

## Corporate Insolvency and Governance Bill

### Department for Business, Energy and Industrial Strategy

RPC rating: **fit for purpose**; EANDCB not yet validated

#### Overall assessment

The impact assessment (IA) is well-structured, written clearly and with a good level of monetisation. The Department and The Insolvency Service have previously submitted two assessments in this policy area for RPC scrutiny: a consultation stage IA<sup>1</sup> covering, in particular, a proposed company moratorium and a validation IA<sup>2</sup> on an earlier *ipso facto* measure relating to maintaining continuity of essential (utilities and IT services) supplies, respectively. The Department has developed its analysis and consultation with stakeholders since receiving the 'fit for purpose' RPC opinions on these cases and this further development is reflected in the present IA. Given this, and in view of the pressing need for these measures during the current emergency limiting the scope for further analysis and evidence gathering, the RPC is content that the IA is sufficient for ministerial and parliamentary decision-making.

The RPC considers, however, that the assessment of the direct impacts on business presented (as represented by the EANDCB figure) should be strengthened in some areas to be validated for business impact target (BIT) purposes (at least under the metric for the previous parliament). The impacts on business are large and subject to considerable uncertainty and the evidence for these impacts is limited in places, partly due to the Department not having had time to consult on recent changes to the proposals. Some of the evidence also appears to date back to 2010; there are references to further evidence which are not fully explained. The Department will need to address these issues, explained more specifically below, in a revised IA for validation of a BIT figure. This revised IA should be submitted for validation in time for the measures to be reported in the Government's BIT report for the first year of the current parliament.

The IA includes an annex describing temporary measures in the Bill and provides a shorter, largely qualitative assessment of their likely impact. As these measures are expected to last less than 12 months, they are outside the better regulation framework requirements. The annex would, however, benefit from some additional assessment, particularly in the area of risk, as described below.

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<sup>1</sup> RPC ref 3285, 29 March 2016.

<sup>2</sup> RPC ref 3264, 11 February 2016.

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## Description of proposal

The Department states that the IA covers reforms to the insolvency framework to bring the UK into line with international best practice for company rescue, and that the Government are keen to introduce these reforms now as part of their response to Covid-19. The Government believe that the measures will enable UK companies, on which the lockdown has an impact, to gain “breathing space” from their creditors to continue trading, whilst seeking a rescue, or during a restructuring. They will also enable companies to continue to buy much-needed supplies whilst attempting to rescue their business.

The measures to be introduced relate to company moratoriums, suspension of *ipso facto* (termination) clauses, and flexible restructuring plans.

### Company moratorium

This measure will introduce a new moratorium to cover all companies in financial difficulty. It will replace the current ‘Schedule A1 Moratorium’ that is available only to small companies entering a Company Voluntary Arrangement (CVA). The intention is that the moratorium will be a breathing space in which the directors will seek to find the best solution for the distressed company. Such solutions may include entering into a consensual agreement with creditors or commencing a formal insolvency procedure such as a CVA, administration, scheme of arrangement or restructuring plan. To be eligible for a moratorium, the company must be insolvent, or likely to become insolvent, with rescue being a reasonable prospect. When a company enters the moratorium, the arrears owed to creditors will be frozen, but the company will be obliged to meet ongoing trading costs and debt obligations during the moratorium. The key proposal is that the moratorium will last for 20 business days, with the possibility of an extension to 40 business days.

### Suspension of *ipso facto* (termination) clauses

Only suppliers of essential utilities and IT goods or services to insolvent companies are covered by existing legislation which prohibits suppliers from enforcing *ipso facto* (termination) clauses against companies facing financial difficulties. The proposal would broaden this scope significantly. It will prohibit all suppliers from enforcing termination clauses in contracts for the supply of goods and services. Suppliers will have to continue to fulfil their commitments under contract with the debtor company in the event of it becoming insolvent, or entering a moratorium, even where the company has pre-insolvency arrears. This measure is intended to prevent companies from being held “hostage” by key suppliers that ask for additional “ransom” payments to secure continued supply of goods and services. As a

temporary measure, small company suppliers will be exempt from the requirement during the Covid-19 emergency.

### Flexible restructuring plan

This measure will involve the creation of a new restructuring procedure proposed by a company or its creditors. Under it, creditors will be divided into separate classes, by similar type and priority, by the proposer. The plan will bind all creditors (and members) if more than 75 per cent of creditors, by value, vote in favour in each class. Whole classes of creditors (and members) that vote against the proposed restructuring plan can be 'crammed down' (i.e. the plan will be imposed on dissenting creditors) if the court agrees it is fair and equitable to do so. The measure will address the scenario where a secured creditor can block a company rescue, despite the proposals being supported by more than 75 per cent of senior secured creditors by value.

The above are all permanent proposals. The Bill also includes the following temporary measures, which are covered in an annex to the IA and included in the Bill's Explanatory Notes:

- Flexibility on holding AGMs and other meetings.
- Extending filing deadlines at Companies House.
- Temporary suspension of wrongful trading.
- Temporary suspension of statutory demand provisions and a restriction on winding up petitions.

The IA states: "... as these measures are of a temporary nature... they are not subject to better regulation guidance [and]... are out of scope of this impact assessment." (paragraph 1.7, page 4).

### **Impacts of proposal**

The Department estimates an overall net societal and business benefit of £1.9 billion over ten years in present value terms, and an equivalent annual net direct cost to business (EANDCB) figure of -£222.9 million. Both of these figures are dominated by the estimated impact of the suspension of *ipso facto* (termination) clauses.

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### Company moratorium

Costs relate to preparing an eligibility report, legal materials to authorise, dealing with creditor challenges and monitoring compliance. Overall, the Department estimates a cost of £23,400 per case. Based upon an estimated (mid-point) 1,250 cases making use of the moratorium, the estimated total cost to business is £29.6 million each year.

The main monetised benefit comes from an estimated 10-20 cases where evidence from consultation suggests cost savings from restructuring and refinancing could be of the order of £0.21 million to £3.16 million per case, resulting in a mid-point total benefit of £25.3 million each year. There is an estimated further benefit of £5 million each year, primarily consisting of better returns to business creditors in 20-30 cases where businesses in difficulty move into a better outcome, such as a CVA rather than administration, following a moratorium.

### Suspension of *ipso facto* (termination) clauses

The prohibition of enforcing termination clauses means that a supplier will be obliged to continue to supply goods and/or services to the company beyond the point of entering an insolvency procedure, incurring the risk of non-payment should the debtor company be unable to meet its liabilities.

Businesses can mitigate these losses by taking out trade credit insurance and the Department uses the estimated cost of this as the main cost of this measure to suppliers. It is estimated that around 198,000 suppliers would have to pay between £1,060 and £2,120 each year, amounting to a mid-point aggregate cost of around £289.6 million each year. Legal costs are estimated at £3.3 million, making a total cost of £292.9 million each year.

The main benefit from the measure is improved outcomes for business creditors, mainly through avoiding company liquidation. The benefit is estimated through the following steps:

- 16,000 annual liquidations (using company insolvency statistics)
- 10 per cent are avoided by the proposal (informed by survey evidence)
- Average creditors' claim in an administration £6.3 million (based upon Insolvency Service sample data collected in 2020)
- Average return of this to creditors is 11 per cent (as above).

This amounts to an aggregate benefit of around £1.1 billion each year. The Department makes two adjustments to this figure. First, part of the benefit arises from the prohibition of ransom payments and such payments represent an economic transfer from suppliers to the debtor company. Surveys suggest that this might apply

to around half of all suppliers; reducing the benefit by half results in an ongoing benefit to creditors of £555 million. Secondly, some of these returns would accrue to non-business creditors such as HMRC and local authorities. Analysis of a sample of Companies House filings estimated that non-businesses accounted for around 10 per cent of the returns to creditors. Adjusting by this amount gives an estimated ongoing benefit to business creditors of £499 million. There is an additional benefit in relation to companies that would be able to continue in administration or a CVA. This is smaller than that if the company avoided liquidation altogether but, based upon an estimated 225 cases, the Department estimates a figure of £35.1 million. This makes a total estimated benefit to business creditors through this measure of £534.1 million each year.

The Department, therefore, estimates a net benefit of around £240 million each year. This accounts for a large majority of the -£222.9 million EANDCB figure.

#### Flexible restructuring plan

Following stakeholder engagement, the Department anticipates there will be around 50-100 restructuring plans per year, although most of these are expected to replace existing schemes. The Department estimates that a small number of creditors will seek recourse via the courts to be removed from the restructuring plan, resulting in an estimated cost of £0.02 million each year. The Department estimates a benefit from increased returns to creditors resulting from growth of the restructuring market. Using the same method as for the moratorium proposal, the Department estimates a benefit of £4.0 million each year, based upon a (mid-point) 25 per cent growth in the market, making a net benefit of £3.98 million each year.

### **Quality of submission**

The IA is well-structured, written clearly and with a good level of monetisation. The IA includes sufficient information to support the rationale for intervention, citing support from the *World Bank* for the measures, reference to an EU directive with similar requirements and support from consultation for extending the *ipso facto* (termination) clause measure. The IA includes useful sections on non-regulatory alternative options and monitoring and evaluation plans. The RPC is content that the IA is sufficient for ministerial and parliamentary decision-making.

As noted above, however, the Department will need to submit a revised IA later in the year for validation of a BIT figure, addressing the points below. The impacts on business are large and subject to considerable uncertainty. Whilst the RPC accepts that estimates in this case will inevitably be subject to significant uncertainty, there are areas where the Department can address further the robustness of its estimates.

These include where evidence goes back to 2010 and where there is reference to, but little explanation of, additional evidence.

As described below, the present estimates of business impact differ significantly in places from those presented in the earlier assessments. Whilst the approach in the present IA appears to be more-developed, the IA should include an explanation for the main differences to earlier estimates to demonstrate further that the present figures are robust.

### Company moratorium

The monetised cost benefit impact of this measure is broadly neutral and approximately in line with the estimates in the 2016 consultation stage IA. The IA would benefit from addressing further the robustness of the estimates where:

- they appear to rely in significant part on evidence from many years earlier, in particular consultation in 2010 (paragraph 6.10, page 13);
- there have been changes to policy and where the Department acknowledges “*Due to the time constraints around these measures it has not been possible to update these figures via further consultation*” (paragraph 6.17). The Department has adjusted its estimates accordingly but there appears to be limited updated stakeholder evidence, or at least a need for further explanation in support of the adjustments. For example, regarding a widening of eligibility criteria, paragraph 6.27 states that “*The proposals have developed since the consultation stage, and these changes mean that instead of 10-20 cases the number of moratoriums could be between 1,000-1,500.*”; and
- there are references to further evidence being gathered (for example paragraph 6.12) but with little explanation.

The IA would benefit from explaining whether there are any additional costs to business creditors, such as lost interest from the arrears being frozen for 20 days.

### Suspension of *ipso facto* (termination) clauses

The estimates of business impact differ significantly from those presented in the earlier assessments referred to above. Whilst the approach in the present IA appears to be more-developed, the IA should include an explanation for the main differences to earlier estimates to demonstrate further that the present figures are robust. In particular:

*Benefits.* The data and assumptions used in the present IA are presented with those of the 2016 assessment (in brackets) as follows:

- 16,000 annual liquidations (13,700)
- 10 per cent avoided by the proposal (7 per cent)
- Average creditors' claim in an administration £6.3m (£1.2m)
- Average return of this to creditors 11 per cent (4 per cent).

The present proposal is much broader, going beyond essential supplies, but the saving per case appears to be markedly higher than in the 2016 assessment. An explanation for why the benefits are so much higher in the present IA would be helpful. The IA provides an explanation (paragraph 6.59) for choosing 10 per cent over 7 per cent (step 2 above); it would be helpful if the IA did the same for the other steps listed above.

*Costs.* The Department's estimated costs are much higher than in the previous assessments; as noted above, the new method produces an aggregate cost of around £290 million each year. The approach appears to be robust but supporting explanation for how the estimates compare to those previously estimated would be helpful.

The IA would also benefit from:

- addressing whether the cost of trade credit insurance might have increased, and exclusions added, in the present economic climate, and possibly as the product becomes more complex (with the number of options available to companies in distress expanding);
- stating whether or not suppliers could still have to bear the cost of deductibles or some other uninsured (or uninsurable) costs;
- providing further support for its approach to estimating the number of suppliers affected, in particular whether suppliers' lack of information on the financial strength of the companies they supply could mean that more suppliers might feel the need to take out such insurance; and
- explaining further the use of the cost of trade credit insurance to represent the impact on suppliers of an increased risk of bad debt and why this approach captures fully the impact on business (i.e. on the suppliers and/or their insurance providers).

A particular concern of the RPC is that the existing average cost of trade credit insurance, as used in the IA, which is presumably calculated from a wide range of suppliers with varying levels of customer financial risk, could significantly understate the cost to businesses supplying companies at heightened financial risk, on which the impacts of the proposals seem most likely to fall. The Department will need to address this issue before a business impact target figure could be validated.

Overall, a narrative providing a broad explanation for the overall scale of gross and net business impact, relative to the 2016 measure, would be helpful. The IA would also benefit from addressing how far it has made use of any post-implementation information relating to the measure introduced in 2016.

*Impacts on insurers.* The IA would benefit from assessing the impacts on insurers and reinsurers, such as familiarisation costs, any transition costs to change their products to reflect the new regime and possible increased administration costs resulting from the product being more complex. The IA could also address any benefits to insurers, such as increased profit from a larger market and any increase in premiums.

*Risk.* The risk of companies using this measure, and others in the Bill, to increase their debts, with consequent possible increased losses to creditors, appears to be mitigated by requirements for companies to meet ongoing trading costs and pay for continued supplies. However, the IA would benefit from addressing this issue explicitly.

### Flexible restructuring plans

The impact of this measure is estimated to be relatively small. However, the IA would benefit from explaining the sources of information, for example: “*Following stakeholder engagement, it is anticipated that in the normal course of business, there will be around 50-100 restructuring plans per year*”. (paragraph 6.82).

### Small and micro business assessment (SaMBA)

The SaMBA is short but sufficient, given that the measures will potentially benefit small and micro businesses at risk of going into liquidation, and small and micro businesses as creditors. As a temporary measure, small company suppliers will be exempt from the suspension of the *ipso facto* (termination) clauses measure during the Covid-19 emergency, given that many of these will also be facing financial constraints. The IA would nevertheless benefit from a more-detailed SaMBA, as for the continuity of essential supplies IA and as recommended in the RPC’s opinion of the consultation stage IA.



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### Business impact target (BIT) assessment

The IA does not include a BIT assessment section. It appears that all impacts on business are treated as being direct. The IA would benefit from a discussion supporting this treatment of the impacts on business being direct, with reference to RPC guidance.<sup>3</sup> In particular, the Department will need to provide support for its assessment that the benefit from flexible restructuring plans, which appears to result from the measure stimulating growth of the restructuring market, is a direct impact on businesses.

### Risk of double counting

The Department seeks to demonstrate that its assessment of impacts do not count the same cost or benefit twice, for example by explicitly taking account of transfers and acknowledging that some potential benefits of flexible restructuring plans have already been accounted for under the benefits of the company moratorium (paragraph 6.86). However, given that there are number of measures in the Bill in pursuit of very similar objectives, the IA would benefit from demonstrating more explicitly the absence of double counting, in particular explaining clearly where impacts are on different businesses or types of insolvency.

### Impacts on civil and voluntary organisations (CVOs)

The IA would benefit from discussing specifically the impacts of the measures on CVOs, and demonstrating that the estimated impacts on business take account of these impacts, where applicable.

### Impacts on public sector organisations

All of the monetised impacts appear to be on business (the societal and business net present figures have the same value). The measures would appear to have implications for public sector organisations, such as the Insolvency Service, the courts and the legal sector, and the IA would benefit from discussing these impacts.

### Options

The IA would benefit from addressing further why these measures are intended to be made permanent now, as opposed to being introduced as an emergency temporary measure (as with those in the annex to the IA), with an option to make them permanent.

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<sup>3</sup> <https://www.gov.uk/government/publications/rpc-case-histories-direct-and-indirect-impacts-march-2019>

The IA would also benefit from providing some assessment of the impact of the temporary exemption for small suppliers, for example on achievement of the policy objectives.

### Training costs

The Department monetises familiarisation costs to insolvency practitioners (IPs), corporate managers and directors (page 11). This usefully includes the cost to IPs of attending training courses. The Department should also address the opportunity cost of IPs attending this training.

### Risk to larger companies and post-implementation evaluation

As noted above, small company suppliers will be temporarily exempt from the suspension of *ipso facto* (termination) clauses. The IA and post-implementation review/evaluation would benefit from addressing further the risk that some larger suppliers may find themselves threatened with insolvency if they are forced to continue to supply to an insolvent company.

### Temporary suspension of some of the measures

The IA states that some elements of the permanent measures, such as the *ipso facto* measure in relation to small suppliers, will be suspended during the Covid-19 emergency. The Department's assessment assumes that all elements of the reforms are enacted, i.e. it estimates the impact of the measures in their longer term, "steady", state (paragraph 6.1, page 11). The IA would benefit from providing further details of the temporary suspensions and how long they are expected to last.

### Annex on temporary measures

The IA includes an annex describing temporary measures in the Bill and provides a shorter, largely qualitative assessment of their likely impact. As measures expecting to last less than 12 months, they are outside of better regulation framework requirements.

The annex provides a good description of these measures, their scope and the factors affecting an assessment of the likely impact, especially in relation to the measure providing 'flexibility on holding AGMs and other meetings'. This proposal and 'extending filing deadlines at Companies House' are clearly deregulatory and beneficial to business. The other two measures: 'temporary suspension of wrongful trading' and 'temporary suspension of statutory demand provisions and a restriction on winding up petitions' would appear to have a more mixed impact on business. The Department acknowledges that they shift some risk or cost onto creditors or commercial landlords. The annex provides a good discussion of why this risk can be

expected to be relatively low in relation to ‘temporary suspension of wrongful trading’. However, the annex would generally benefit from providing some further assessment of risks. For example:

- ‘*flexibility on holding AGMs and other meetings*’: further details on how concerns of smaller retail investors might be alleviated;
- ‘*extending filing deadlines at Companies House*’: how the risk of having a negative impact on the accuracy and timeliness of the data contained on the company register could be balanced when setting extended deadlines; and
- ‘*temporary suspension of statutory demand provisions and a restriction on winding up petitions*’: whether this measure covers landlords of residential accommodation (in addition to commercial premises) and, therefore, whether a significant proportion of the benefit falls on private tenants at the expense of businesses.

### Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£222.9 million
Business net present value	£1,918.5 million
Societal net present value	£1,918.5 million

### RPC assessment

Classification	Under the framework rules for the 2017-19 parliament: qualifying regulatory provision  To be determined once the framework rules for the current parliament are set
EANDCB	Not validated at this stage

Business impact target score	Not validated at this stage
Small and micro business assessment	Sufficient

Regulatory Policy Committee