

Corporate Insolvency and Governance Act

Department for Business, Energy and Industrial Strategy

RPC rating: **fit for purpose**

Background

The RPC issued an opinion on the final stage impact assessment (IA) of the Corporate Insolvency and Governance Bill on 28 May 2020.¹ That opinion concluded that the IA was sufficient for ministerial and parliamentary decision making but that the assessment of the direct impacts on business needed to be strengthened for business impact target (BIT) validation purposes. The RPC invited the Department to submit a revised IA for this purpose, in time for the measure to be reported in the Government's BIT report for the first year of the current parliament. Following the Bill's successful passage through Parliament, the Department has submitted a revised, 'enactment stage' IA to the RPC for this purpose.

Overall assessment

The Department has made a number of significant changes to the final stage IA to address the comments in the 28 May 2020 RPC opinion. The most significant change is in response to the RPC's concerns around the use of the existing average cost of trade credit insurance to estimate the cost of the suspension of *ipso facto* (termination) clauses. The RPC was concerned that it could understate significantly the cost to businesses supplying companies at heightened financial risk, on which the measure seemed most likely to have an impact. The Department accepted this point and now assumes a best estimate closer to the upper end of the range previously estimated, increasing estimated costs by nearly £50 million each year. This accounts for the large majority of the revision to the equivalent annual net direct cost to business (EANDCB) figure. The Department has also addressed two other RPC comments that were directly related to the EANDCB: clarification, and inclusion, of staff time opportunity costs for insolvency practitioners attending training; and around why the estimated benefits to business from flexible restructuring plans were direct. On the latter, the Department has now made clear that these do not come from resultant growth in the market (which would normally be an indirect impact and, therefore, excluded from the EANDCB).

¹ <https://www.gov.uk/government/publications/corporate-insolvency-and-governance-bill-rpc-opinion>

The Department has also responded to the comments in the RPC opinion that do not necessarily affect the EANDCB and have made a number changes to the IA as a result. Overall, the RPC considers that the Department has strengthened the IA significantly and that the estimated direct impact on business can now be validated for BIT purposes (under the framework rules for the last parliament, pending the setting of the rules for the present parliament).

Description of proposal

The Department states that the enactment stage 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, while 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.

The enactment IA describes how Covid-19 has already had an impact on the economy, and how the number of company insolvencies increased by 50-100 per cent during previous recessions. In a “normal” year, it is estimated that around 200,000 jobs and £23 billion of output are lost to insolvency, indicating the potential scale of impact of significant increases in insolvency (paragraphs 3.8-3.9).

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

Company moratorium

This measure introduces a new moratorium to cover all companies in financial difficulty. It replaces 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 are frozen, but the company is obliged to meet ongoing trading costs and debt obligations during the moratorium. The key measure 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 measure broadens this scope significantly. It will prohibit all suppliers from enforcing termination clauses in contracts for the supply of goods and services. Suppliers 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 involves the creation of a new restructuring procedure proposed by a company or its creditors. Under it, creditors are divided into separate classes, by similar type and priority, by the proposer. The plan binds 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 Act also includes the following temporary measures, which are covered in an annex to the enactment IA and were 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).

The enactment stage IA also addresses changes made during the Bill's parliamentary passage. It summarises the main changes and explains why they have no significant impact on the estimated business impact (paragraph 1.8, page 5).

Impacts of proposal

The Department estimates an overall net societal and business benefit of £1.5 billion over ten years in present value terms, and an EANDCB figure of -£178.4 million. (This compares to -£222.9 million in the previous, final stage IA.) Both the net present value and EANDCB are dominated by the estimated impact of the suspension of *ipso facto* (termination) clauses.

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. However, the enactment IA acknowledges that the impact is most likely to be on businesses supplying companies at heightened financial risk

and, therefore, costs are likely to be higher than the current average cost of trade credit insurance. Assuming a best estimate to be halfway between the mid-point (which was previously used as the best estimate) and the upper end of the range, results in estimated costs of £337.9 million each year. Legal costs are estimated at £3.3 million, making a total cost of £341.2 million each year.

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

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

These assumptions indicate an aggregate estimated 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 indicated 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 the benefit of the company avoiding liquidation altogether but, based upon an estimated 225 cases, the Department estimates a figure of £35.1 million. This provides for 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 £193 million each year. This accounts for the large majority of the -£178.4 million EANDCB figure.

Flexible restructuring plan

Following stakeholder engagement, the Department anticipates there will be around 50-100 restructuring plans per year, replacing existing scheme arrangements. 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 from permitting restructuring plans. Using the same method as for the moratorium measure, the Department estimates a benefit of £4.0 million each year, making a net benefit of £3.98 million each year.

Quality of submission

The RPC opinion dated 28 May 2020 noted that the final stage IA was 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 enactment stage IA includes useful sections on non-regulatory alternative options and monitoring and evaluation plans. The RPC was content that the final stage IA was sufficient for ministerial and parliamentary decision making. As noted above, however, the RPC opinion stated that the Department would need to submit a revised IA later in the year for validation of a BIT figure, addressing the comments in the opinion affecting the EANDCB.

The Department has made a number of significant changes to the final stage IA by way of addressing these comments in the enactment stage IA. These are discussed below. Overall, the RPC considers that the Department has strengthened the IA significantly and that the estimated direct impact on business can now be validated for BIT purposes (under the framework rules for the last parliament, pending the setting of the rules for the present parliament).

Changes to the IA related directly to the EANDCB

The assumptions used on trade credit insurance to estimate the cost of the suspension of ipso facto (termination) clauses

The most significant change is in response to the RPC's concerns around the use of the existing average cost of trade credit insurance to estimate the cost of the suspension of *ipso facto* (termination) clauses. The RPC's concern was that it could understate significantly the cost to businesses supplying companies at heightened financial risk, on the measure seems most likely to have an impact. The Department has accepted this point and now assumes a best estimate closer to the upper end of the range estimated, increasing costs by nearly £50 million each year. This accounts for the large majority of the revision to the EANDCB figure.

Inclusion of staff time (opportunity) costs

The IA now includes an estimate for the staff time (opportunity) costs for insolvency practitioners attending training courses. This adds around £2.6 million to familiarisation costs.

Clarification of benefits to business from flexible restructuring plans

The IA clarifies how the estimated benefits to business from flexible restructuring plans arise. The Department has explained that the benefit arises from increased returns to creditors as flexible restructuring plans are used instead of existing scheme arrangements, rather than from resultant growth in the market (which would normally be an indirect impact and, therefore, excluded from the EANDCB). The Department has also now helpfully referred to RPC guidance on direct/indirect impacts to inform its assessment here.

Wider changes to the IA

The Department has also responded to the general analytical points, points of detail about evidence sources and other clarification issues in the RPC opinion dated 28 May 2020. In particular, the Department has provided additional explanation in a number of areas:

Company moratorium

- Adjustments to assumptions and data since the consultation stage (for example, why the assumed number of moratoriums cases has increased from 10-20 cases to 1,000-1,500).
- Why there are unlikely to be additional costs to business creditors, such as lost interest from the arrears being frozen for 20 days.

Suspension of ipso facto (termination) clauses

The main differences in the cost and benefit estimates in the enactment stage IA compared to previous related IAs², in particular by including a new table at paragraph 6.42 explaining the main changes to assumptions. For example, the Department explains that a key factor is the use of more up-to-date and comprehensive data, such as from Companies House.

² 'Continuity of essential supplies to insolvent businesses', RPC-3264-BIS, 11 February 2016 and 'Corporate insolvency framework', RPC-3285-BIS, 29 March 2016.

Flexible restructuring plans

Stakeholder engagement leading to the estimate of 50-100 restructuring plans per year.

Risks and post-implementation review (PIR)

The enactment stage IA addresses more-explicitly (principally at paragraphs 4.8, 4.15 and 6.10) how possible increased losses to creditors, are mitigated. The Department also explains that a PIR of the measures will be conducted within three years and that the review will evaluate the risk that some larger suppliers may find themselves threatened with insolvency if they are forced to continue to supply to an insolvent company.

Impacts on insurers

The enactment IA includes further discussion of potential impacts on insurers (paragraphs 6.47 and 6.79).

The Department has also helpfully added new sections on:

- business impact target considerations, addressing direct vs indirect impacts and including information to provide assurance that there is no double counting of benefits;
- impacts specifically on voluntary and community bodies; and
- impacts on the public sector.

Areas for further improvement

The enactment stage IA would benefit from improvement in the following areas:

Trade credit insurance

Providing greater explanation of 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).

Use of more up-to-date evidence

The Department has explained its constraints in obtaining further evidence from stakeholders but the IA would, nevertheless, benefit from the use of more-recent evidence in places, such as that from the 2010 consultation in assessing the impact of the company moratorium.

Small and micro business assessment (SaMBA)

Although the Department has helpfully added to the SaMBA, the IA would, nevertheless, still benefit from further detail, as for the *continuity of essential supplies IA*³ and as recommended in the RPC's opinion of *the corporate insolvency framework* consultation stage IA.⁴

Options

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.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£222.9 million (initial estimate)
	-£178.4 million (final estimate)
Business net present value	£1,535.5 million
Societal net present value	£1,535.5 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	-£222.9 million (initial estimate)

³ 'Continuity of essential supplies to insolvent businesses', RPC-3264-BIS, 11 February 2016

⁴ 'Corporate insolvency framework', RPC-3285-BIS, 29 March 2016.

	-£178.4 million (final estimate) To be determined once the framework rules for the current parliament are set
Business impact target score	-£892.0 million To be determined once the framework rules for the current parliament are set
Small and micro business assessment	Sufficient

Regulatory Policy Committee