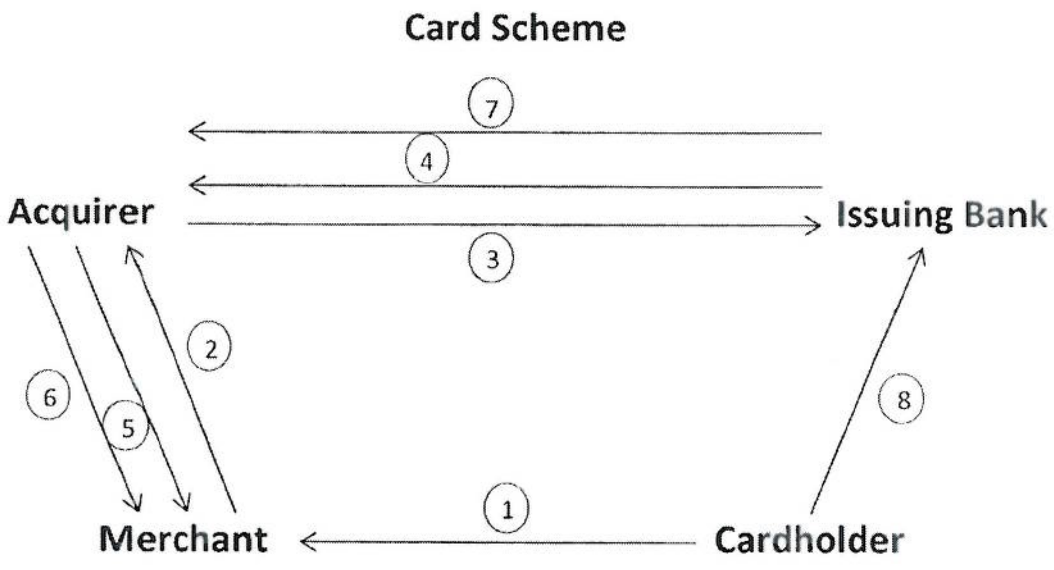
Yours faithfully

Worldpay (UK) Limited

Worldpay (UK) Limited

APPENDIX 1

THE ROLE OF THE ACQUIRER IN A TYPICAL CARD TRANSACTION



1. Cardholder uses card to purchase goods or services from Merchant

2. Merchant transmits card data (card number and amount of transaction) to the Acquirer

3. Acquirer passes that data through the Card Scheme to the Issuing Bank

4. Issuing Bank authorises or declines the transaction and sends the response to the Acquirer through the Card Scheme

5. Acquirer sends message to the Merchant confirming whether the transaction is authorised or declined

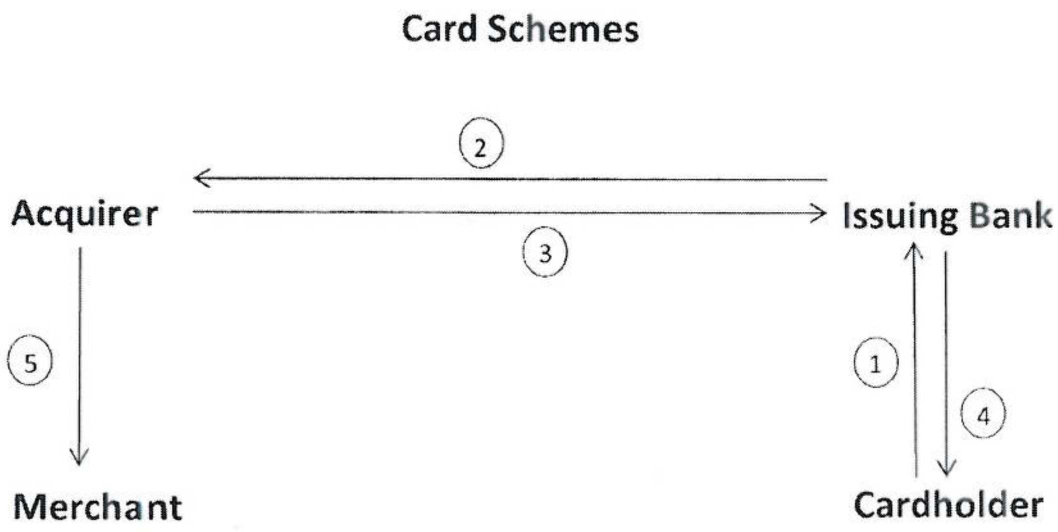
6. If the transaction is authorised, the Acquirer pays the Merchant in accordance with the terms of the MSA

7. Issuing Bank pays the Acquirer a sum equivalent to the value of the transaction via the Card Scheme

8. Issuing Bank charges the Cardholder's account for the value of the transaction

APPENDIX 2

THE CHARGEBACK PROCESS



Cardholder does not receive goods / services as the Merchant is insolvent

1. Cardholder makes a claim to the Issuing Bank in respect of the transaction

2. Issuing Bank raises the chargeback claim to the Acquirer via the Card Scheme

3. If the chargebacks is levied following the chargeback process, the Acquirer pays the value of the transaction to the Issuing Bank via the Card Scheme

4. The Issuing Bank credits the Cardholder's account

5. Acquirer seeks repayment from the insolvent Merchant in respect of the transaction. If payment is not received Acquirer becomes a creditor in the insolvency.

Response to the Consultation on the Supply of Essential Services to Insolvent Businesses

Submission from Barclays

8 October 2014

Introduction

Barclays is a major global financial services provider engaged in personal banking, credit cards, corporate and investment banking, and wealth and investment management. With over 300 years of history and expertise in banking, Barclays provides financial services to more than 48 million customers, operates in over 50 countries and employs over 140,000 people.

Barclays welcomes the opportunity to respond to this consultation. We recognise the importance of maintaining essential supplies to insolvent businesses and, as a significant provider of point-of-sale credit services to UK businesses through the Barclaycard brand, are pleased to have the opportunity to share our experience and expertise.

Barclays is committed to supporting those customers that unfortunately fall into financial difficulty and works closely with insolvency practitioners when required to assist with business recovery plans. However, as the consultation notes, it is important that all stakeholders' interests are protected during the difficult and complex process of rescuing an insolvent business.

We have provided more detailed responses to the consultation's questions below, but would highlight in particular that we are unclear whether payment acquisition services are intended to be captured by the legislation. If they are, Barclays believes this would expose card acquirers to a disproportionate level of financial risk. We are concerned that this would lead to a number of unintended consequences for businesses, including increased pricing and potentially reduced availability of card acceptance facilities. We would therefore urge the Insolvency Service and Department for Business, Innovation and Skills to confirm that card acquirers should be out of the legislation's scope.

It should also be noted that Barclays supports the response submitted by the UK Cards Association, which includes a full explanation of the role card acquirers perform for businesses.

We hope Barclays contribution is of assistance to the consultation process. If you have any queries regarding our response we would be very happy to discuss our views in further detail. Please direct any follow-up questions to Simon Lamb on 01604 256958 or simon.lamb@barclaycard.co.uk.

Yours sincerely

Paul Garside
Chief Risk Officer for Payment Acceptance & Digital Marketplace
Barclaycard

Consultation Questions

1. *Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?*

   No comment.

2. *Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?*

   No comment.

3. *Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?*

   Yes. However, please see our comments below in connection with the proposed scope of such "IT goods or services".

4. *Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?*

   A specific list of types of IT goods and services appears to be the most appropriate way forward in order to avoid ambiguity. However, we consider that the apparent inclusion of payment acquisition services within the scope of this legislation unfairly prejudices card acquirers. Is this the intention?

   Payment acquisition services are not typical services in that the risk profile of the service provider is significantly greater than that which is seen in a usual supplier-customer relationship where the main financial risk is non-payment of charges.

   The principal reason for this is the card acquirer's relationship with the Card Schemes (Visa, Mastercard etc) which underpins their ability to provide card acquiring services to the merchant. This relationship requires the card acquirer to be directly liable for all scheme fines and chargebacks, even though these typically arise as a result of the conduct of the merchant.

   Chargebacks can arise where a merchant fails to comply with card scheme rules regarding how the card transaction is accepted by the merchant. In an insolvency context this would typically be where a merchant fails to deliver goods/services, or the goods are faulty or are not as described. A cardholder will usually raise a claim with their card issuer and if the merchant has no defence the card acquirer will be obliged to reimburse the value of the transaction. In some instances a card scheme fine may also be imposed on a card acquirer for breaches of card scheme rules by its merchants.

   The card acquirer will usually seek to recover those fines, chargebacks etc from its merchant pursuant to their contract. Typically the charges payable for the card acquiring services are only a small percentage of the card transaction value and terminal rental fees comprise a relatively small monthly charge, but the whole transaction value is at risk of chargeback for the non supply of the goods or services in question, and card scheme fines vary based on the severity of the breach but can range from a few hundred pounds to many thousands.

This risk falls on the card acquirer if the merchant is insolvent and unable to pay and will typically be much greater than the risk of non-payment of any rental or service charges.

Accordingly, card acquirers are acutely aware of the risks posed to them by merchant insolvency and will seek to mitigate this risk as much as possible in their contracts. A common example of such a contractual protection would be a provision permitting the card acquirer to accumulate a reserve fund if it suspects the merchant may become insolvent in the near future. This is so that the card acquirer is able in due course to set off at least some of its losses arising from chargebacks and/or card scheme fines against the reserve fund.

Having these contractual protections rendered void or unwound by legislation would significantly increase the risk profile of merchants and may well impact on card acquirers' ability to price them affordably or, in certain cases, provide services to them at all. It may also lead to card acquirers withdrawing facilities earlier to mitigate any risks. Certain businesses/sectors where delivery is deferred (such as travel or ticket booking) present a higher chargeback risk than others by virtue of the fact that there is typically a substantial delay between payment by the customer and performance of the service.

There are also situations where insolvency practitioners will engage third party asset managers to run and manage insolvent businesses for them, e.g. businesses where the business is licensed such as public houses. This has potential for further confusion and uncertainty as to whether the asset manager will have its own card acquiring contract or whether it may attempt to use that in place of the insolvent entity's.

If payment acquisition services are in scope of the legislation then we have further concerns that the current draft list is still too broad. In particular, the proposed wording of s.233(3A)(c) ("any service enabling the making of payments") appears to be problematic. This wording seemingly brings services such as corporate card facilities, BACS facilities or internet banking within scope of the legislation. It is unclear how useful this would be to an insolvent merchant because it is likely that any underlying loan facilities would already have been terminated.

We do not anticipate that it is intended that the legislation preserves an insolvent merchant's ability to continue to make payments (an administrator, for example, would likely have available separate facilities to enable them to fulfil their role). It appears that the wording is intended to capture services which enable customers of the insolvent merchant (rather than the merchant itself) to make payments. We would therefore suggest that the proposed wording of s.233(3A) is amended accordingly.

5. *Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)*

No comment, although we would reiterate our concerns set out above regarding the inclusion of payment acquisition services within the scope of the legislation.

6. *Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?*

Yes, however we have concerns that the scope of "insolvency-related term" in the draft s.233A(6)(c) is too broad. The wording "because of an event that occurred before the company enters administration or voluntary arrangement takes effect" (and the equivalent wording in s.372A(6)(c)) is problematic for two reasons.

Firstly, it does not require that the "event" be linked to the onset of administration/voluntary arrangement (such as a notice of intention to appoint administrators). This seemingly would preclude termination for any reason, even where that termination was not insolvency-related (for example, for a data protection or security of data breach, or other breach of confidentiality).

Secondly, there is no specified timeframe between the onset of administration or voluntary arrangement and the "event" in which the provision will be effective. The drafting simply requires that the event occurs "before the company enters administration or the voluntary arrangement takes effect"/"before the voluntary arrangement proposed by the individual is approved". Arguably, therefore, an historic event dating from years prior to the onset of administration or voluntary arrangement would be caught by this clause.

7. *Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?*

Yes, although if it is intended that the provisions only capture termination and "ransom" payments then it would be preferable to state this rather than rely on the broad, catch-all "any other thing" which provides scope for ambiguity.

8. *Do you believe that the safeguards provided for suppliers are adequate?*

No. The 28 day payment terms set out in the draft s.233A(3)(c) and s.372A(3)(c) are too long (if the payment terms are monthly in arrears this could be 2 months in practice and as CVAs can typically take 6 weeks between proposal and approval this could be an even longer period of uncertainty). The scope for card acquirers to incur further chargeback liabilities and/or Card Scheme fines during this time is significant. Indeed, the draft legislation refers to unpaid "charges", which does not necessarily include the range of other liabilities which may arise under merchant acquiring contracts (such as chargebacks and card scheme fines).

Whilst we accept that the risk of non-payment of such charges is mitigated in the context of administration by virtue of the fact that these charges will rank as expenses of the administration, the situation in the context of a CVA or IVA is markedly different.

Firstly, there is no analogous expenses regime for CVAs or IVAs. Secondly, there is a conceptual issue as to whether these charges would be compromised by the CVA/IVA itself. Whilst this compromise point will ultimately be decided by the drafting of the individual CVAs/IVAs themselves, we would welcome some clarification as to whether there is scope for such charges to be expressly excluded from being compromised by the relevant CVA/IVA, unless otherwise expressly provided for in the CVA/IVA itself.

Continuing a card acquiring contract into insolvency requires office holders to be liable for all liabilities under the contract from the time of appointment, not just 'charges'.

It is also likely that card acquirers will seek relief from the court to terminate where it sees the ongoing daily risks it will be forced to accept are untenable.

We would welcome the opportunity to discuss an acceptable middle ground which both achieves the legislation's aim and protects the interests of card acquirers.

9. *What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?*

   There should be no exceptions and as stated above it should extend to all liabilities from the date of insolvency under the continuing card acquiring contract.

10. *What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:*

    a. *utility supplies;*

       No comment.

    b. *IT goods or services?*

       For the reasons mentioned in our response to Question 4 above, we anticipate that the changes will result in merchant services customers facing increased pricing to reflect the increased risk profile card acquirers will face and may also lead to earlier termination of facilities.

11. *Can you foresee any practical difficulties arising from the proposed changes?*

    In addition to the problems mentioned above, we anticipate that office-holders (and in particular CVA/IVA supervisors) will be reluctant to give personal guarantees for future charges. This would therefore result in a 14-day hiatus during which the service provider may incur further exposure to unpaid charges and other risks with no realistic prospect of a personal guarantee being provided at the end of that period.

    Card acquirers are likely to terminate relationships earlier, or seek additional security and overall card acquiring is likely to become more expensive to cover the additional risks.

    We can also see scope for overseas based card acquirers retaining their contractual rights through the choice of law applying to the merchant agreement.

THE INSOLVENCY SERVICE CONSULTATION ON THE CONTINUITY OF SUPPLY OF ESSENTIAL SERVICES TO INSOLVENT BUSINESSES ("CONSULTATION")

THE RESPONSE OF ELAVON FINANCIAL SERVICES LIMITED

INTRODUCTION

Elavon Financial Services Limited (**"Elavon"**) is a merchant acquirer. Merchant acquirers are suppliers of facilities enabling retailers to accept payments by credit and debit cards. This note is Elavon's response to the proposed amendments to sections 233 and 372 of the Insolvency Act 1986 (**"the Act"**) set out in the draft statutory instrument, The Insolvency (Protection of Essential Supplies) Order 2014 (**"Proposed Amendments"**).

EXECUTIVE SUMMARY

- The Proposed Amendments go much further than we believe was intended by the Enterprise and Regulatory Reform Act 2013 ("**ERR Act**") and the Consultation. Merchant acquirers are not utility suppliers but are regulated financial institutions providing financial service facilities to merchants and retailers. The way that merchant acquiring and card processing systems work means that merchant acquirers face substantial losses in the event that businesses fail to continue to trade due to insolvency. In essence, the merchant acquirer is an underwriter of the merchant's trading risk and not a supplier of utilities.

- In order to properly manage their exposure to such risk, the merchant acquirer relies heavily upon its contractual terms with the merchant. Section 3A brings merchant acquirers within the scope of the Act and section 233A effectively compels a merchant acquirer to continue to provide banking services to an insolvent business thereby underwriting the post-insolvency trading. The protections at sections 233A (3) and (4) are inadequate, in our view, to allow the merchant acquirers to manage the substantial financial risks that occur as a result of a retail insolvency.

- It is Elavon's experience, prior to a retail insolvency, that responsible insolvency practitioners will positively engage with us to arrange for security or other protection of Elavon's risk, so as to allow the credit and debit card facilities to remain in place after the formal insolvency commences. The Proposed Amendments are likely to diminish the need for insolvency practitioners to undertake that engagement, which again we consider is not something that the Government intends by this Consultation.

- The wholesale shift in the apportionment of the risk will have the effect of restricting the availability of facilities to all types of merchants and will lead to an increase in charges levied by Elavon for their services.

Before setting out Elavon's comments on the Proposed Amendments, Elavon is of the view that it would be helpful to explain the background to what constitutes merchant acquiring, as well as the risk and decision-making processes that Elavon and other merchant acquirers undertake when dealing with customers who are insolvent.

MERCHANT ACQUIRING

The participants in a credit or debit card transaction

A typical credit or debit card transaction is made up of four separate contractual relationships that inter-lock. Below is a diagram setting this out and here is a description of the relevant parties to those contracts.

- the cardholder – the individual who purchases goods or services using a card. The cardholder enters into a contract with the merchant (Contract 1). The cardholder's use of the card is governed by a contract between the cardholder and the card issuer (Contract 4);

- the merchant – the retailer and the supplier of the goods or services purchased. The merchant's ability to accept and facilitate payment by card is governed by the terms of its merchant services agreement with the merchant acquirer ("**MSA**") (Contract 2);

- the merchant acquirer – the supplier of facilities enabling the merchant to accept payment by card. The merchant acquirer is a party to the MSA. (Contract 2) The merchant acquirer is also bound by the rules of various card schemes, such as MasterCard and Visa (**"Scheme Rules"**). The Scheme Rules govern the rights and obligations between the merchant acquirer and the relevant card scheme (Contract 3);

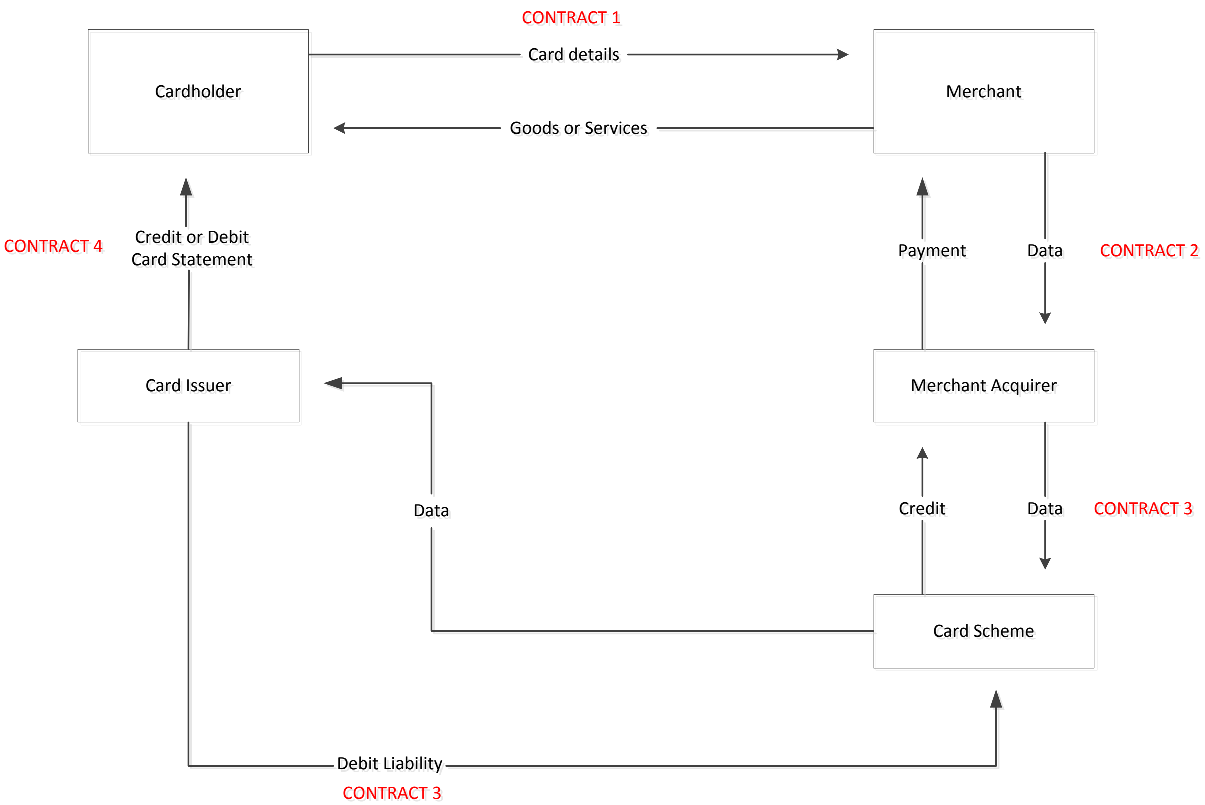
- the card issuer – the supplier of the card facility to the customer. The card issuer is a member of the relevant card scheme and, like the merchant acquirer, similarly bound by the Scheme Rules (Contract 3). The card issuer will have a contract with the cardholder in relation to the use of the credit or debit card (Contract 4);

- the card schemes - further to the Scheme Rules (Contract 3) operate clearing systems to facilitate the processing of the payment data and the payments in respect of any particular credit or debit card transaction.

The transaction process

Regardless of whether a card transaction takes place face-to-face, over the telephone or the internet, the fundamental principles for any transaction are essentially the same.

The system is governed by the four sets of inter-locking contractual relationships described above and the diagram below sets out the flow of information and financial transfers in a typical card transaction. The various stages are explained below:



1. The cardholder purchases goods from the merchant using a card and the goods or services are either supplied immediately or later, for example in relation to mail order or ecommerce transactions (Contract 1).

2. At the point of the acceptance of the card, pursuant to Contract 1, an electronic signal is passed to the card issuer via the merchant acquirer and the card scheme to allow the card issuer to verify that the card had not been reported lost or stolen, and that there is sufficient credit on the card in respect of the specific transaction. This authorisation is communicated back electronically by the card issuer to the card scheme, then by the card scheme to the merchant acquirer and then by the merchant acquirer to the merchant. In a face-to-face

transaction, the electronic terminal at the merchant will then print out the receipt for the customer, and the customer receives the goods.

3. The merchant captures the card data and the amount of the transaction and at the end of its business day electronically submits that data to the merchant acquirer (Contract 2). The merchant acquirer passes the transaction data on to the card scheme.

4. Under the terms of its MSA (Contract 2), provided certain contractual commitments are met by the merchant, the merchant acquirer will have a contractual obligation to pay the merchant a sum equivalent to the valid card transaction less the merchant acquirer's service charge. The MSA will also usually set out when the payment is to be made and the circumstances when the merchant acquirer can defer payment or terminate Contract 2.

5. Due to the volume of transactions which are processed on any given day, daily reconciliations are conducted by each card scheme pursuant to Contract 3. The reconciliation sets off payments owing to the merchant acquirer by the various card issuers in respect of new transactions (described above) against obligations of the merchant acquirer to the various card issuers as a result of chargebacks or to the card scheme itself as a result of fines or other assessments (see below). It is important to understand that the merchant acquirer’s obligation to pay its merchant under Contract 2 is independent of settlement by the card scheme of the card scheme's liability to the merchant acquirer under Contract 3.

Merchant acquirer risks and obligations

The Scheme Rules, impose certain obligations on merchant acquirers in order to balance the interests of the participants within the card schemes. Those obligations create risks for merchant acquirers because, under the Scheme Rules, merchant acquirers are held liable for the performance and conduct of the merchant. The main risks and obligations can be categorised as follows:

Chargebacks

There is provision in the Scheme Rules (Contract 3) for debit or credit card transactions to be reversed and the cardholder credited or refunded. This procedure is known as a chargeback and can happen for a variety of reasons, including where:

- a cardholder has not received the goods or services;
- the goods or services delivered are defective and/or there is a dispute between the merchant and the cardholder;

- the cardholder's card has been used fraudulently without the knowledge or authorisation of the cardholder (including counterfeit cards); or

- there are technical problems during the transaction process outlined above.

The cardholder’s entitlement to such a refund or credit and the rights and obligations arising as between the card issuer and the merchant acquirer are governed by the Scheme Rules (Contract 3).

In very broad terms, under the Scheme Rules, where a cardholder validly disputes the transaction and a chargeback occurs, the merchant acquirer has a contractual obligation to refund the card issuer, and this happens through the clearing process referred to at paragraph 5 above (Contract 3). The window for chargebacks can vary from 45 to 180 days from the date of transaction or the date on which the performance of the underlying contract was due. It is important to understand that the chargeback window will therefore extend the chargeback risk associated with any contract for future performance even further into the future, and therefore preserve the contingent risk associated with the underlying contract, potentially for years.

<u>Chargeback losses</u>

Where the merchant acquirer has refunded the card issuer through the card scheme the value of a chargeback, the merchant acquirer will, under the terms of the MSA, be entitled to claim that sum from the merchant. However, it is important to stress that the two payments, merchant acquirer to card issuer (via the card scheme) under Contract 3 and the merchant to merchant acquirer under Contract 2 are separate.

If the merchant cannot or will not make a payment to the merchant acquirer (for example because it has become insolvent or otherwise ceased to trade between the date of the transaction and the date of the chargeback), the merchant acquirer will have already refunded the card issuer by reason of its contractual obligation under the Scheme Rules (Contract 3) via the card scheme’s daily reconciliation process (as described above) and therefore the merchant acquirer will bear that loss.

<u>Other acquiring liabilities</u>

As mentioned above, a merchant acquirer's obligations under the Scheme Rules create risks because the merchant acquirer is held liable for the performance and conduct of the merchant. If a merchant breaches the Scheme Rules and operating regulations, the Scheme Rules can impose fines and assessments on the merchant acquirers, for example if a merchant suffers a data breach, does not comply with data security requirements, engages in illegal transactions or the merchant is a victim of fraud. The liabilities of a merchant acquirer to the card scheme under the Scheme Rules (Contract 3) can be very substantial and if the merchant is insolvent, these other acquiring liabilities also become a loss to the merchant acquirer.

<u>MANAGING THE RISK OF CHARGEBACK LOSSES AND OTHER ACQUIRING LIABILITIES</u>

Before entering into an MSA, the merchant acquirer will carry out due diligence on the potential new merchant including in relation to its business model, the nature of the business and the type of transactions that will be processed. That information allows the merchant acquirer to reach a decision as to the level of chargeback and other acquiring risk involved in acquiring for that merchant.

Merchants will be considered higher risk, for example, where:

- the merchant is supplying the goods or services after the card is debited for the transaction, as the merchant receives payment for the transaction before the goods or services are despatched or performed. If the merchant then fails to deliver, for example if it becomes insolvent, cardholders may not receive their goods or services; or

- where a merchant is going to carry on business solely or mainly in Cardholder Not Present (CNP) transactions. These are transactions where the cardholder is not physically present, for example, transactions conducted via the internet or over the telephone, where there is not the added security of a face to face transaction and physical inspection by the merchant of the card and (normally) the availability of Chip and PIN technology.

Under the MSA (Contract 2), merchants will usually be required to inform the merchant acquirer of changes, including in relation to its business model, the nature of its business, and/or its financial position, so that, throughout the relationship, the merchant acquirer can accurately assess the risk of acquiring for that merchant. The risk managers within merchant acquirers will also monitor transaction volumes, as well as the financial performance of the merchants and the risk of insolvency.

In a situation where a merchant acquirer considers a merchant to be at risk of failing to deliver on its obligations to cardholders (whether this is linked to the merchant's potential insolvency or not), it will usually only agree to continue to provide services on the proviso that cash cover is provided by the merchant to cover the chargeback risks and other acquiring risks as described above. This provision of cash cover is usually achieved by exercising powers in the MSA (Contract 2) to delay payment to the merchant of the transaction values.

Elavon does not, however, automatically enforce those provisions as a matter of course, but instead will assess the merchant's financial position and consider whether it has the risk appetite to continue to provide its services to the merchant. Elavon might also consider whether additional security (e.g. debentures or guarantees) could be obtained to provide Elavon with sufficient comfort to carry on providing its services.

The MSA (Contract 2) will also contain provisions to allow Elavon to terminate the service or suspend certain parts of the service in the event that the merchant faces or is likely to face insolvency. This power to suspend or terminate is absolutely critical in ensuring that Elavon does not incur the chargeback losses and other acquiring liabilities that come from a failure of a merchant to deliver on its obligations to the cardholders. Merchant insolvency is one of the biggest financial risks to any merchant acquirer.

THE PROPOSED AMENDMENTS

<u>Section 3A</u>

The Consultation refers to ensuring continuity of supply of utilities and IT goods or services to insolvent businesses and the ERR Act refers to a supply for the purpose of enabling anything to be done by electronic means.

Elavon is concerned that the Proposed Amendments go much further than is envisaged by the ERR Act or the Consultation in bringing IT goods and services within the scope of the Act.

The goods and services referred to in the new section 3A include "any service enabling the making or payments" and "data storage and processing". Without further definition, our view is that the Proposed Amendments would apply to merchant acquirers.

It is Elavon's position that the wording in Section 3A should be amended so that merchant acquirers do not fall within the scope of the Act.

<u>Section 233A</u>

"Supply"

Section 233A (1) disables contract terms which terminate the supply, or allow a supplier to do any other thing, because the retailer enters administration or a voluntary arrangement takes effect.

There is no clarity on the term "supply" in the context of merchant acquiring. The service of a merchant acquirer has two key features: the first is to allow the merchant to collect card transaction data from cardholders via the terminals and the second is to remit the value of the card transactions to the merchant.

The simple proposition is that if the merchant acquirer is compelled to continue the supply by reason of the disabling of its usual contract right to cease, suspend or terminate it will be forced to accept and process card transactions and therefore expose itself to the chargeback losses and other acquiring liabilities described above.

"Charges"

The safeguards contained in section 233A (3) and (4) focus on the liability incurred by the supplier in respect of its charges for supplying its services and the payment of those charges.

Unlike a traditional utility or IT supplier, payment for the service rendered (i.e. the merchant service charge) is not all important, as the risk of trading with an already insolvent business or one that is likely to become insolvent lies predominantly elsewhere. The risk of financial exposure through the loss of the merchant service charge amounts to a fraction of a merchant acquirer's financial exposure. It is chargeback losses and the other acquiring liabilities detailed above that form the largest part of a merchant acquirer's financial exposure. Merchant service charges typically do not exceed 2% of the value of a transaction value, whereas the chargeback losses amount to the entire transaction value and the other acquiring liabilities, such as fines, can as individual items amount to four or five figure sums. It is worth noting that our total value of defaults in the last 12 months are in the region of £3,500,000 and the vast majority of this sum arises from chargebacks payable by Elavon as a result of the insolvency of merchants.

WORKED EXAMPLE

It is worthwhile considering a real life example of how Elavon would look to monitor its risk in dealing with a merchant and how that process would change in the event that the Proposed Amendments come into force.

The merchant is a white goods retailer. Deposits are paid by customers on credit card, but the goods can take up to 4 weeks to be delivered. If the merchant becomes insolvent and the goods are not delivered, the merchant acquirer would face a substantial chargeback liability to the value of the transactions relating to the undelivered goods.

<u>1. Elavon's current approach</u>

Elavon would be monitoring the merchant's financial position and its volumes of transactions to ensure that in the event of insolvency there would be no chargeback losses. In the event that Elavon became concerned as to the viability of the merchant it might begin to use its contractual rights to defer payments to the merchant in order to establish a fund to pay any chargebacks in the event that the merchant enters into insolvency.

In the event of an administration or CVA, it is likely that Elavon would either terminate the agreement or entirely suspend the service pending discussions with the relevant insolvency practitioner. To allow the service to continue in any scenario where the viability of the merchant's business is in jeopardy (and therefore the ability of the merchant to deliver its services or products to the cardholders) would run a strong risk that chargebacks would occur and Elavon would be responsible for the losses.

2. Implications for Elavon if the Proposed Amendments were implemented

Elavon would be prevented from relying on the provisions in the MSA which allow it to suspend its services upon insolvency and the relevant insolvency practitioner would only be obliged to pay the merchant services charge. Elavon would effectively be compelled to continue to provide banking services to the insolvent merchant. Elavon would be responsible for the value of the transactions in the form of chargebacks without any recourse available to the insolvent merchant. Further, in the event that the insolvency practitioner alters the merchant's terms and conditions with its customers, for example, by extending the period for delivery of the goods, Elavon's chargeback exposure would be increased accordingly.

This would allow the insolvency practitioner to utilise the merchant acquiring facility of the insolvent business with all the risks associated with that being borne by Elavon.

3. Steps Elavon would take to protect itself if the Proposed Amendments were implemented

The wholesale shift in the apportionment of risk that the Proposed Amendments would bring will fundamentally alter the relationship between the merchant and the merchant acquirer and will present a significant challenge for merchants in their ability to both receive card payments and at the same time effectively manage their working capital.

The effect of the Proposed Amendments would be that Elavon has no ability to effectively manage its risk either immediately prior to or after a formal insolvency.

Elavon provides over 100,000 point sale facilities to UK merchants to support acceptance of credit and debit cards. Elavon performs full credit and risk reviews of 250 of its largest UK merchants on a yearly basis and the monitoring team which tracks merchant activity and behaviours will perform 100 "mini reviews" for UK SMEs every week. Our customers are under constant review and we believe that the Proposed Amendments would have the following day to day impact on merchants who wish to utilise credit or debit card facilities:

- the merchant acquirer would require much more substantial "day one" security in the form of guarantees from a parent entity, personal guarantees from directors, debentures and legal charges over assets such as real estate and cash deposits;

- the merchant acquirer would seek to restrict the proportion or the value of credit card transactions processed by the merchant in order to minimise the risk in the event of insolvency;

- the merchant acquirer would exercise its contractual right to defer payment to the merchant as a matter of course in order to build cash cover for any subsequent insolvency event. This would place difficult restrictions on the availability of working capital for otherwise healthy retail businesses;

- the merchant acquirer would seek to build additional protections into the MSA, for example to impose more regular reporting requirements on merchants in respect of financial information, to enable Elavon to assess where a merchant's financial position is deteriorating (and Elavon's potential exposure is increasing). That level of scrutiny would create additional expense for the merchant acquirers which could be passed on to the merchants in the form of larger merchant service charges;

- the merchant acquirer would be more inclined to take an earlier and harsher view of merchants who suffer adverse financial events because the risks of supporting a business that might become insolvent would be too great. This might lead to merchants having those facilities terminated when currently that would not happen;

- the merchant acquirer may decide not to offer its services to merchants in more high risk sectors, where it considers the risks of supporting an insolvent business in that sector to be too great. This would lead to merchants being denied merchant acquiring facilities in certain sectors. Merchant acquirers might seek to charge higher merchant service charges to those merchants that are deemed higher risk. This approach is likely to affect SME and/or micro merchants more than larger merchants.

Policy Unit
The Insolvency Service
4 Abbey Orchard Street
London
SW1P 2HT

8 October 2014

Dear Jo Swinson

Continuity of supply of essential services to insolvent businesses

Ofwat is the statutory economic regulator for water companies in England and Wales. We are responsible for ensuring that water companies' charges are reasonable. This is achieved through, amongst other things, a combination of: a periodic review of companies' cost requirements and proposed charges built from those costs; charging guidelines; dispute resolution; and from 2017 the introduction of competition in the provision of retail services to non-household customers.

We recognise that securing supply of essential inputs for companies in financial difficulty is a laudable objective. Securing essential inputs and thereby maintaining a company as a going concern significantly increases the probability that a failing firm can be turned around by insolvency practices, saving jobs and maintaining benefits to the economy.

However we consider that preventing service providers from being able to actively manage bad debt risk may have unintended adverse consequences for water service providers and customers more generally. Placing limitations on bad debt risk management may raise charges for all customers. In the context of regulation, bad debt is a cost which water companies are able to pass through to all customers in the form of higher charges in general so long as companies are able to demonstrate they are efficiently managing their costs. Insofar as changes to insolvency practice increased the cost of bad debt for water companies, this would raise costs to end customers.

There may also be an adverse impact on future competition. Competition for the provision of retail water services is set to be introduced form 2017. Restricting the contracts that can be agreed between companies may limit incentives to enter the retail market. For example, smaller retailers may be prevented from providing

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services to large non-household customers if they are not able to appropriately manage the potential risk from customer insolvency. This may effectively foreclose the market for larger customers and limit the scope of potential suppliers to that class of customers to only the largest retailers. Other unintended consequences may arise through alternative mechanisms. Crucially, since competition is expected to provided considerable benefits to non-household customers, it is imperative that it is able to develop unhindered.

We would welcome the opportunity to discuss the consultation with you further. Because we only became aware of your consultation late last week we have had limited time to provide a response. Further engagement would enable us to better understand the issues you are considering and the potential solutions available and facilitate a more proactive discussion. We understand that other sector economic regulators have concerns similar to those which apply in the water sector. We would be happy to conduct further engagement unilaterally or in conjunction with those other regulators.

You can contact me by the details below. You can also contact Mathew Stalker who is working with me in this area: Mathew.Stalker@ofwat.gsi.gov.uk 0121 644 7573.

I look forward to hearing from you.

Yours sincerely

Richard Khaldi
Senior Director of Customers and Casework

Q1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within the scope of the existing provisions?

Yes, we do consider the proposed amendments to sections 233 and 372 will be effective in bringing on–sellers of utility and IT services within the scope of the existing provision.

Paragraph 25 of the Consultation document refers to deregulation of certain utilities. Under the Water Act 2014, from April 2017, all business customers of water companies wholly or mainly in England will be subject to retail competition. The market for the supply of water will therefore become subject to the "on-selling" in a similar way to some other utilities and IT provision and the same issues are likely to apply. Please note that this answer is subject to the point made in answer to question 6.

Q2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

Yes

Q3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods within the scope of 233 and 372?

Yes

Q4. Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

No view

Q5. Are there other types of IT goods and services that you believe should be brought within the scope of sections 233 and 372?

No view

Q6. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

While we have no comment on the substantive effect of these sections, we would point out that as water and sewerage undertakers, our members provide services to customers under the Water Industry Act 1991 ((as amended) (the "Act")and not under any contractual provisions. Charging terms and policy are set out in charges schemes made by water and sewerage undertakers under Section 143 of the Act. Accordingly, they are unable to rely on any contractual termination clauses. If the proposed legislation is intended to enable those provisions to apply in the water sector, the draft sections would need to be amended accordingly.

Further, companies are unable to disconnect water supplies to domestic customers under the provisions of the Act. We would therefore seek confirmation that the new legislation will not override the provisions of the Act in this respect.

Q7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding ransom payments as a condition of continuing supply?

Yes

Q8. Do you believe that the safeguards provided for suppliers are adequate?

We have concerns about the safeguards provided to suppliers.

One proposal outlined in the consultation is to ensure continuity of utility supplies by preventing reliance on insolvency termination clauses. This will be balanced by a number of safeguards to protect the supplier. These include obtaining a personal guarantee from the insolvency office holder as a condition of continuing the supply, allowing the supplier to withdraw the supply if charges are not paid within 28 days and applying to the Court to terminate the contract.

The ability to request a personal guarantee from the insolvency office holder as a condition of continuing the supply is already set out in the Insolvency Act 1986. In practice a standard letter from the insolvency practitioner rejecting personal responsibility is usually received and not pursued any further.

Under current legislation, ransom payments cannot be levied in order to maintain supply, but water and sewerage charges are treated as an expense of the insolvency proceedings and rank ahead of other creditors and the insolvency practitioners' fees on an insolvency.

Nevertheless, on some occasions, there will be insufficient funds in the insolvency for the water and sewerage charges to be paid. Previously, practitioners have been very reluctant to agree any personal liability. The culture and practice of insolvency practitioners will need to change quite fundamentally if the intended continuity of service to insolvent companies is to be maintained.

Given the current proposal of a 14 day window during which the requirement of a guarantee must be communicated, in writing, to the insolvency practitioner it is (we believe) crucial that there is a legislative provision that utility companies are given active formal notification, in writing, of the onset of the insolvency proceedings.

Q9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office holder as a condition of continuing supply?

We can see no reason therefore for there to be any exceptions from the ability to seek a personal guarantee. Paragraph 39 of the Consultation proposes that a guarantee from a third party would be a reason not to seek such a letter. However, this requires water and sewerage companies to form a view as to the credit-worthiness of the third party. In practice, only where a surety is provided would there be an ability to limit ongoing additional insolvency risk.

Q10. What impact, if any, do you believe the changes would have on the pricing of contract in relation to:

a) utilitysupplies

b) IT goods and services

For water, provided the supply could be terminated if no guarantee is forthcoming we find the proposed guarantees acceptable. If the supply could not be terminated in the absence of a guarantee we do not consider the proposed guarantees as offering adequate protection for the reasons given in response to question 8. If such guarantees are not forthcoming, this could result in increased debt levels which will subsequently result in increased charges.

We would like the position to be clarified.

Q11. Can you see any practical difficulties arising from the proposed changes?

In order to avoid disconnecting water supplies, water companies will need to move the accounts out of their current collection routes into routes designed specifically for these situations where they cannot disconnect. To ensure this happens it is of paramount importance that there is legislative provision that water companies are given an active, formal notification of the onset of the insolvency proceedings.

Failure to inform the water companies could lead to confusion and supplies being disconnected.

Policy Unit
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8 October 2014

Sent by email only to policy.unit@insolvency.gsi.gov.uk

Dear Colleague,

Ofgem response - continuity of supply of essential services to insolvent businesses

Thank you for the opportunity to respond to your consultation.

Ofgem is the regulator of Great Britain's gas and electricity markets. We are a non-ministerial government department and an independent National Regulatory Authority. Our principal objective is to protect the interests of existing and future energy consumers. In line with our wider duties, we seek to act proportionately in ways to protect these interests and ensure that regulated companies are able to finance their activities. We think that these two themes are particularly important for the government's consideration of using its legislative powers to provide for the continuity of supply of essential services to insolvent companies. Our response is not confidential.

Our views

Business consumers have been a key focus of our policy development. Since 2010, we have introduced specific policies to encourage engagement and protect business consumers, particularly micro-businesses. These include the recent Retail Market Review;[1] with new requirements for contract end dates on micro-business bills and enforceable Standards of Conduct. We have also consulted on a code of practice for third party intermediaries, which we expect to implement by the end of 2015.

We support measures to help protect the interests of business consumers and would agree that suppliers and re-sellers should not unfairly impede the chances of rescuing a viable business. However, to facilitate a robust consideration of the proportionality and impact of the proposals, we encourage you to contact energy suppliers to understand in more detail the specific risks and costs they may face to continue supply to insolvent businesses. It would also be useful to provide more clarity on how the proposals would be enforced.

We have briefly summarised how the energy retail market works and our view of some of the potential impacts on suppliers.

[1] https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/retail-market-review

How the energy retail market works

Gas and electricity suppliers buy gas and electricity from the wholesale market (or directly from producers) and arrange for it to be delivered to the end consumer through transmission and distribution networks. Suppliers forecast how much energy their consumers will use for each half hour in electricity and for each day in gas, and purchase this energy in the forward markets.

In the business retail market, over 80%[2] of consumers have a fixed term energy contract. For most consumers, and particularly micro and small businesses, prices are fixed for the duration of the contract. To be able to provide this price certainty, suppliers buy much of their future energy requirements in advance at a fixed price, known as hedging. This removes their exposure to the daily (or spot) price of a good or service and reduces the risk of short term price movements.

If the consumer has terminated a contract and not agreed a new fixed term, or moved into new premises and not agreed a contract, they will often be supplied under a Deemed contract.[3] Prices for these contracts are usually significantly more expensive. An information request last year indicated a typical annual micro-business electricity bill was, on average, 82% higher than a new fixed term contract.[4] Suppliers attribute this to a higher bad debt risk, increased exposure to changes in short term wholesale prices and the higher cost to serve contracts of an uncertain length. Although we do not have any data, we expect insolvent businesses would be supplied on a Deemed contract if a supply contract is terminated (but not disconnected) when a business enters administration.

Debt and disconnection

As you noted in the consultation, energy suppliers are able to disconnect supplies if the customer does not pay. In practice this is unlikely to happen immediately following non-payment, but suppliers will follow different practices and disconnection timelines. In December 2012 we published a letter summarising suppliers' practices on debt and disconnection and our expectations for good practice.[5] However, there are no specific licence conditions that regulate business disconnections.

Potential impacts

Business consumers are heterogeneous and suppliers face different costs and risks to supply different types of consumer. Suppliers need to manage these costs by estimating how much electricity or gas to buy in advance. Uncertainty of demand increases costs, which will ultimately be passed to other consumers. It could be especially difficult for a small supplier to continue supply to an insolvent business at the same prices if that customer represented a significant proportion of their revenue.

A potential unintended consequence of the proposals is how they may conflict with other contractual terms that allow suppliers to vary prices in certain circumstances. Larger businesses can have more complex, bespoke contracts whereby a surcharge applies if consumption varies by a defined amount from forecast. Even if the supplier were unable to increase charges or terminate the contract because of insolvency, a significant reduction in consumption (and a possible surcharge) is likely to be an indirect consequence. A fixed price contract could also come to an end during the insolvency period, and it is unclear

[2] In our 2013 business consumer survey, 83% of all electricity and gas respondents said they had a fixed term contract.
https://www.ofgem.gov.uk/ofgem-publications/85187/non-domquantfinalforpublication181213.pdf
[3] The circumstances where a deemed contract occurs is set by relevant legislation: Schedule 2B paragraph 8(1) of the Gas Act and Schedule 6 paragraph 3(1) of the Electricity Act.
[4] Proposals for non-domestic automatic rollovers and contract renewals. 14 February 2014.
https://www.ofgem.gov.uk/ofgem-publications/86071/automaticrolloversconsultationfinal.pdf
[5] https://www.ofgem.gov.uk/ofgem-publications/57748/non-dom-disconnection-openletter-20-12-2012.pdf

The Office of Gas and Electricity Markets
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whether the proposals would force suppliers to continue supply at the same prices or restrict the ability of the supplier and customer to agree a bespoke contract.

We note that the proposals do not apply retrospectively. When a consumer comes to the end of a fixed term, they can negotiate new terms or change supplier. If they do neither, they will be automatically renewed onto a fixed or variable price contract, usually at a higher price than if they had negotiated. In our 2013 business survey 40% of business consumers reported they had not switched in the past 5 years and 12% said their contract was automatically extended with the same supplier.[6] The proposals therefore may not apply to a significant number of business contracts unless they switched supplier or expressly agreed a new contract with the same supplier after the proposals became effective.

I hope you find our response useful. If you would like to discuss any of the points please contact me or Jonathon Lines (jonathon.lines@ofgem.gov.uk).

Yours faithfully,

Meghna Tewari
Head of Non-domestic Retail Markets

[6] Another 11% said they were unsure of their current contract.

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9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Consultation on Continuity of Supply of Essential Services to Insolvent Businesses.

Response to consultation questions .

Q1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?

No. The wording is not specific enough. It is difficult to see how the term 'carries on a business which includes giving of such supplies' could be seen to apply to a landlord without specifying that it is intended to.

Whilst we welcome the proposed amendments and extension of cover afforded by sections 233 and 372, we consider that they will be of limited effect without specifying or defining what is meant by an 'on seller' of services and/or specifying those services, such as provision by a landlord, which it is intended to cover.

Q2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

Unable to comment.

Q3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

Yes – although so far as an on seller of such services is concerned see comments at Q1 above.

Q4. Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

Yes. Could consideration be given to adding a generic 'catch all' clause to future proof the legislation.

Q5. Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)

Consider widening the scope of (d) to include maintenance of supply.

Q6. Do you consider that new sections 233A and 372A will be effective in

preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Yes.

Q7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

Yes.

Q8. Do you believe that the safeguards provided for suppliers are adequate?

Yes.

Q9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

1. **Where a deposit is held and the amount of which is deemed adequate to meet future demand based on latest consumption figures and where necessary to meet any contractual termination costs should these arise.**
2. **Where the supplier has a line up to a solvent entity to pay/guarantee the supply to the insolvent entity.**

Q10. What impact, if any, do you believe the changes would have on the pricing of contracts in relation to;

a) **utility supplies**
b) **IT goods and services**

Unable to comment.

Q.11 Can you foresee any practical difficulties arising from the proposed changes?

Without specific and clear wording so as to clearly identify and capture both the activities and the providers of those activities within the scope of the legislation, there is a risk of challenge and thus potential increase in costs to the practitioner appointed over the distressed entity.

Continuity of supply consultation

KPMG Restructuring response to the continuity of supply consultation paper prepared by The Insolvency Service and issued on 8 July 2014.

Who we are

This response is prepared on behalf of the KPMG Restructuring practice, which is made up of some 620 staff including 38 appointment-takers, 21 of whom are partners and 17 associate partners and directors. In addition to those taking appointments, a further 31 staff have passed the JIEB examinations and 78 the CPI examinations. We are a national practice with 13 of our offices within England, Wales and Scotland undertaking Restructuring work.

We have a strong presence on several of the Technical and Regulatory committees in existence for the insolvency profession, including representation on the Joint Insolvency Committee, the R3 General Technical Committee, the ICAEW Technical Committee, the ICAEW Professional Standards Board, the IPA Council and the ICAS Technical Committee. In addition we have a member of staff on the R3 Education, Courses and Conferences Committee. This demonstrates the commitment we have made and continue to make to the insolvency profession.

Major issues and areas of concern

We have provided comments on what we consider to be the main areas of concern; for this reason we have chosen not to respond to the specific questions raised by the Insolvency Service as part of the consultation.

Generally the aims of the changes proposed are sensible and should help to promote business rescue and assist Insolvency Practitioners to do their jobs; acting in the best interests of the creditors as a whole. We remain concerned at the preferential status that many of the utility suppliers have created and welcome any assistance that can be provided to prevent the ongoing practice of increased rates and ransom payments, which are currently operating at the detriment of other creditors and the insolvency estate.

Whilst we recognise the need to safeguard the suppliers' position where they continue to provide supplies to the company in formal insolvency, it is essential that current shortcomings resulting from changes in the supplier market, the legislation under which they operate and the practices that they adopt are addressed.

Proposed changes

1. Applying existing provisions to "on-sellers" of utility supplies and 2. Adding IT suppliers to the list of utility suppliers covered by Sections 233 and 372

The proposed inclusion of "on-sellers" and IT suppliers to the scope of Section 233 of the Insolvency Act is welcomed. We are, however, concerned that the current scope is not sufficiently wide and should, in addition, cover supplies necessary to ensure "access to internal and external web, computer and physical information systems, required to support any element of the operation of the business". This would ensure that the Insolvency Practitioner has access to key information systems such as Health & Safety systems for engineering plants, Bloomberg for market traders etc.

In addition, whilst the changes proposed address the ongoing provision of IT services, they do not address licenses. It is critical that, in addition to providing services, the relevant hardware and software licenses remain in place and are not terminated upon insolvency. For example, the loss of such a licence could prevent an Insolvency Practitioner from being able to run the company's payroll.

3. Ensuring continuity of utility and IT supplies by preventing reliance on insolvency termination clauses

Insolvency proceedings

It is not clear why the proposed changes will only cover administration and voluntary arrangements. We believe that Section 233A should also apply to liquidations (i.e. provisional, voluntary and compulsory) which:

- may be used to rescue companies (eg where administration is not available, such as for insurance companies, or due to the ability to disclaim onerous contracts in a liquidation, a remedy which is not available in an administration or voluntary arrangement) and
- are important insolvency processes in their own right. As for administrations and voluntary arrangements, it is important that one creditor is not able to leverage its own position for its own benefit and to the detriment of the wider creditor group.

If the changes only apply to administration and voluntary arrangements, then this will create an unnecessary asymmetry between the different insolvency processes which will impact companies' choice of insolvency procedure and may lead to abuse of the administration process.

Termination clauses

Whilst the proposed wording of Section 233A seeks to address reliance on termination clauses, we are also concerned that this section would not of itself prevent a supplier claiming that a contractual clause had been triggered (eg as a result of the company having failed to pay a pre-administration debt or the supplier perceiving that the company has a higher credit risk) which allowed the supplier to move a company in administration to a higher tariff. The effect of the higher tariff is that the supplier recovers part of its loss incurred pre-administration, at the expense of the other creditors and the insolvency estate. In order to prevent the continuation of these "ransom charges", the scope of the proposed wording of Section 233A needs to be widened to include any contractual trigger which directly or indirectly arises as a result of insolvency process.

Personal guarantees

Whilst we acknowledge that Section 233 provides for the use of personal guarantees to secure ongoing supply and, therefore, accept there is limited scope to change this, given that the supplies made in administration are administration expenses with a "super priority" (ahead of the officeholders' remuneration), this position seems somewhat unreasonable. The consultation paper notes that "it is anticipated that it would be highly unlikely for any supplies made to an insolvent business in administration [to] remain unpaid"; it is, therefore, unclear why a personal guarantee is considered to be justifiable in these circumstances. Directors are not required to provide such personal guarantees where supplies are made to a company generally.

It is also important to note that, whilst such sums might generally be considered to be small, this is frequently not the case; the sums personally guaranteed can be significant. By way of illustration, the post-administration gas and electricity supplies for the Peacocks administration in 2012 totalled some £1.5 million and guarantees could have been demanded for this entire sum. This will clearly have potential to be larger still when additional suppliers are included under the scope of Section 233 and will have further ramifications for Insolvency Practitioners being asked to put their own personal assets at risk, whilst simply trying to fulfil their role.

Where personal guarantees are required, it is important that they are limited to the cost of charges for goods and services requested by the Insolvency Practitioner and received by/benefitting the insolvent company. Such guarantees should <u>not</u> cover charges accrued after the Insolvency Practitioner has requested the cessation of the supply and is no longer benefitting from the supply, nor should it include any termination charges; which can be significant and would normally rank as an unsecured claim.

The 14-day period provided within Section 233A(4) may, in certain circumstances be impractical; particularly where there is debate over the wording of the personal guarantee being required. We would be concerned that sufficient time is allowed for the wording of any such guarantee to be agreed and that such suppliers are not simply allowed to railroad the Insolvency Practitioner into signing an agreement to comply with the 14-day deadline. This is clearly particularly important given the personal implications.

In addition, to avoid any possibility of the recovery of any loss incurred pre-appointment, we would suggest that the wording within Section 233A(4) should clearly cover “future charges” only; the current reference to “charges” has the potential to be exploited.

Timescale for payment

Looking also at the timescale for payment, it is proposed that utility providers are allowed to withdraw supply if any charges in respect of that supply are not paid with 28 days from the day on which payment is due. It is suggested that this provision should be amended to provide that it will not apply in the case of a bona fide dispute between the parties and in the case of estimated meter readings. In our experience electricity and gas suppliers on large retail insolvencies can take many months to provide an accurate estimate of charges and have on occasion proved completely unable to do so. It is important that these practical difficulties do not impact supply.

Conclusion

We welcome this consultation and the long-overdue changes to Section 233. To enable us to continue to rescue businesses and carry out our role as Insolvency Practitioners effectively, it is important that the current issues with the utility companies are addressed. Whilst the proposed changes go some way to addressing the issues that we currently face, we do not believe that these are sufficiently wide to adequate address all of the issues and, to avoid ongoing exploitation of “loop holes” within the legislation. It is important that the legislation clearly sets out the position and the expected procedures to be adopted, to avoid further ambiguity.

Given our significant experience in this area and our ongoing involvement with cases such as Peacocks, we are very keen to assist with this consultation and ongoing work to amend and refine this legislation. If we can provide further assistance or attend further consultation discussions, please do not hesitate to contact us.

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Continuity of supply of essential services to insolvent businesses

Response of the Association of Business Recovery Professionals ('R3') to the consultation document issued by The Insolvency Service in July 2014

Introduction

1. The Association of Business Recovery Professionals ('R3') represents insolvency practitioners authorised to practise in all jurisdictions of the UK. R3's membership comprises licensed insolvency practitioners, lawyers and other professionals involved in the insolvency and turnaround industries. Over 97% of authorised insolvency practitioners are members of R3.

2. R3 has long argued as part of our 'Holding Rescue to Ransom' campaign[1] that the provisions of section 233 of the Insolvency Act 1986 should be extended to cover supplies of all essential services, and that suppliers of services should be prevented from taking advantage of formal insolvencies by adopting obstructive tactics in order to extract ransom payments (sometimes just to give themselves priority in respect of arrears contrary to the pari passu principles but often simply to take economic advantage) , or impose unreasonable contract terms, as a condition for further supply. R3 has also argued that the exercise, on grounds of insolvency alone, of contractual termination provisions should be precluded, subject to appropriate safeguards for suppliers. We therefore welcome the Government's decision to consult on this issue although we are concerned about the delay: the Government included an amendment on this issue in the Enterprise and Regulatory Reform Bill in early 2013. However, as we point out in our comments below, we feel that the proposals set out in the consultation document do not go far enough, and that too many essential services are likely to fall outside their scope. We also believe that the extent of liabilities incurred for the supply of essential services needs to be more clearly limited and defined, and that the protections against the imposition of unreasonable contract terms should be strengthened.

3. We are also disappointed that the opportunity has not been taken to widen the application of section 233 to other forms of insolvency process where supplies may still be necessary, such as in liquidations, especially where trading is necessary to complete work in progress, and in provisional liquidations, where trading may continue for some time. The same applies to administrative receiverships and Scottish receiverships, which are also outside the scope of the proposed changes We recognise that any such change would require primary legislation, but we see no policy reason to limit the application of this provision.

[1] http://www.r3.org.uk/what-we-do/working-in-parliament/holding-rescue-to-ransom

Protection of essential supplies – the scope of the proposals

4. We welcome the provisions bringing on-sellers of utilities within the scope of sections 233 and 372. It might be helpful to expand these sections to:

- provide that any expense incurred on the provision of a supply is to rank as a necessary disbursement – this would remove any uncertainty about its ranking, and
- make it clear that 'supplier' includes a company that is a group undertaking.

Both of these provisions are included in regulation 14(6) of the Investment Bank Special Administration Regulations 2011, which deals with continuity of supply.

5. It is important that subsections (3A) should be drafted broadly enough to cover as many essential services as possible, and that any scope for suppliers to be able to exploit any uncertainty or ambiguity should be avoided. For example, it is not clear whether 'any service enabling the making of payments' or 'data storage and processing' would include the services of payroll bureaux. Many businesses depend on these, and could be held to ransom if the amended sections 233 and 372, or new sections 233A and 372A were held not to apply to them.

6. Similarly, we are uncertain whether the infrastructure supporting electronic communication and networking is covered, either by new subsections 233(3A) or 372(3A), or existing 233(3)(d) or 372(4)(d). Again, see regulation 14 of the Investment Bank Special Administration Regulations, where infrastructure is specifically referred to. We also suggest that software licences should be specifically mentioned, as they are in regulation 14.

7. In the new sections 233(3)(f) and 372(4)(f), the expression 'for the purpose of enabling or facilitating anything to be done by electronic means' seems to introduce an element of uncertainty and lack of clarity which could be exploited by suppliers. We suggest that removing the words 'enabling or facilitating' would avoid this.

8. In the draft statutory instrument, the new subsection inserted after subsection (4) of section 372 is numbered (3A). It would be more logical if it were numbered (4A).

Insolvency-related contract terms

9. The provisions dealing with insolvency-related contract terms are welcome in principle, but need some amendment in detail if they are to have the required effect. The key point is that contracts should continue on the same terms as before the insolvency, and the mere fact of the insolvency should not lead to more onerous terms being imposed: otherwise the economic effect is unchanged and the office holder's objectives can still be frustrated. We also suggest that any contractual termination which has occurred within 30 days of the insolvency should be reversible, and the contract reinstated on the same terms as previously.

10. The new protections will only apply to contracts entered into after the relevant section comes into force. Many businesses with long-term contracts may therefore not benefit from them. Moreover, insolvency practitioners will be faced with a portfolio of supply contracts, some of which would be covered by these provisions

whilst others are not – leading to precisely the same issues that currently prevent continuity of trade, recovery of key data or preservation of assets. There may also be some uncertainty over when a new contract is entered into, which could be exploited by suppliers. We would argue that the provisions need to have universal effect from the time they are enacted.

11. The new provisions prevent suppliers from terminating contracts, but do not prevent them from altering the contract terms, including increasing the price. This needs to be explicitly addressed in the legislation.

12. The time-limit of 28 days within which payment under a contract must be made is inappropriate and unnecessary. In an administration the office holder may well be operating under severe cash-flow constraints, but suppliers have the protection of paragraph 99 of Schedule B1 to the Insolvency Act 1986, under which liabilities on contracts entered into by the administrator are charged on the assets. The purpose of this provision is to ensure that suppliers will be paid out of the assets, even in cases where the administrator may not have access to readily available funds. Furthermore, experience shows that utility bills are often incorrect, and it can take time for an amended bill to be submitted and agreed. In voluntary arrangements, the manner in which ongoing trading is to be funded must be dealt within the proposal. The 28 day provision is therefore unnecessary.

13. The provisions allowing a supplier to require a personal guarantee by the office holder are also inappropriate. This was and is an unwelcome feature of the existing 233 legislation, as it is disproportionate. In principle, there is no reason why a supplier should enjoy a greater level of comfort from an insolvency office holder than it would from the directors of a solvent trading company. Any office holder giving a personal guarantee would be entitled to an indemnity out of the assets, and as we have pointed out, in an administration suppliers have the comfort of knowing that they will be paid out of the assets as an expense of the proceedings. As a general rule, administrators have been able to reach appropriate agreement with utility suppliers without the need to provide personal guarantees, but having the proposition that they should give them set out in legislation is unhelpful, and as a matter of practice personal guarantees are not sought or generally given for any other form of supply.

14. In individual voluntary arrangements, and company voluntary arrangements which do not run concurrently with administration, responsibility for managing the ongoing business generally rests with the debtor or directors. It is inappropriate to require a personal guarantee from the supervisor in such circumstances, and no supervisor is likely to give one.

15. We recognise that the personal guarantee provisions of the draft SI are mandated by the Enterprise and Regulatory Reform Act, but as we have indicated, they are not necessary to achieve the desired level of protection for suppliers.

16. There are a number of other practical issues which can cause difficulties with suppliers, which the legislation needs to address. One of these is the problem of termination charges. Sometimes suppliers levy substantial disconnection charges on the termination of a contract. Draft subsections 233A(3)(c), 233A(4)(a), 372A(3)(c) and 372A(4)(a) refer to the payment of ‘any charges in respect of the continuation of the supply’. If ‘any charges’ were to include termination charges incurred during the

course of the insolvency, the effect would be to give super-priority status to charges which would only have ranked as an unsecured claim if the contract had been terminated before the insolvency. The definition of the charges payable as an expense of the proceedings needs to be narrowly drawn in order to prevent this.

17. Other problems can arise where an office holder transfers to another supplier. It can take up to three weeks to arrange a transfer, so there needs to be provision to prevent the first supplier from terminating the supply during the time it takes to effect the transfer. There should also be provision to allow immediate termination of a supply by an office holder where the supply is no longer needed, in order to avoid incurring any ongoing costs to the detriment of the estate.

18. Finally, the draft legislation is silent on the question of what happens if a supplier terminates a supply in breach of the new provisions. There needs to be some protection available to the insolvent estate for failure of a supplier to supply.

Answers to specific questions

Q1 **Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within scope of the existing provisions?**

Yes, subject to the amendments we suggest in paragraph 4 above.

Q2 **Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?**

We do not understand the purpose of this question. On the face of it, we do not see why not.

Q3 **Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?**

Yes, subject to the amendments we suggest above.

Q4 **Do you agree with the proposed approach to specify types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?**

Yes. See comments in paragraphs 5 to 7 above.

Q5 **Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372? (Please be as specific as possible)**

Yes. See comments in paragraphs 5 to 7 above.

Q6 **Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?**

Yes.

Q7 **Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?**

No. See our comments in paragraphs 16 to 18 above regarding the need for protection against modifying contractual terms, and termination payments.

Q8 **Do you believe that the safeguards provided for suppliers are adequate?**

Yes.

Q9 **What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?**

As we explain in paragraphs 13 to 15 above, suppliers have sufficient protection under existing law, and we believe the proposed ability to seek personal guarantees are inappropriate and unnecessary.

Q10 **What impact, if any, do you believe the changes would have on the pricing of contracts in relation to: a) utility supplies; b) IT goods or services**

None.

Q11 **Can you foresee any practical difficulties arising from the proposed changes?**

See our comments above.

We should be happy to discuss any of the points raised in this response in greater detail.

Association of Business Recovery Professionals
6 October 2014

Continuity of supply of essential services to insolvent businesses

We are pleased to submit our response to this consultation. Whilst we generally welcome the proposals set out in the consultation which proposals should support the achievement of corporate rescue in viable cases, we have some concerns and observations on the practicalities which we address under the relevant question below.

The whole approach whereby there is personal liability for the IP needs to be put into context.

Most individuals trading businesses do not give personal liability for the debts since there are normally incorporated. Most of the businesses subject to this consultation will also be incorporated but there is a continuation of the assumption that the IP will undertake to pay for charges in a way which never happens in normal commercial practice.

In addition, he is going to be asked to do so, often with limited knowledge of the business, the time periods he will need to have this in place for and the liquid assets available to pay for these charges.

With this in mind we have some ideas, captured in the responses below, covering alternatives such as a period of grace before termination takes place, more emphasis on deposits rather than PG's and a prohibition on suppliers simply insisting on personal guarantees (PGs)

Whilst it is the case under the existing sections 233 and 372 that the "supplier may make it a condition of the giving of supply that the office holder personally guarantees the payment of any charges" we would not wish to see this become a non-negotiable stance by suppliers. PGs are an anathema to most Insolvency Practitioners (IPs), and there is a risk of precedent being set where creditors and suppliers not covered by these proposals may also seek similar provisions as conditions of their ongoing support in rescue situations. Each case must be capable of being considered on its own commercial merits. Agreement with one essential supplier on one case should not mean that the supplier presumes that IP will deal with all his cases involving that supplier in the same way. Circumstances will remain where the payment of a deposit and/or a higher "on price" are commercially more appropriate, and the IP should retain the discretion to negotiate case by case, supplier by supplier.

Consultation questions

Q1. Do you agree that the proposed amendments to sections 233 and 372 will be effective in bringing on-sellers of utility and IT services within the scope of the existing provisions?

Generally speaking, yes we agree. All suppliers to be caught by the proposals will need to be fully engaged with the process – but ultimately they will take decisions on commercial grounds. We query what sanctions, if any, are available against suppliers who will not engage: it is unlikely that all potential suppliers would be caught by an Ombudsman scheme or similar (and in any event, such schemes are likely to take too long to resolve issues in an insolvency context to be of assistance.)

We would also note that there will be cases where the IP is appointed to a landlord, and we note that the consultation document refers to landlords as onsellers- is it the intention that the IP is then also caught by the proposed legislation and forced to continue to supply?

Q2. Do you agree that the amendments will be effective in preventing supplies made for wholesale purposes from becoming subject to the provisions?

We have no comment on this question.

Q3. Do you agree that the proposed changes will be effective in bringing suppliers of IT goods or services within the scope of sections 233 and 372?

Probably. The interaction of this proposal as regards providers of goods (as opposed to services) and any claim they have for retention of title (RoT) on those goods needs to be considered. Any valid RoT clause is likely to be of more commercial benefit to the supplier than the proposals. As regards services, the key is likely to rest with the future pricing offered and agreed, and whether these become more commonly shared in the insolvency communities. Many larger suppliers have experienced, specialist teams that deal with insolvency cases and they are well able to look after their own commercial interests. But a smaller, but no less essential, supplier may not be aware of the legal requirements brought by the proposals, and his only remedy may involve the expense of going to Court.

Q4. Do you agree with the proposed approach to specific types of IT goods or services that should be brought within the scope of sections 233 and 372? If not, would a more generic definition of IT services be preferable?

Broadly yes, but any definition needs to be "future proofed" given the speed of change in the nature, and delivery of IT goods and services. A more generic definition may therefore be preferable. Given the experienced in house legal teams many of these suppliers have, we would wish to avoid debate in the heat of the early days of an insolvency over what may or may not be covered by this legislation: drawing the widest possible definition is therefore likely to be of assistance.

Q5. Are there any other types of IT goods or services that you believe should be brought within the scope of sections 233 and 372 (Please be as specific as possible)

We would like to see wording added to ensure that all forms of electronic communications used by the insolvent business and any software development and support services including those of a security amd/or troubleshooting nature, are clearly included.

Q6. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from relying on insolvency termination clauses?

Any supplier will act in its commercial interest and only exercise termination clauses if there is no commercial sense (in its view) in continuing to trade with an insolvent customer. Normally this would mean certainty on payment for future supplies. In our experience suppliers use the threat of termination to negotiate a higher price for the future supply and they are likely to continue to try to do so.

Q7. Do you consider that new sections 233A and 372A will be effective in preventing suppliers of utility and IT goods and services from demanding 'ransom' payments as a condition of continuing supply?

'Ransom' can be other than a higher on-supply cost. What sanction is there for suppliers who continue to demand such payments? In many situations, a deposit may be required (and as a firm we favour that route where at all possible, rather than the granting of PGs). We would query whether the proposals adequately deal with an essential supplier being required to fully consider and accept what may be perfectly reasonable and commercial counter proposals which achieve a similar aim of certainty around future payment, with no ransom cost.

We would therefore prefer to see a clause inserted requiring the supplier to fully consider all reasonable options to a PG: that is they cannot insist on a PG.

Q8. Do you believe that the safeguards provided for suppliers are adequate?

In part. An important point is for the supplier to clearly, correctly and consistently identify who the liability lies with. We have many examples of bills from the same supplier being addressed in a variety of different ways which can take considerable time (and therefore cost to the insolvent estate) to sort. This has a greater impact than just "poor housekeeping".

Q9. What, if any, exceptions should be provided from the ability to seek a personal guarantee from the insolvency office-holder as a condition of continuing supply?

As noted in our introductory comments, PGs are an anathema to most IPs. We are concerned about the precedent created by invoking PGs in this legislation, and whether there may be unintended and adverse consequences of doing so here.

There needs to be complete and consistent clarity as to when a PG is no longer in place: it is possible that situations might arise where, say, an administrator has received his discharge but the PG is still in place. An industry agreed standard may help create this clarity.

Our preference and practice has been to lodge funds on deposit with the supplier against future bills wherever this is practical and commercial and we would suggest other options like this should be available in place of a "compulsory" PG. Similar clarity is needed as to when such funds are returned to the insolvent estate or are drawn against unpaid post appointment goods and services. There are likely to remain cases where a higher "on cost" is more acceptable to the IP than the granting of a PG.

It would be helpful if the legislation addressed the point at which the costs of essential suppliers covered by a PG (or similar comfort of future payment) determine.

A further practical point concerns final meter readings which are not always possible to obtain right to the hour of cessation due to lack of access or, where the supply comes to light long after the event. The IP is also likely to assess the personal risk in taking on cases where a PG is likely to be required, and this may result in in less choice of IPs in certain segments of the market, which would seem to run counter to much of recent policy.

Also, what if the supplier is itself not UK domiciled? How can they be brought to adhere to the proposed legislation?

Q10. What impact, if any, do you believe the changes would have on the pricing of contracts in relation to:

a) **Utility suppliers**
b) **IT goods and services**

In theory, anything that creates certainty of payment for future supplies should ensure that pricing remains closer to pre appointment levels. However, for the reasons we've outlined above each situation is likely to remain subject to commercial negotiations on its merits.

For the utility suppliers to recognise the unique circumstances when an officeholder is appointed and to avoid some of their standard requirements when there is a change to the account holder, such as credit checks, and then use that to increase" on price

Q11. Can you foresee any practical difficulties arising from the proposed changes?

Yes. We have a number of observations to make in response to this question.

The proposals allow for a period of 14 Days for a supplier to give written notice that a PG is required. The IP also requires a limited period post appointment to assess his requirements without the threat of disconnection. We would like to see it confirmed that no action to terminate can be taken in this period by way of the proposals working for both parties. Our recent experience with some utility suppliers is that a near instant response is needed, and a day one request for a PG would significantly reduce the time an IP has to consider his strategic options.

In certain cases where supply is metered it is near impossible to obtain accurate and timely readings both to open and close out the liability. We would like to see consistency across the industries in how the liability is agreed in these cases.

We wonder how communication will take place to all the possible suppliers that may be caught by this legislation.

We also wonder how charges are to be raised and ranked where termination takes place and suggest the legislation should ensure that the pre insolvency rates only can be applied if these are to rank as expenses of the insolvency, where there is no agreement to the contrary.

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8 October 2014

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20/10/3 3rd October 2014

Policy Unit
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Dear Sir/Madam

“CONTINUITY OF SUPPLY”

Our Committee, as representative of insolvency practitioners in Northern Ireland, has considered the July 2014 Consultation Paper (“the Paper”) on “Continuity of supply of essential services to insolvent businesses” issued by The Insolvency Service.

We concur with the rationale outlined in the Paper and, therefore, support amending Sections 233 and 372, Insolvency Act, 1986 to

1. Apply current “essential supplies” requirements to “on-sellers” of utility supplies.
2. Bring suppliers of IT services, including “on-sellers” of such services, within the scope of Sections 233 and 372.
3. Oblige utility and IT suppliers to continue to supply an insolvent business, subject to specified safeguards.

Yours faithfully

John Bowen-Walsh
Secretary
Insolvency Technical Committee

itc/s/ContinuityofsupplyconsultationJuly2014

COMMENTS

Insolvency Service Consultation on Continuity of supply of essential services to insolvent businesses

7 October 2014

ICAS comments on Insolvency Service consultation

Continuity of supply of essential services to insolvency businesses

Introduction

1. ICAS regulates approximately 77% of insolvency practitioners (IPs) who take appointments in Scotland. ICAS also regulates 7 appointment taking IPs based in England & Wales, and one based overseas.

2. ICAS supports the UK Government's objective to ensure that insolvency practitioners are more effectively able to rescue viable businesses whilst ensuring that adequate safeguards are in place for suppliers.

3. As personal insolvency and certain areas of corporate insolvency are devolved to Scotland our comments are restricted to the proposed amendments in respect of s.233 Insolvency Act 1986.

Protection of essential supplies

4. The extension of existing provisions to '*on sellers*' of utility supplies is welcomed.

5. ICAS agrees that the addition of suppliers of IT goods and services to the list of utility suppliers at s.233 recognises how dependant the modern business environment is upon IT.

Insolvency related terms of a contract

5. Extending the proposed s.233A to cover other forms of formal insolvency process where supplies including IT services and supplies may be required would have been welcomed. This would have recognised those occasions where it is necessary to continue trading.

6. To further support the 'rescue' culture we suggest that consideration be given to contracts continuing on the same terms as before for a set period of time. This would assist the office holder in achieving his objectives and provide suppliers some assurance for a fixed period. Many suppliers try to change the tariffs significantly post insolvency which greatly inhibits the IP from trading and obstructs the rescue culture.

7. The provision for an office-holder within 14 days of notification by a supplier that supply will be terminated to personally guarantee the payment of any charges in respect of the continuation of supply incurred after the insolvency event is unhelpful. Similar to other expenses which invariably are paid from the assets, any guarantees would come from the assets and be an additional expense of the process. Practice demonstrates administrators reach agreement with utility suppliers without having to provide personal guarantees.

7 October 2014