

CORPORATE GOVERNANCE AND INSOLVENCY

Title: Corporate Insolvency and Governance Bill IA No: RPC Reference No: Lead department or agency: Insolvency Service (Exec Agency of BEIS)	Impact Assessment (IA)
	Date: 21/04/20
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Primary Legislation
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Summary: Intervention and Options	RPC Opinion: Green: fit for purpose; EANDCB not yet validated

Cost of Preferred (or more likely) Option (2019 prices, 2020 present value)			
Total Net Present Value	Business Net Present Value	Net cost to business per year	Business Impact Target Status
£1,918.5m	£1,918.5m	£-222.9m	Qualifying Provision

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

The Covid-19 emergency and the economic risks that it poses required the Government to look at the insolvency framework to consider whether reforms are necessary to ensure viable companies in financial difficulty have the opportunity to be rescued as a going concern. Existing UK insolvency law has some options for business rescue, but there are gaps when compared, for example, to best practice standards published by the World Bank and recent EU directives set out in the 2019 EU Restructuring Directive. The absence of some of the tools available in other jurisdictions may mean that some viable companies impacted by Covid-19 are not able to be rescued, resulting in liquidation and business closure. Adoption of these additional rescue support measures will strengthen the UK's insolvency framework and bring it up to international best practice; supporting viable

What are the policy objectives and the intended effects?

The reforms we propose will provide greater opportunities for company survival and better returns for creditors during and after the Covid-19 emergency. There is a short-term policy objective to give the UK economy more restructuring tools that are flexible to help UK companies get through the Covid-19 emergency and be able to continue trading when the economy emerges. In particular, the new moratorium will provide vital breathing space from creditor enforcement actions whilst a financially distressed company explores options for rescue. These measures will also have a longer term benefit of saving viable companies, maintaining productivity and preserving jobs.

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

Do Nothing & non-regulatory option: The impact of Covid-19 on companies and the UK economy would be higher as companies will lack the necessary restructuring tools to recover from the emergency. Without these reforms, a higher number of companies may end up in insolvent liquidation rather than be rescued, resulting in lost productivity and increased levels of redundancies.

Regulatory option (preferred option): This will introduce new rescue options into the UK's insolvency framework: company moratorium, suspension of Ipso Facto clauses and a flexible restructuring plan. These measures were previously announced in the Government response to a public consultation on corporate insolvency published in August 2018. It is important to introduce these measures now as part of the Government's support package to help UK companies get through and emerge from the Covid-19 emergency.

Will the policy be reviewed? Yes. If applicable, set review date: Within 5 years of commencement				
Does implementation go beyond minimum EU requirements?		N/A		
Is this measure likely to impact on international trade and investment?		No		
Are any of these organisations in scope?	Micro Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) N/A		Traded: n/a		Non-traded: n/a

CORPORATE GOVERNANCE AND INSOLVENCY

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister

Paul Scully

Date:

29-05-2020



Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2020	PV Base Year 2020	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 445.6	High: 3,462.0	Best Estimate: 1,953.8
COSTS (£m)		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)	
Low	65.1	1	219.8	1,957.4	
High	260.4		425.2	3,920.2	
Best Estimate	162.7		322.5	2,938.8	
Description and scale of key monetised costs by 'main affected groups'					
<ul style="list-style-type: none"> Familiarisation costs - cost to insolvency practitioners, corporate managers and directors to familiarise themselves with the new procedures and legislative requirements on the new measures, comes to a best estimate of £162.7m. Suspension of Ipso Facto (termination) clauses – mostly ongoing insurance costs to suppliers from being required to continue to supply, and legal costs in applying to a court to be exempt using the hardship claims, comes to a best estimate of £292.9m. Company moratorium – ongoing costs to companies and creditors from preparing eligibility reports, monitoring compliance, preparing legal material and creditor challenges, comes to a best estimate of £29.6m. Flexible restructuring plan – ongoing cost to creditors of disputing the provision of a restructuring plan comes to a best estimate of £0.02m. 					
Other key non-monetised costs by 'main affected groups'					
There are no non-monetised costs of this policy.					
BENEFITS (£m)		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)	
Low	0	0	507.2	4,365.8	
High	0		629.6	5,419.4	
Best Estimate	0		568.4	4,892.6	
Description and scale of key monetised benefits by 'main affected groups'					
<ul style="list-style-type: none"> Suspension of Ipso Facto (termination) clauses – ongoing benefits to creditors from both increased and continuing company rescue, improving overall returns. This comes to a best estimate of £534.1m. Company moratorium – ongoing benefit to creditors from reduced restructuring costs and benefits from better outcomes, comes to a best estimate of £30.3m. Flexible restructuring plan – ongoing benefit to creditors from improved returns from restructuring, and growth in the restructuring market, comes to a best estimate of £4.0m 					
Other key non-monetised benefits by 'main affected groups'					
<ul style="list-style-type: none"> Increased job preservation and reduction in social costs. Improved returns to unsecured creditors, helping the business community invest more. Improved returns to secured creditors, resulting in greater business lending and reduced risk premiums being charged on loans. 					
Key assumptions/sensitivities/risks				Discount rate (%)	3.5
<ul style="list-style-type: none"> Costs & benefits assume a steady state economy. The Covid-19 pandemic will have a significant impact on the economy and therefore will affect the initial take up of the proposed measures. Some aspects of the measures will not be applied during the Covid-19 pandemic, e.g. suspension of Ipso Facto clauses for small firms. As the measures are permanent and will be in force after the pandemic the analysis estimates impacts with full implementation. Some calculations are based on evidence gathered during a 2010 consultation. Due to time constraints, it has not been possible to update this evidence through further consultation. The risk of this has been mitigated to some extent by applying GDP deflators. 					

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs:	Benefits:	Net:	
£ 341.4	£568.4	£-227	-1,114.4

1. Background

- 1.1 This impact assessment covers reforms to the insolvency framework to bring the UK into line with international best practice for company rescue.
- 1.2 The Government is keen to introduce these reforms now as part of its response to Covid-19. They will enable UK companies, impacted by the economic lockdown, 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 while attempting to rescue their business.
- 1.3 The UK is recognised as being a world class place in which to do business, invest and innovate. Key to this are its corporate governance and insolvency framework. The insolvency framework in the UK is highly regarded internationally and is a key contributor to the UK being a great place to do business and invest. The World Bank's Doing Business rankings illustrate this reputation, and "Resolving Insolvency" is one of the measures that contributes to the UK's overall position in the rankings. In the most recent report¹, the UK was ranked 14th in the world for "Resolving Insolvency". However, the Covid-19 emergency and the economic risks that it poses have required the Government to look at the insolvency framework urgently, to consider whether it will ensure that businesses that would be viable but for the Covid-19 situation are able to be rescued.
- 1.4 The World Bank Principles of Effective Insolvency and Creditor/Debtor Rights Systems² takes account of international best practice in company rescue proceedings, and notes that jurisdictions that have an insolvency framework that focuses on rescue or restructuring (as opposed to one that favours liquidation or asset sales) usually provide better returns to creditors and stakeholders. There are several changes that could be made to improve the outcomes for UK companies in distress which the reforms aim to address, including greater use of moratoriums, the suspension of Ipso Facto termination clauses, and restructuring plans that provide the option of 'cram down' on dissenting creditors.
- 1.5 The Government consulted extensively on a range of reforms to the insolvency framework between 2016 and 2018 and published a response in August 2018³. Following publication, the Government announced that it would implement the measures when a suitable legislative vehicle became available.
- 1.6 The reforms aim to ensure that the existing framework delivers the best outcomes, as well as ensuring fair and efficient procedures to protect the rights and responsibilities of debtors and creditors. Insolvency procedures are an important part of the framework of corporate law and practice but must be set in context. The level of company insolvencies has historically been low compared to the size of the UK company population – around 1 in 240 companies become insolvent each year according to pre-Covid statistics⁴.
- 1.7 In addition to these insolvency framework reforms, the Government will announce temporary measures to address the immediate Covid-19 emergency. As these measures are of a temporary nature and are not subject to better regulation guidance, they are out of scope of this impact assessment. Further information on the temporary measures are included in the Explanatory Memorandum (EM) and Annex. For completeness, the Annex to the EM is attached to this IA.

¹ <https://www.doingbusiness.org/en/data/exploreeconomies/united-kingdom>

² World Bank (2015) Principles for Effective Insolvency and Creditor/Debtor Rights Systems - [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf)

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version_with_Minister_s_photo_and_signature__AC.pdf

⁴ <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2019>

2. Problem under consideration

- 2.1 The core corporate insolvency framework has remained largely unchanged since 2003 and changes in the way other nations approach dealing with financially distressed companies led to the Government seeking improvements to the existing framework.
- 2.2 Recent changes in the insolvency regimes in several different countries show a general convergence in the principle features of restructuring and rescue frameworks of sophisticated market economies. Certain ideas and approaches, with some modification for local conditions, appear to work well across the globe.
- 2.3 This is reflected in the World Bank's Doing Business methodology⁵, and in other texts such as the UNCITRAL⁶ Legislative Guide on Insolvency Law⁷, which give recommendations on the core provisions for an effective and efficient insolvency law. By way of illustration, the UNCITRAL Legislative Guide on Insolvency Law sets out provisions relating to a stay of enforcement action, treatment of contracts and a reorganisation plan in its examination of core features of effective frameworks. The proposed measures in this assessment were developed with these in mind and tailored to ensure the right fit for companies in the UK.
- 2.4 The onset of the Covid-19 pandemic has led to increased financial pressure on businesses, particularly where commercial activity has become restricted. Therefore, there is an urgent need to introduce these measures to support companies through this period, to mitigate the risk that viable companies in difficulty as a result of Covid-19 fail because the right tools for rescue and survival are not available.
- 2.5 Furthermore, without making enhancements to our current offering, the international reputation of the UK as a global restructuring hub will come under pressure and we are in danger of losing ground against other developed regimes. For example, the EU, where a new restructuring directive⁸ very similar to our own proposals came into force on 16 July 2019, and where its essential provisions must be implemented by Member States no later than 17 July 2021.
- 2.6 The measures to be introduced relate to company moratoriums, suspension of Ipso Facto clauses and flexible restructuring plans.

Company moratorium

- 2.7 A "moratorium" gives companies a period of protection during which they can identify, negotiate and agree a restructuring plan or other form of rescue. The World Bank recommends that a "stay of actions by secured creditors should be imposed"⁹ in reorganisation proceedings and that the "stay should be of limited duration... to strike a proper balance between creditor protection and insolvency proceeding objectives and provide for relief from the stay by application to the court".
- 2.8 The UK insolvency framework currently allows small companies only to access a moratorium through the Schedule A1 Insolvency Act 1986 moratorium, where directors propose a Company Voluntary Arrangement (CVA). This provides breathing space whilst they restructure their debts. However, a report noted just 8 companies used this mechanism in 2013¹⁰. This report recommended that a new form of pre-insolvency moratorium be introduced.
- 2.9 Introducing a new form of moratorium as envisaged by these measures will help provide companies of all sizes in financial difficulty breathing space to consider their rescue options.

⁵ <https://www.doingbusiness.org/en/methodology>

⁶ United Nations Commission on International Trade Law

⁷ See: http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html

⁸ <https://eur-lex.europa.eu/eli/dir/2019/1023/oj>

⁹ World Bank Principle C5.3

¹⁰ <https://www.wlv.ac.uk/news-and-events/latest-news/2018/june-2018/cva-reforms-needed-says-insolvency-and-restructuring-profession.php>

Suspension of Ipso Facto (termination) clauses

- 2.10 When a company enters an insolvency procedure, it can trigger clauses often found in supply contracts between the company in difficulty and their suppliers. These clauses currently permit suppliers to stop providing goods and services to the company if it enters into an insolvency procedure such as administration. Suppliers may use this clause to ask for additional payments (known as ransom payments) for supply to continue, particularly where the supply is essential to continued trading.
- 2.11 A 2013 survey of 249 insolvency practitioners found that in 41% of cases, key suppliers withdrew their supply and in 49% of cases, key suppliers asked for ransom payments¹¹.
- 2.12 Ipso Facto clauses can severely impede any chance of company rescue as it puts pressure at a critical time and diverts funds which could be used to facilitate rescue. Reducing the chances of a successful company rescue also increases the risk of redundancy for employees.
- 2.13 Such ransom payments may also result in certain creditors effectively receiving 'preferential' payments at the expense of other creditors, overriding the basic insolvency principle whereby all creditors within a class are treated equally.
- 2.14 On 1 October 2015, an amendment to the Insolvency Act 1986 was introduced, which ensures continuity of essential supply of utilities and IT goods or services to insolvent companies.
- 2.15 However, responses to the 2018 consultation showed widespread agreement for extending this measure¹², to cover other suppliers in addition to utilities and IT. This will help companies to continue trading while undergoing a restructuring process. This measure complements the other proposals - flexible restructuring plan and moratorium - to help facilitate company rescue.

Flexible restructuring plan

- 2.16 In the UK there are currently several options for companies seeking a restructuring of their debts. Many companies seek an agreement with their creditors on a consensual basis without the need to enter a statutory process. Where such an approach is not possible, legislation provides ways of achieving a binding statutory compromise, through a company voluntary arrangement (CVA)¹³ or a scheme of arrangement¹⁴. These statutory mechanisms are flexible and well-regarded internationally, they enable the company to negotiate with creditors to develop a proposal which is then put forward for approval.
- 2.17 In some cases, the negotiations between individual secured creditors and the company can significantly increase the cost and duration of the restructuring process. Particularly in cases involving complex capital structures and the need to obtain agreement amongst a diverse range of stakeholders. It can also lead to individual creditors leveraging their position to obtain a better outcome, at a cost to other groups of creditors, by holding out for a better deal, frustrating and delaying the restructuring process.
- 2.18 World Bank Principle C14.3 (which relates to reorganisation proceedings) refers to the need for clear criteria for plan approval based on fairness to similarly-situated creditors. It recommends that the law should provide the opportunity for plans or proposals to be approved if a minority of creditors reject it, on the condition that the plan complies with rules of fairness and offers the opposing creditors or classes an amount equal to or greater than would be received in a liquidation scenario¹⁵. One way to achieve this is a "cram-down" mechanism whereby restructuring plans can be imposed on dissenting creditors, providing they would be no worse off as a result than the plan not proceeding. To reflect that liquidation may not necessarily be the alternative outcome of a company proposing a restructuring plan, the comparator used in this measure is that the creditor will not receive less than in the 'next best alternative'.
- 2.19 Therefore, this measure follows the guidance from the World Bank to introduce a statutory, multi-class restructuring procedure, including a "cram-down" mechanism to aid company rescue.

¹¹ R3 and ComRes: Association of Business Recovery Professionals Membership Survey, August 2013, Termination Clauses.

¹² [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG - Government response doc - 24 Aug clean version with Minister s photo and signature AC.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version_with_Minister_s_photo_and_signature_AC.pdf)

¹³ Part 1 of the Insolvency Act 1986

¹⁴ Part 26 of the Companies Act 2006 Part 26 of the Companies Act 2006

¹⁵ [http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles\(3\).pdf](http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf) (page 51)

3. Rationale for intervention

- 3.1. Corporate insolvency will often result in losses to creditors and for the debtor company, a loss of value and the need to make employees redundant. It therefore creates strong incentives for those affected to engage in zero sum game behaviour.
- 3.2. Furthermore, corporate insolvency has a wide impact and can have consequences beyond the parties directly involved, often the loss of a vital business relationship can lead to knock-on effects on other firms – the “domino effect” in action. R3¹⁶ has estimated 1 in 4 UK companies were hit by this “domino effect” in the last 6 months of 2017¹⁷. The measures proposed will help mitigate this negative externality¹⁸ to some extent by supporting the rescue of firms and avoiding insolvencies which lead to this “domino effect”. The effect can be mitigated further by firms using trade credit insurance: this product protects a company from non-payment from businesses, avoiding knock-on effects from corporate insolvency.
- 3.3. Two of the biggest issues in company rescue, where government intervention may improve the overall outcome, are coordination problems and transaction costs.
- 3.4. **Coordination problems including ‘rent seeking’**^{19,20} - the ability of a minority of creditors to destabilise a negotiation process in the hope of extracting some commercial advantage (even where this is a worse outcome for creditors as a whole) by for example forcing early recovery of their debt, or by delaying response to compromise offers in the hope that others will compromise instead. A further potential difficulty is where smaller creditors, with little or no financial interest in the outcome, may stall negotiations as there is little incentive to participate. Creditors will act individually and be unaware of the broader impact that their actions will have on companies, causing company rescue to become more difficult and therefore worsening the position for all creditors.
- 3.5. **Transaction costs** - delays and difficulties in initiating and concluding negotiations (particularly in complex multi-creditor scenarios) can increase the costs associated with restructuring a company. Administrative costs, opportunity costs and the costs of any professionals employed to assist with restructurings all increase over time and contribute to the erosion of business value. Reducing these transaction costs, by making the regime flexible and accessible, will reduce the cost of restructuring companies.
- 3.6. Government intervention in insolvency and restructuring proceedings can minimise these effects by removing barriers, streamlining processes and regulating structures that promote successful company rescue, reducing insolvent liquidations of otherwise viable businesses. The measures proposed will help facilitate restructuring and rescue and avoid the negative consequences of opportunistic behaviour by some creditors. The measures are mutually reinforcing and aim to strike a balance between the interests of creditors and debtors, providing improvements for both through better returns, improved outcomes and preserving value by maintaining the company as a going concern if possible. As a result, an improved rescue regime could lead to enhanced job/skill preservation, improved competitiveness and productivity, and ultimately greater economic growth.
- 3.7. The impact of the Covid-19 pandemic means there is an urgent need to amend the UK’s insolvency framework to provide additional tools to support and rescue companies. The measures proposed by this package will do that.
- 3.8. The economy has already been impacted by Covid-19. PMIs²¹, consumer confidence²² and new job vacancy postings²³ have all fallen and Universal Credit claims have surged by over 1 million²⁴,

¹⁶ The Association of Business Recovery Professionals (trade body for insolvency practitioners), <https://www.r3.org.uk>

¹⁷ <https://www.r3.org.uk/press-policy-and-research/news/more/29093/store/459207/page/3//R3> Business Distress Index, Wave 25 - <https://www.r3.org.uk/press-policy-and-research/policy-research/r3-research-into-business-distress-issues/>

¹⁸ A consequence of an activity which affects other parties without this being reflected in market prices

¹⁹ Rent seeking aims to increase one’s share of existing wealth without creating any benefits or new wealth.

²⁰ seeking to extract value through manipulation as opposed to seeking to add value through economic transactions

²¹ <https://www.markiteconomics.com/Public/Home/PressRelease/61f043b216da42618ff2559dd8435bc6>

²² <https://www.gfk.com/en-gb/insights/press-release/uk-consumer-confidence-decreases-by-two-points-to-9-for-march-2020/>

²³ <https://www.resolutionfoundation.org/publications/the-economic-effects-of-coronavirus-in-the-uk/>

²⁴ <https://www.gov.uk/government/organisations/department-for-work-pensions/about/statistics>

while over 500,000 businesses have been identified as being in significant or critical distress²⁵. These early data points are consistent with a downturn that could be more severe than in 2008/09. The possibility of this has been echoed by the IMF²⁶ and OBR²⁷. Early models of the impact of Covid-19 have suggested that UK GDP growth in 2020 as a whole could range between -3%²⁸ and -13%²⁹, with scenarios for corporate insolvencies ranging from 30,000 to 160,000³⁰.

- 3.9. Historically, the number of company insolvencies increased by over 50% during the financial crash of 2008/09, and it more than doubled in the 1990s recession³¹. In a “normal” year c.200k jobs and c.£23bn of output are lost to insolvency³², so a 50% to 100% increase (or greater) would have a severe effect on businesses, individuals and supply chains.

4. Policy Objective

Company Moratorium

- 4.1 The policy objective is to give struggling companies a short period of protection during which they can negotiate and agree a restructuring plan or other form of rescue, which may give companies a better chance of survival.
- 4.2 Action taken by creditors can cause viable companies to fail unnecessarily because they do not have any time to look at rescue options. This adversely affects the interests of the company, its creditors and employees, as well as the wider economy where companies are forced into formal insolvency proceedings, which might otherwise be rescued. Other than formal insolvency, there is no process via which distressed companies can seek temporary protection from enforcement action taken by creditors. This means that there is little opportunity for a company to properly explore rescue options.
- 4.3 The main purpose of the moratorium will be to provide a period of protection or “breathing space” for companies in which they can plan their rescues free from creditor enforcement action which may result in the forced closure or cessation of the business. When a company enters the moratorium, the arrears owed to creditors at that point will be frozen and no creditor can commence or continue legal action against the company, but the company will be obliged to meet ongoing trading costs during the moratorium. This will then provide companies with a “breathing space” that will allow them to consider the best option for the company. The key element of the proposal being that the moratorium will last for 20 business days, with the possibility of an extension to 40 business days (and beyond 40 business days with the agreement of creditors or the permission of the court).
- 4.4 The intention is that the moratorium will allow directors to seek the best solution for the distressed company whilst protected from creditor enforcement action. This could be a consensual agreement with creditors or a formal insolvency procedure such as a CVA, administration, scheme of arrangement or restructuring plan or securing new finance. A restructuring that has benefited from increased planning time is more likely to result in a stronger, more resilient company going forward.
- 4.5 In order to be eligible, the company should be insolvent or likely to become insolvent, and its rescue as a going concern should be more likely than not. As a temporary-measure, this “rescuability” criterion will not apply, to make it easier for companies which would be viable but for the Covid-19 emergency to access the regime. (Stakeholders advise that “rescuability” in the current circumstances is a difficult judgement to make.)

²⁵ <https://www.begbies-traynorgroup.com/news/business-health-statistics/coronavirus-pushes-financially-distressed-companies-over-the-half-million-mark>

²⁶ <https://blogs.imf.org/2020/04/06/an-early-view-of-the-economic-impact-of-the-pandemic-in-5-charts/>

²⁷ <https://obr.uk/coronavirus-reference-scenario/>

²⁸ <https://www.pwc.co.uk/services/economics-policy/insights/uk-economic-update-covid-19.html>

²⁹ <https://obr.uk/coronavirus-reference-scenario/>

³⁰ <https://www.capitaleconomics.com/clients/publications/uk-economics/uk-economics-update/business-insolvencies-to-reach-same-level-as-the-gfc/>

³¹ <https://www.gov.uk/government/statistics/insolvency-statistics-october-to-december-2013>

³² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/780091/Commentary_domain_update.pdf

- 4.6 During the moratorium, no legal action can be taken or continued against the company without leave of the court. A company in a moratorium will remain under the control of its directors with the moratorium overseen by a monitor (a licensed insolvency practitioner). If it becomes clear that the company cannot be rescued, the monitor must bring the moratorium to an end and creditors will be able to enforce their debts again.
- 4.7 These proposals will keep the UK's restructuring framework in line with international best practice, including recent EU developments.

Suspension of Ipso Facto (termination) Clauses

- 4.8 This proposal will prohibit the enforcement of "termination clauses" in contracts for the supply of goods and services. This means suppliers will have to continue to fulfil their commitments under contract with the debtor company in the event of insolvency, or entering a moratorium, even where there are pre-insolvency arrears. This would prevent companies from being held 'hostage' by key suppliers that ask for additional "ransom" payments. However ongoing continued supplies must be paid for.
- 4.9 The provision would cover administration, compulsory and voluntary liquidation, company voluntary arrangements as well as the proposed new procedures of moratorium and restructuring plan. The company must be able to meet its post-entry obligations to affected suppliers as and when they fall due. Suppliers will retain the ability to terminate contracts on any other ground permitted by the contract such as non-payment of liabilities.
- 4.10 To mitigate the transference of risk onto suppliers, there will be a statutory 'hardship provision' to protect suppliers that cannot (rather than will not) supply. Furthermore, as a temporary measure, small company suppliers³³ will be exempt from the requirement during the Covid-19 emergency, which represents 99% of the business community, although 63% of turnover is through businesses that do not fall within the definition of a small business³⁴.
- 4.11 The aim is that this will create a valuable tool to help companies restructure and provide better returns to creditors, particularly when used in conjunction with other insolvency and rescue tools. Viable companies (and the jobs of those that they employ), that would otherwise fail, will be rescued as a going concern to the benefit of the wider economy.
- 4.12 Furthermore, avoidance of ransom payments will lead to a fairer distribution of available funds to the general body of creditors as well as supporting working capital requirements for going concern trading.

Flexible restructuring plan

- 4.13 This measure will involve the creation of a new restructuring procedure (restructuring plan) proposed by a company or its creditors (expected to almost always be the former).
- 4.14 Under it, creditors will be divided into separate classes, by similar type and priority, by the proposer. After class division is approved by the court, creditors (and shareholders if relevant) vote on the proposed restructuring plan. The plan will bind all creditors (and members) if more than 75% of creditors, by value, vote in favour in each class.
- 4.15 Whole classes of creditors (and members) that vote against the proposed restructuring plan can be crammed down if the court agrees it is fair and equitable to do so. The court would only sanction a cramdown where it was satisfied that the dissenting creditors would receive no less than they would in the next best alternative scenario such as an administration or liquidation.
- 4.16 By introducing a new mechanism for developing restructuring plans, the measure will address the scenario where a relatively junior ("out of the money") secured creditor can block a company rescue, despite the proposals being supported by more than 75% of senior secured creditors by value.

³³ The definition of small business is any business with 0-49 employees <https://www.gov.uk/government/publications/business-population-estimates-2019/business-population-estimates-for-the-uk-and-regions-2019-statistical-release-html>

³⁴ <https://www.gov.uk/government/publications/business-population-estimates-2019/business-population-estimates-for-the-uk-and-regions-2019-statistical-release-html>

- 4.17 To prevent abuse of the cram down mechanism, the new procedure will have several safeguards, such as court oversight, to make sure creditors' rights and interests are duly considered at all stages of the process.
- 4.18 The impact of this measure is that companies with viable businesses that are struggling to meet debt obligations, can restructure with limited disruption to their operations. This will facilitate company rescue and over the longer term boost returns to creditors and support job preservation.
- 4.19 This type of plan is a key element of the EU 2019 directive³⁵ on preventive restructuring frameworks.

5. Description of options considered

Do Nothing

- 5.1. The impact of Covid-19 on business would be higher, with fewer mechanisms for rescue available. The outcome of this will be an increased number of insolvencies, more job losses and an increased negative impact on the UK economy.
- 5.2. In addition, the UK would fail to improve upon the framework and would not realise the benefits of more successful company rescues with higher returns to creditors, job preservation and productivity maintained.

Option 1: non-regulatory option

- 5.3. In the absence of regulation, an alternative could be to increase awareness and use of current options already available. However, compared with regulation, there will be fewer options and support available to companies during the Covid-19 emergency, meaning a greater negative impact on the UK economy.

Company Moratorium

- 5.4. Existing procedures, such as the small companies Schedule A1 Moratorium, and administration, offer a mechanism for companies seeking a period of breathing space. Greater use of these procedures could help companies access protections.
- 5.5. However, the Schedule A1 Moratorium is restricted to small companies and used very rarely with just 8 cases in 2013. Administration provides a moratorium for the company, however this is part of a formal insolvency process, whilst the company moratorium offers a breathing space upstream of this to provide a better rescue alternative. Administrations rarely lead to a company being saved as a going concern (1.3% of cases), based on a random sample of 469 administrations starting after 2016 sourced from Companies House.
- 5.6. Through existing procedures only, a small proportion of companies in financial difficulty can access moratorium protections therefore a regulatory option is needed.
- 5.7. Aside from increasing awareness and use of current alternatives, the Government could work with creditors to encourage increased use of forbearance. This could offer similar protections to that of a company moratorium. Forbearance is available to the SME sector but is not a regulatory requirement, unlike personal finance where it is. Research has shown 6% of borrowers are in receipt of forbearance³⁶, this was mainly composed of waivers on loan conditions with few cases of direct payment relief and so rarely offered a period of breathing space. Therefore, a regulatory alternative is necessary to achieve the policy objective.

Suspension of Ipso Facto (termination) clauses

- 5.8. On 1 October 2015, an amendment³⁷ to the Insolvency Act 1986 commenced, which ensures continuity of essential supply of utilities and IT goods or services to insolvent companies.
- 5.9. Consequently, only a small number of suppliers are covered by existing legislation and the issues with ransom payments impeding company rescue and equitable distribution to creditors remain.

³⁵ <https://eur-lex.europa.eu/eli/dir/2019/1023/oj>

³⁶ <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/220518-boe-governor-110618.pdf>

³⁷ <https://www.legislation.gov.uk/ukxi/2015/989/introduction/made>

The business community could be encouraged to not include termination clauses in contracts to address this, however company insolvency increases risks and termination clauses are a means to mitigate this so encouragement alone will not change behaviour.

5.10. Therefore, a regulatory alternative is needed to address the problems identified.

Flexible restructuring plan

5.11. The Government could encourage the use of existing restructuring mechanisms such as the Companies Act 2006, Schemes of Arrangement. However, this will not address the issue of certain creditors blocking restructuring to the detriment of most creditors, undercutting the principle of fairness in insolvency as the scheme does not provide any mechanism for 'cram down' between classes.

5.12. Negotiations and restructuring can often incur high costs and without a 'cram down' mechanism reaching an agreement can prove costly. This non-regulatory approach would ignore international best practice consensus, and as a result UK companies may be forced to relocate to another jurisdiction (forum shopping) in order to achieve a successful restructuring.

5.13. As with 'do nothing' the non-regulatory option would not meet the policy objective.

Option 2: Regulatory option (preferred option)

5.14. The second option is to introduce new measures via legislation. This is the preferred option and the only option that will deliver the policy objectives.

5.15. Following the impact of Covid-19, the need to introduce new measures has become more urgent, given the increased risk to business and the UK economy. Therefore, measures that will most benefit company rescue have been picked out from the consultation and could be given effect via emergency legislation.

5.16. The three proposed measures are outlined in full in the policy objective section.

6. Costs & Benefits

6.1. Some elements of these permanent measures will be suspended during the Covid-19 emergency. For example, the Government does not believe that suspension of Ipso Facto clauses should apply to small suppliers given that many will be facing financial constraints during the Covid-19 emergency. However, for the purposes of this impact assessment we assume that all elements of the reforms are enacted. It therefore shows the impact of measures in their longer term, "steady", state and does not account for possible increases in insolvencies as a result of the Covid-19 pandemic.

Familiarisation costs

6.2. Insolvency practitioners (IPs) will have to spend some time familiarising themselves with the changes to ensure they can carry out their duties in accordance with the law.

6.3. The trade body R3 runs regular training sessions for IPs and it is likely that these changes would be incorporated into those programmes. The costs of these programmes vary according to the type of membership, venue and subject but a half day course typically costs around £180 and a full day course around £400. As we are unaware at this stage of the degree of training that will be required, we will use these two estimates as upper and lower boundaries.

6.4. As of 1 January 2019, there were 1,244 appointment taking IPs³⁸; we assume that each of these will complete the training course to learn about the new requirements. This gives a range for the cost of familiarisation of £0.22m to £0.50m.

6.5. In addition to IPs, corporate managers and directors will also need to familiarise themselves with the proposed changes. We propose that directors will need to spend up to half a day (1-4 hours) to familiarise themselves with the new measures, not through formal training (as in the case of IPs)

³⁸

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/807755/Annex_1_Annual_Review_of_IP_Regulation_2018_Final.pdf

but through for example their existing channels for keeping up to date with regulations such as reading trade journals. Using the Annual Survey of Hours and Earnings³⁹, there are around 2.4m corporate managers and directors at an hourly rate of £22.92. This hourly rate then needs to be increased by 18%⁴⁰ to account for non-wage costs, giving a total hourly rate of £27.05. This gives a range of familiarisation costs per corporate manager and director as £27.05 - £108.14 and a total cost of familiarisation for directors and managers of £64.9m - £259.6m.

- 6.6. This gives a total cost of familiarisation as between £65.1m and £260.4m and a best estimate of £162.7m.

Company moratorium

- 6.7. This measure will introduce a new moratorium to cover all companies in difficulty which will replace the current Schedule A1 Moratorium that is only available to small companies entering a CVA. The moratorium aims to provide a protected period for companies allowing them to consider the best decision for the company and enables “breathing space” during which a restructuring agreement can be negotiated with creditors. 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.
- 6.8. 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. This may mean a consensual agreement with creditors or a formal insolvency procedure such as a CVA, administration, scheme of arrangement or restructuring plan. In order to be eligible for a moratorium the company must be insolvent or likely to become insolvent and rescue is a reasonable prospect. A company in a moratorium will remain under the control of its directors with the moratorium overseen by a monitor (a licensed insolvency practitioner) who will assess eligibility.
- 6.9. The costs and benefits of the moratorium proposal are summarised in Table 1 and are more fully explained in subsequent paragraphs.

Table 1: Cost and benefits of Company Moratorium

Type of cost/benefit	Impact	Minima £	Maxima £	Best Estimate £
Ongoing cost to companies / creditors	Cost of preparing a report on eligibility	7.0m	10.5m	8.8m
	Costs of monitoring compliance with the moratorium	6.4m	9.6m	8.0m
	Costs of preparing legal material to authorise the breathing space	10m	15m	12.5m
	Cost of creditor challenges during moratorium period	0.04m	0.54m	0.29m
Total Cost				29.6m
Ongoing benefit to creditors	Benefits of enabling restructuring of distressed companies to be completed at a lower cost and in a faster time	3.2m	47.4m	25.3m
	Benefits to creditors from better outcomes			5m
Non-monetised benefits	Increased job preservation reduction in social costs			

³⁹ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>

⁴⁰ https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Hourly_labour_costs_in_euro_in_2019.png

CORPORATE GOVERNANCE AND INSOLVENCY

Type of cost/benefit	Impact	Minima £	Maxima £	Best Estimate £
	Improved returns to unsecured creditors helping the business community invest more			
Total benefit				30.3m

Minima – The lowest estimate composed of lowest estimate calculated on 1,000 cases

Minima – The lowest estimate composed of lowest estimate calculated on 1,500 cases

Best estimate – calculated by taking the midpoint per case and calculating on 1,250 cases

Costs/Benefits of moratorium

6.10. The 2010 consultation⁴¹ is the most recent source of evidence on the costs and benefits of the proposed changes. Evidence provided by respondents identified 4 areas of monetised costs and benefits that could arise from the proposed changes. Given the length of time since the consultation all the evidence provided has been updated to account for the time value of money using GDP deflators⁴².

6.11. Broadly the 6 areas were:

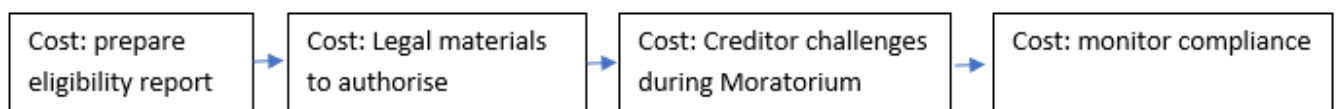
- Benefits of enabling the restructuring of distressed companies to be completed at a lower cost and in a faster time;
- Benefits to creditors from better business outcomes;
- Costs associated with preparing a report on eligibility for a breathing space by a nominated person;
- Costs of monitoring compliance with the terms of the breathing space for the period it is in force;
- Costs of preparing legal material to authorise the breathing space; and
- Cost of creditor challenges during moratorium period.

6.12. Further evidence has been gathered on the benefits of restructuring through Companies House and other sources to understand the benefits to creditors through better outcomes.

6.13. The eligibility criteria set for the moratorium, that the company is insolvent or likely to become insolvent and rescue is a reasonable prospect is akin to existing insolvency procedures such as administration (and may replace some of them), we therefore estimate around 1,000-1,500 cases will use this procedure annually (though this may be higher during the Covid-19 emergency).

Monetised costs

6.14. Introducing a new moratorium process into the insolvency framework will result in new processes and costs being imposed on users. The figure below illustrates the processes required to introduce a Moratorium in chronological order and costs.



6.15. The moratorium will require a nominated person to produce a report on the proposed plan. The 2010 consultation stated the costs would be £0.006m to £0.05m, whilst some respondents felt that the cost would be higher. However, since the Government response the eligibility criteria has been changed enabling more companies to use the moratorium, many are likely to be smaller resulting in lower costs. Therefore, taking the lower end of the range of costs appears reasonable. Applying GDP deflators provides a new estimate of **£7,000** per case.

⁴¹ Copies of the 2010 consultation stage impact assessment are available at the National Archives <http://webarchive.nationalarchives.gov.uk/20120407112234/http://www.bis.gov.uk/insolvency/Consultations/Restructuring?cat=closedwithresponse>

⁴² <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-march-2020-budget>

- 6.16. The next step is to seek legal agreement to enter the moratorium. This will require legal costs in producing materials and preparing a notice to file at the court to obtain the moratorium. Creditors can also dispute this which will incur additional costs.
- 6.17. The stakeholder response to the 2010 consultation occurred before changes to the policy. Due to the time constraints around these measures it has not been possible to update these figures via further consultation. Therefore, in the absence of updated figures wage costs have been used to estimate costs. The production of legal materials will require an insolvency lawyer and typical hourly costs are around £250/hour⁴³. The legal materials may take around a week to produce costing **£10,000 per case (40 hours in a week x £250/hours) this will be used as a working assumption of the costs of the legal agreement.**
- 6.18. Court applications will be required of creditors and other interested parties where they wish to challenge the decisions of the insolvency professional supervising the moratorium (the monitor), the basis of the moratorium, or the actions of the company's directors during the moratorium period. Following engagement with stakeholders we expect that only a small percentage of moratoriums, 1%, will generate a high level of dissatisfaction amongst creditors such that they will wish to make a court challenge (bearing in mind the costs, the involvement of the independent monitor, and that the purpose of the moratorium is to allow directors to deal responsibly with the company's financial affairs). **If 1% of moratoriums were to lead to a court application, then there might be 10-15 per year.** On average there are 9 creditors per case according to Insolvency Service management information so between 90 and 135 affected creditors could be involved in cases. In a case it is possible for more than one creditor to challenge, so using a range of challengers per case of between 1 and 9 gives a total number of challengers between 10 and 135.
- 6.19. Estimating the cost per case is difficult as this will vary on a case by case basis. The size of the costs will depend on the level of dispute and time it takes to reach agreement. Similar challenges to insolvency court procedures have been estimated to cost business around £4,000 per case resulting in an **ongoing cost to business of £40,000-£540,000 with the midpoint £290,000 the best estimate.**
- 6.20. Following authorisation, the nominee will need to monitor compliance until the moratorium completes, which is 20 business days with the possibility to extend to 40 business days. The consultation considered a moratorium of 3 months in length and estimated this would cost between £0.1m and £1.8m per case to monitor compliance.
- 6.21. However, at the consultation stage the moratorium was still in policy development and the criteria for eligibility has changed markedly since, with the expected users of the procedure increasing from 10-20 to 1,000-1,500 per annum. Consequently, a greater number of smaller and less complex companies will be using the moratorium reducing monitoring costs.
- 6.22. The eligibility criteria set for the moratorium, that the company is insolvent or likely to become insolvent and rescue is a reasonable prospect is akin to that for company administration. Therefore, it would be reasonable to assume that the costs involved would be similar.
- 6.23. A data collection by the Insolvency Service⁴⁴ showed insolvency practitioners received on average £77,000 in remuneration per case. Administrations on average last 12 months resulting in a monthly cost of £6,400.
- 6.24. A period of 20 business days is broadly equivalent to one month thus the **costs should be around £6,400 per case.** The likely cost may be lower than this as the duties of an Administrator include tasks such as realisations which would not be undertaken when monitoring a moratorium, though this may be offset by some moratoriums being extended. Our assumption is that these factors will net off at zero.
- 6.25. Collectively the best estimate of costs for producing a report, getting legal agreement for the breathing space and monitoring compliance will cost £23,400 per case. We previously estimated that between 1,000 and 1,500 cases might make use of the moratorium, taking the midpoint of 1,250, **the best estimate of the total cost to business will be £29.6m.** This represents an

⁴³ <http://www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1316.pdf>

⁴⁴ Insolvency Service Data Collection, 2020

ongoing annual cost to business from this new regulatory procedure which is in scope of the business impact target.

Monetised benefits

- 6.26. At the consultation stage⁴⁵ the eligibility test for a moratorium differed from the current proposals. The respondents expected few companies to make use of the measure in that form as alternative options were available. Some respondents felt that the alternative options could achieve objectives of quicker resolution at lower cost. Therefore, the consultation stage impact assessment estimated that few companies would use the measure, perhaps 10-20 a year. The estimates of costs/benefits and uptake in the previous impact assessment were based on the measures in their old form and limit the extent they can be used to assess impact in this impact assessment.
- 6.27. 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.
- Therefore, given the differences between these groups of cases we will treat them separately in the impact assessment. The benefits for the 10-20 cases covered in the consultation can be calculated using the consultation response. This group will benefit most from the cost savings in the moratorium.
 - The remaining cases are insolvent or likely to become insolvent with a reasonable prospect of rescue akin to an administration. The benefits can be calculated by estimating the improved outcome of these cases following the moratorium compared to the counterfactual of simply entering an administration.
- 6.28. For the 10-20 cases covered in the consultation the moratorium should enable directors and insolvency practitioners time to negotiate and implement a restructuring plan and find a solution efficiently. This will benefit company rescue with significant cost savings from restructuring and refinancing. Evidence in the consultation estimate the costs of restructuring varied significantly between £2m and £15m and that cost savings could be in the order of 10-20 percent of costs. After uprating for inflation this equates to cost savings per case between £0.23m and £3.51m. These savings are primarily derived from reduced time spent co-ordinating divergent creditors' interests, including lower costs on legal fees and other professional services to reach agreement.
- 6.29. This cost saving will be passed on directly to creditors in the form of higher returns. However, some of these benefits will accrue to non-business creditors such as HMRC. An analysis of a random un-weighted sample of 125 records filed at Companies House over a 3-year period, and an OFT market study⁴⁶ of insolvency practitioners, estimated that non-businesses such as HMRC accounted for around 10% of the returns to creditors.
- 6.30. This results in cost savings to business per case between £0.21m and £3.16m. An estimated 10 to 20 cases will occur each year, taking the midpoint of cases, i.e. 15, this equates to an estimated range of benefits between £3.2m and £47.4m, and using the midpoint as best estimate the **ongoing benefit to business is £25.3m. As direct benefits from the change in legislation they are in scope of the business impact target.**
- 6.31. Other benefits will arise from two routes:
- Firstly, some firms within administration will have the possibility of using the moratorium to restructure, e.g. CVA or other restructuring arrangement, improving creditor outcomes.
 - Secondly, the use of administration could be reduced as it is no longer necessary to enter administration to effect a CVA or other form of restructuring.
- 6.32. Data from Companies House and the Insolvency Service data collection provides evidence on the outcomes following administration.
- 6.33. The table and Sankey diagram below show the process following Administration. The data are from a random sample of 469 administrations starting after 2016 sourced from Companies House.

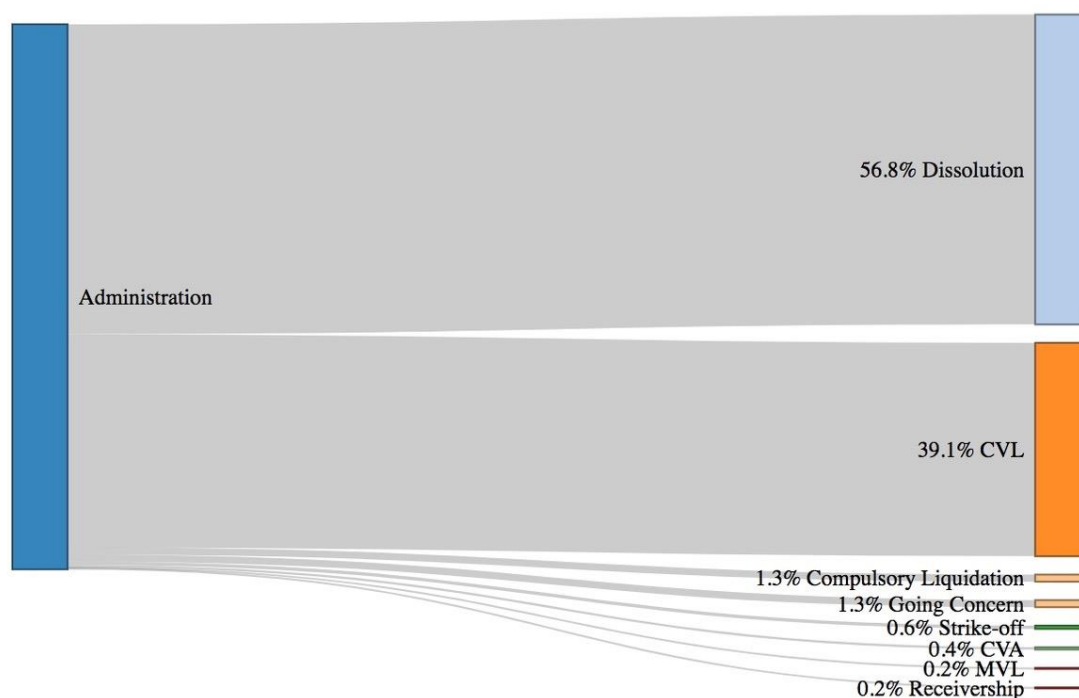
⁴⁵https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf

⁴⁶http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/shared_of/reports/Insolvency/of1245

Table 2: Process following administration

Process after administration	Number	Percentage
Dissolution	266	56.8%
Creditors voluntary liquidation (CVL)	183	39.1%
Compulsory Liquidation	6	1.3%
Going Concern	6	1.3%
Strike-off	3	0.6%
Company voluntary arrangement (CVA)	2	0.4%
Members' voluntary liquidation (MVL)	1	0.2%
Receivership	1	0.2%

Source: Companies House Data Collection of 469 administrations

Figure 1: Sankey diagram of process following administration

- 6.34. The data collection shows that saving the company as a going concern (1.3%) or performing a restructuring such as a CVA (0.4%) following an administration is uncommon with only 1.7% of cases falling in these groups.
- 6.35. Use of the moratorium to restructure should increase the numbers of CVAs, restructurings and companies saved as a going concern. Therefore, of the 1,000-1,500 moratoriums, we estimate that 2%, around 20-30, may move into better outcome, such as a CVA, rather than administration following moratorium.
- 6.36. The benefit of 20-30 cases moving from **administration to CVA/restructuring** can be calculated by assuming the return in restructuring is at least as good as that in a CVA. The average unsecured creditor claims in an administration is £3.1m and an analysis of filings at Companies House of CVAs and administrations that commenced in 2012/13 estimated that unsecured

creditors received 6.75% more from a CVA than an administration. The OFT Market study shown 24% of unsecured creditor claims were from non-business creditors. The benefit to business creditors per case (6.75%*3.1m*76%) will be £159,000 and consequently the benefit to business creditors will be between £3.2m and £4.8m with a **best estimate of £4m**.

- 6.37. Separately, other data shows that many companies were not able to conduct a restructuring and used **administration as a mechanism to effect a CVA** or other form of restructuring. With the introduction of a moratorium companies should be able to restructure without resorting to administration, saving time and money. Companies House data shows that around 1% (48/5,059) of administrations entered a CVA following administration⁴⁷. Based on the number of moratoriums this corresponds to 10-15 cases.
- 6.38. To estimate the benefit to creditors in these cases we consider that the benefits to avoiding administration must be at least as high as those that can be secured in administration. This provides a lower bound to our estimate of benefits to avoiding administration. As the counterfactual is that without intervention companies would enter administration the net benefit is zero in the lower bound.
- 6.39. An upper bound for the benefit can be calculated by assuming all 10-15 cases will avoid an administration and move into CVA/restructuring. With an assumption that the return in restructuring is at least that in a CVA. The average unsecured creditor claims⁴⁸ in an administration is £3.1m⁴⁹ and an analysis of filings at Companies House of CVAs and administrations that commenced in 2012/13 estimated that unsecured creditors received 6.75% more from a CVA than an administration. The OFT Market study shown 24% of unsecured creditor claims were from non-business creditors⁵⁰. The benefit to creditors per case (6.75%*3.1m*76%) will be £159,000 and consequently the benefit to creditors will be between £1.6m and £2.4m with a best estimate of £2m.
- 6.40. **The mid-point between the upper and lower bound can be used to estimate an ongoing benefit to business creditors from avoiding using administration as a route to restructuring. This amounts to £1m. The total benefits from improved business creditor outcomes from the moratorium is £5m, made up of £4m from improved restructuring outcomes for business creditors for companies in administration, and £1m from avoiding using administration as a route to restructuring.**

Non-monetised benefits

- 6.41. The measure will result in significant ongoing cost savings to business from restructuring and refinancing as well as improved outcomes.
- 6.42. The savings will potentially save jobs leading to wider benefits, e.g. wellbeing of workforce, fewer social problems and fewer impacts on mental health. Businesses will benefit from the preservation of business value, valuable knowledge and goodwill through the moratorium and improved restructuring outcomes.
- 6.43. This will also improve returns to unsecured creditors – most often small businesses trading with other businesses. Unsecured creditors tend to receive low returns due to their position. This will improve returns, benefiting the business community through making more money available to invest in business.

Suspension of Ipso Facto (termination) Clauses

- 6.42 This section considers the costs and benefits of suspending Ipso Facto clauses. A summary of the costs and benefits is set out in Table 3.

⁴⁷ This differs to the data collection as it is based on the population of completed administrations over the latest 5 year period giving a more accurate figure whilst the data collection is based on a sample of administrations.

⁴⁸ A CVA affects the rights of all the company's unsecured creditors. Secured and preferential creditors only affected if they agree to proposals. Only unsecured creditors vote on a CVA proposal.

⁴⁹ Insolvency Service Data Collection, 2020

⁵⁰ http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.offt.gov.uk/shared_offt/reports/Insolvency/oft1245 An Office of Fair Trading (OFT) study found that on average HMRC debt accounted for 24% of total unsecured debt (based on 384 records for which data was available). (See page 18 footnote 6)

Table 3: Costs/benefits of suspension of Ipso Facto (termination) clauses

Type of cost/benefit	Impact	Low £	High £	Best Estimate £
Ongoing cost to suppliers	Increased cost to suppliers from loss of termination clauses	193.1m	386.2m	289.6m
	Legal cost to suppliers from hardship claims			3.3m
Total Cost				292.9m
Ongoing benefit to creditors	Increased company rescue leading to improved returns			499m
	Continuing company rescue leading to improved returns	0m	70.2m	35.1m
Non-monetised benefits	Increased job preservation, reduction in social costs			
	Improved returns to unsecured creditors helping the business community invest more			
	Improved returns to secured creditors resulting in greater business lending and lower risk premiums being charged on loans			
Total benefit				534.1m

*Costs/Benefits of proposal**Monetised Costs*

- 6.43 A company is considered to be insolvent if either the value of its assets is less than the value of its liabilities and/or it is unable to pay its debts as and when they fall due. When a company enters insolvency the risk to suppliers increases since the company cannot service liabilities and may well already have defaulted on its debts. To mitigate this risk suppliers often include “Termination Clauses” in contracts to enable them to cease supply at the point of insolvency. The prohibition of termination clauses imposes a cost to suppliers and transfers risk to them. The supplier will be obliged to continue supply beyond the point of entering an insolvency procedure, unless the supplier has grounds to terminate, incurring the risk of non-payment should the debtor company be unable to meet its liabilities.
- 6.44 Businesses can mitigate these losses by taking out trade credit insurance. This product works by insuring a firm’s debtor book against payment defaults. The cost of this insurance varies between 0.1 and 1% of business turnover, though for most firms this is 0.15-0.3%⁵¹. Using these as a range of estimates we can use 2019 Business Population statistics to calculate the average turnover of businesses and estimate cost per supplier. The turnover of all businesses is £4.15 trillion and dividing by the number of businesses, 5.9 million, average turnover is £707,000⁵². This means the average cost of insurance per supplier is estimated to be between £1,060 and £2,120.
- 6.45 Trade credit insurance is not a new product. The Association of British Insurers, whose members cover 90% of the UK domestic insurance market, show that £315 billion of turnover is already

⁵¹ <https://rowlands-hames.co.uk/how-much-does-credit-insurance-cost/>

⁵² Table 1: 2019 Business Population estimates. Total Turnover of Business/Number of Businesses
<https://www.gov.uk/government/statistics/business-population-estimates-2019>

insured⁵³. The ONS Business Population estimates show £4.15 trillion of business turnover in the UK, thus 8% of UK business turnover under the measures is already insured.

- 6.46 The measure applies to administration, compulsory and creditors' voluntary liquidation, CVAs as well as the proposed moratorium and flexible restructuring plan. Published insolvency statistics show that there were 18,200 procedures in scope during 2019⁵⁴; whilst we estimate a further 1,000-1,500 moratoriums and 100-200 restructuring plans arising from this package of measures. In total 19,800 cases annually will be affected assuming current trends are maintained.
- 6.47 Estimating the number of suppliers in scope per case is difficult as the suppliers will vary by business sector and business size. The companies may already have most of their necessary supplies covered by existing legislation which prevents IT suppliers and utilities from terminating supply at the point of insolvency⁵⁵. The consultation stage impact assessment indicated that the average company may have 10 further suppliers⁵⁶ and this is corroborated by internal analysis of Insolvency Service management information, resulting in 198,000 suppliers being impacted.
- 6.48 Using the cost per business of purchasing trade credit insurance and accounting for part of the market already insured we estimate the annual cost to suppliers will be between **£193m and £386m**. The best estimate is the midpoint of this range, **£290m**. These costs are within scope of the business impact target as an ongoing cost of the insolvency procedure for business suppliers.
- 6.49 The overall cost is likely to be lower than this as the number of suppliers affected may count a supplier more than once as suppliers typically supply to many different firms.
- 6.50 Prohibiting termination clauses will disadvantage suppliers as their contractual rights will be interfered with by the provision. Interdependencies in the supply chain may mean that a company entering a moratorium can have a knock-on effect on suppliers and this may cause further hardship for distressed companies. As a safeguard of last resort, suppliers will be allowed to exercise termination clauses on the grounds of undue financial hardship; where not doing so will more likely than not result in an insolvency procedure for the supplier. In this case the supplier would need to seek permission from court to terminate supplies. Given the high threshold and potential costs, this will occur in very rare circumstances.
- 6.51 The number of suppliers likely to enter insolvency can be estimated by applying the annual corporate insolvency rate (1 in 240)⁵⁷ to the 198,000 suppliers affected; resulting in 820 potential cases.
- 6.52 The legal costs are; securing a court date, preparation costs, proving hardship. These will vary on a case by case basis. Similar insolvency court challenge procedures have been estimated to cost business around £4,000 in the consultation stage impact assessment⁵⁸. Resulting in an ongoing cost to business of around **£3.3m**.
- 6.53 However, the actual cost is likely to be lower given the effect on the debtor company and its prospects for rescue must also be considered, and the costs involved may discourage some suppliers challenging.
- 6.54 **Therefore, the total estimated ongoing cost to suppliers for this measure is £292.9m (£289.6m+£3.3m).**

Monetised Benefits

⁵³ <https://www.abi.org.uk/products-and-issues/choosing-the-right-insurance/business-insurance/trade-credit/>

⁵⁴ <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2019>

⁵⁵ On 1st October 2015, an amendment to the Insolvency Act 1986 commenced, which ensures continuity of essential supply of utilities and IT goods or services to insolvent businesses

⁵⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525529/Consultation_stage_corporate_insolvency_consultation_Impact_Assessment_-_Mar_2016.pdf

⁵⁷ <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2019>

⁵⁸ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525529/Consultation_stage_corporate_insolvency_consultation_Impact_Assessment_-_Mar_2016.pdf

- 6.55 The main benefit from the measure will be improved outcomes for business creditors. The measure will support company restructuring and stop actions which harm distressed companies in insolvency.
- 6.56 A survey of insolvency practitioners by R3 (2013)⁵⁹ concluded that 7% of liquidations could be avoided if essential utility and IT suppliers were unable to rely on contractual termination clauses and were required to supply insolvent companies on pre-insolvency terms.
- 6.57 The survey found key trade creditors were more likely to demand ‘ransom payments’ or attempt to renegotiate terms than essential suppliers on the whole, with 49% doing so compared to 55% for IT, 36% for telecom and 25% for utility suppliers.
- 6.58 An earlier survey by ComRes (2010)⁶⁰ found that suppliers demanded ransom payments or varying terms in most SME cases, which form 99.9% of the business community⁶¹.
- 6.59 If non-essential suppliers were unable to rely on termination clauses too, then the proportion of liquidations avoided would be at least the 7% from essential supplies. This is likely to be higher as there are more trade creditor suppliers than essential suppliers in a typical insolvency, and they are more likely to demand ransom payments than typical essential suppliers. Therefore, we estimate around 10% of liquidations could be avoided through the measure.
- 6.60 During 2019 there were around 16,000 compulsory and creditors’ voluntary liquidations (CVLs) in the UK⁶², applying 10% would mean around 1,600 liquidations would be avoided. Companies that avoided liquidation would instead likely enter administration – the primary company rescue procedure – which would lead to an improved outcome for creditors.
- 6.61 The Insolvency Service collected data on a sample of 500 administrations and 232 CVLs in 2020⁶³. The average creditors’ claim in an administration amounted to £6.3m and the average returns to creditors in administration and CVL were 16% and 5% respectively.
- 6.62 The benefit to creditors can be calculated by multiplying the average creditor claim in administration (£6.3m) by the improvement in average returns (16-5=11%) to find the benefit per case and then multiplying by the number of liquidations avoided (1,600). (Note that creditor claims in administration have been used in this calculation, as the profile of cases avoiding liquidation will likely be similar to administration cases.) In total this amounts to a £1,109m benefit to creditors attributable to an improved creditor return from a better outcome.
- 6.63 However, part of the benefit arises from the prohibition of ransom payments. The loss of ransom payments represents a transfer from suppliers to the debtor company which is not an ongoing benefit. Therefore, the benefit needs to be scaled back by the ransom payments avoided to exclude the transfer and calculate the ongoing benefit. The surveys show around half of suppliers demand ransom or vary terms, so reducing the benefit by half results in an ongoing benefit to creditors of £555m.
- 6.64 However, some of these returns would accrue to non-business creditors such as HMRC and local authorities. Analysis of a random unweighted sample of Companies House filings⁶⁴ estimated that non-businesses accounted for around 10% of the returns to creditors. Therefore, the estimated ongoing benefit to business creditors is **£499m** (90% of £555m).
- 6.65 The use of termination clauses also impacts rescue for companies in administration and CVAs. The estimate from the ComRes (2010) survey on the proportion of CVAs and administrations that go into liquidation due to suppliers demanding ransom payments or renegotiating terms (13%) mirrored the percentage of liquidations that could be avoided if key suppliers did not rely on termination clauses (14%).

⁵⁹http://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf

⁶⁰ Survey Findings Rescue to Ransom 2010

⁶¹ <https://www.gov.uk/government/publications/business-population-estimates-2019/business-population-estimates-for-the-uk-and-regions-2019-statistical-release-html>

⁶² <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2019>

⁶³ Insolvency Service Data Collection, 2020

⁶⁴ https://webarchive.nationalarchives.gov.uk/20140402172033/http://oft.gov.uk/shared_oft/reports/Insolvency/oft1245

- 6.66 Using the same method as above we estimate around 10% of liquidations could be avoided through the measure. As the impact of termination clauses are similar for administrations/CVAs and liquidations, an estimate can be made on the number of companies that could be rescued.
- 6.67 There were around 2,250 administrations and CVAs in the UK during 2019⁶⁵ and ordinarily 10%, i.e. 225, would lapse into liquidation due to suppliers demanding ransom payments or renegotiating terms. The measure would mean that 225 cases would continue in administration/CVA leading to better outcomes through company rescue such as improved creditor returns, retention of jobs and know-how.
- 6.68 The benefit to creditors in cases is difficult to calculate as creditors would receive some benefit under an administration/CVA, however these benefits would be smaller than those if the company avoided liquidation altogether. Therefore, the benefit will lie somewhere in between avoiding a liquidation and the counterfactual of entering liquidation.
- 6.69 The upper estimate, of avoiding liquidation can be calculated as before; considering the improvement in return per case and considering returns to business creditors. This results in a £156m (£6.3m*11%*225) ongoing benefit to creditors; however, as noted above, the loss of ransom payments is a transfer and needs to be scaled back. Applying the same reduction leads to an ongoing benefit to creditors of £78m and after accounting for the 10% of returns to non-business creditors there is a £70.2m benefit to business creditors.
- 6.70 The lower estimate is the counterfactual, that the company falls into liquidation; this represents no change to business creditors.
- 6.71 The mid-point of the range, **£35.1m** represents the estimated ongoing benefit to business creditors through continuation of business rescue.
- 6.72 **Therefore, the total estimated ongoing benefit to business creditors through this measure is £534.1m (£499m+£35.1m).**

Non-monetised benefits

- 6.73 Overall, the measure would result in greater company rescue with 1,600 liquidations moving to administration and a further 225 administrations/CVAs continuing rather than entering liquidation, helping to reduce job losses.
- 6.74 This will also improve returns to unsecured creditors – most often small businesses trading with other businesses. Unsecured creditors tend to receive low returns due to their position. This will improve returns, benefiting the business community by making more money available to invest in business.
- 6.75 Furthermore, returns to secured creditors will also improve as more companies rescued will enable them to retrieve more money in insolvency. This will help in two ways:
- the improved returns will mean more money to lend to other businesses and stimulate the economy; and
 - the higher returns in insolvency may reduce the risk in lending leading to a lower risk premium being charged on business loans.

Flexible restructuring plan

- 6.76 Table 4 sets out a summary of the costs and benefits of flexible restructuring plans.

Table 4: Costs & benefits of flexible restructuring plans

Type of cost/benefit	Impact	Low £	High £	Best Estimate £
Ongoing cost to creditors	Cost of disputing the provision of a restructuring plan	0	40k	20k
Total Cost				20k

⁶⁵ <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2019>

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Ongoing benefit to creditors				
	Improved return from growth of restructuring market	0m	8.0m	4.0m
Non-monetised benefits	Increased job preservation, reduction in social costs			
	Improved returns to unsecured creditors helping the business community invest more			
	Improved returns to secured creditors resulting in greater business lending			
Total benefit				3.98m

Costs/Benefits of proposal

Monetised Costs

- 6.77 A secured creditor that is bound into a restructuring plan may not wish to be included in the restructuring plan, even with the requirement that the dissenting creditor not be made worse off from being included. The creditor will have recourse to the court if they wish to be removed from the restructuring plan. The Government believes very few creditors will seek to dispute the decision and seek recourse via the courts.
- 6.78 The provision includes important safeguards for creditors such as court oversight and the requirement that at least one class of impaired creditors must vote in favour of the restructuring plan for a cross-class cram down to be confirmed by the court. There is also court oversight and the plan must be fair and equitable to all parties. Under the restructuring plan legislation, a dissenting class of creditors must be satisfied in full before junior classes may receive any distribution under the restructuring plan. This safeguards creditor interest by applying the ordinary order of priority. These protections will ensure creditors are better protected and reduce the likelihood of disputes.
- 6.79 Collectively, with all the safeguards and the added cost of making the application to court, previously estimated to be around £4,000 per case, we believe that there are likely to be almost no cases which will be disputed in court.
- 6.80 The fairness of a plan being crammed down on to dissenting classes will be examined in any dispute. The Government has determined the next best alternative for creditors if the restructuring plan was not agreed is the best valuation basis. Administration would often be the outcome should the plan be rejected. If the court ruled that creditors' interests were best served by the restructuring plan, then cram down would occur, if creditors would receive no less than the next best scenario.
- 6.81 The measures taken and the process of dialogue and negotiation should mitigate the risk of disputes to the point where challenges are avoided. Given the complexities of valuation, for example assets that are difficult to value such as goodwill, and the choice of valuation method employed which creditors can challenge in a restructuring plan, it is difficult to gauge the likelihood of challenges. However, the Government's approach intends to achieve the best balance and the negotiations between the company and its creditors will help to narrow differences to the point that challenges can be avoided.
- 6.82 Following stakeholder engagement, it is anticipated that in the normal course of business, there will be around 50-100 restructuring plans per year. However, most of these will replace current scheme of arrangement applications. As these applications will replace an existing comparable judicial procedure, this should not result in a notable net increase in court costs.

- 6.83 Therefore, we can estimate a low scenario legal cost from the measure as £0, due to the applications replacing an existing comparable judicial procedure and with the expectation there will be few or no challenges.
- 6.84 A high scenario legal cost can be estimated based on the proposed measure growing the restructuring market (i.e. most but not all applications will replace scheme of arrangement applications). Considering this increased growth, we take into consideration stakeholder views that a low proportion of this growth is likely to submit challenge, we estimate a high scenario of 10% of annual flexible restructuring plans, at £4,000 cost per case, submitting a legal challenge. This results in a high scenario cost of £40,000.
- 6.85 **The mid-point of the high and low scenarios can then provide the ongoing cost of £20,000 for legal disputes to a restructuring plan.**

Monetised Benefits

- 6.86 A restructuring plan supports companies in being able to continue with limited disruption, resulting in better outcomes for the debtor company and creditors. For the purposes of this impact assessment we are assuming that it will lead to very few cases switching from the company moratorium into a restructuring plan. However, this benefit has already been accounted for under the benefits of the company moratorium.
- 6.87 Another benefit from the proposed measure will be increased returns to creditors from the growth of the restructuring market. As mentioned previously, following engagement with stakeholders, it is expected that there will be around 50-100 flexible restructuring plans per year.
- 6.88 Analysis of data from Companies House indicates that between April 2014-2019 there were on average around 400 schemes of arrangement per financial year. As mentioned in the 'costs' of the measure section, it is expected that most of the flexible restructuring plans will replace current scheme of arrangements. Between April 2014-2019, the trend on scheme of arrangements has been mostly flat, suggesting the restructuring market is not growing over time.
- 6.89 Therefore, we can make a low scenario assumption that the measure does not grow the market but replaces existing schemes of arrangements. However, due to the presence of certain mechanisms not currently available, such as the cram down mechanism, it is reasonable to expect that the market would grow to some extent. Consequently, we can make a high scenario estimate, based on stakeholder engagement that most flexible restructuring plans will replace current schemes of arrangement, that the market would grow per year by 50% of the higher estimated number of annual flexible restructuring plans (i.e. 50% of 100).
- 6.90 As Companies House data shows that the current restructuring market is flat over the last few years, we can assume that this measure will cause an immediate growth in the market, but will then be static over time.
- 6.91 The terms of a restructuring plan would vary on a case by case basis, so it is difficult to calculate the benefits directly. However, we can take the same approach as in the benefits of moratoriums switching to flexible restructuring plans, where will be at least that in a CVA and this would offer an improvement to administration in the counterfactual.
- 6.92 Using the same method as the moratorium proposal, the benefit per case would be £159,000. Multiplying that by the growth of cases in the market (50) provides a high scenario benefit of £8.0m.
- 6.93 **We can then take the midpoint of the low and high scenarios to provide an ongoing midpoint benefit from the growth of the restructuring market to be £4.0m.**

Non monetised benefits

- 6.94 As mentioned in the benefits section, there is the expectation that the proposed measure will grow the restructuring market to some extent. Not only will this provide a benefit in return to creditors, but it will also produce a benefit in terms of outcomes for business, for example an increase in the number of companies saved as a going concern.

- 6.95 The improved outcomes for companies will help both secured and unsecured creditors by improving returns. This in turn benefits the economy and makes more money available to invest in business.

7 Impact on small and micro businesses

Suspension of Ipso Facto (termination) clauses

- 7.1 As the policy would cover administration, compulsory and voluntary liquidation, company voluntary arrangements as well as the proposed new procedures of moratorium and restructuring plan; the policy would be inclusive of all company sizes, meaning the benefits are open to all.
- 7.2 There is a risk that the costs are shifted to suppliers, however this will be mitigated by the statutory 'hardship provision', as well as the temporary measure that small company suppliers will be exempt from the requirement during the Covid-19 emergency.

Company moratorium

- 7.3 Small companies will still be able to benefit from measures already in place, such as the ability to access a moratorium through the Schedule A1 Insolvency Act 1986 moratorium. So, although as mentioned this measure is underused, no benefits currently available will be taken away.
- 7.4 The proposed company moratorium has no eligibility criteria around business size, so the benefits are designed to be available and benefit all in this sense.
- 7.5 The company moratorium is not enforced and is an optional measure for a company. Therefore, costs associated with the measure are a choice for small and micro businesses.

Flexible restructuring plan

- 7.6 The flexible restructuring plan will be available to all business sizes, meaning benefits are open to all. Furthermore, current measures, such as scheme of arrangement, will still be in place so current benefits will not be taken away.
- 7.7 Whilst open to all, it is anticipated that the measure will be used by a small proportion of companies, with around 50-100 restructuring plans estimated annually. Furthermore, the proposed measure will appeal more than current measures to cases involving complex capital structures and that have a diverse range of stakeholders. Therefore, the take up by small and micro business is expected to be small.
- 7.8 The measure is expected to almost always be proposed by the company, meaning that costs associated with the measure would be a choice for small and micro businesses.

8 Wider Impacts

- 8.1 The preferred option has been considered in line with the Public Sector Equality Duty. It is not anticipated that any of the measures will have any disadvantages because of protected characteristics.

9 Potential Trade Implications

- 9.1 No trade impact is expected as a result of these measures.

10 Monitoring & Evaluation

- 10.1 In line with Better Regulation guidance, a post-implementation review (PIR) of the measures will be conducted, making use of guidance on evaluation in the Magenta book⁶⁶. In line with the guidance, a PIR will be conducted five years after the measures come into force. However, they could be evaluated sooner to ensure the measures are fit for purpose, or if existing stakeholder channels provide anecdotal evidence that they have not landed as expected, suggesting a review is required.
- 10.2 The PIR will be used to establish if the three measures set out were able to achieve their aims (mentioned in section 4), if they resulted in any unintended consequences and if the measures could be improved upon.
- 10.3 Estimating the counterfactual will be a challenging aspect, given the nature of the policy rollout. For this reason, the PIR is likely to focus on monitoring and process evaluation elements. Furthermore, the Covid-19 pandemic will have a significant impact on the success of the measures, given its impact on the economy. Therefore, any non-experimental pre- and post-policy monitoring will need to be cautious in its narrative.
- 10.4 Ideally a mixed methods approach will be used to inform the PIR, such as monitoring data and primary data collection.
- 10.5 Monitoring data on the use of the measures in this impact assessment and the resulting outcomes for companies will need to be collected and analysed over time. Collaboration with Companies House can identify what monitoring data will be available. Companies House already collects data on the use and outcomes of existing measures and it is anticipated that Companies House will collect data on use of company moratoriums and flexible restructuring plans.
- 10.6 Options will be explored on whether this data can be supported through primary data collection (quantitative and/or qualitative) with stakeholders to help understand how the measures have been used and if that is in line with their intended purpose. This approach can also reveal any unintended consequences of the measures, and whether any adaptations need to be made.

⁶⁶ <https://www.gov.uk/government/publications/the-magenta-book>

**ANNEX: Impact of temporary measures outside of scope of Better
Regulation Guidance**