EXPLANATORY MEMORANDUM TO

THE INSOLVENCY (PROTECTION OF ESSENTIAL SUPPLIES) ORDER 2015

2015 No. 989

1. Introduction

This explanatory memorandum has been prepared by the Department for Business Innovation and Skills and is laid before Parliament by Command of Her Majesty. This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The instrument amends the Insolvency Act 1986 to prevent essential IT and utility suppliers of businesses in certain formal insolvency procedures from exercising contractual rights to terminate the supply or to increase charges to the insolvent company on account of the insolvency.

2.2 The purpose is to ensure that insolvency practitioners are able to secure supplies that are essential to facilitate a prospective rescue of the business. The instrument provides safeguards for those suppliers who will be affected to ensure they may terminate the contract or the supply in certain specific circumstances.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Context

4.1 Sections 233 and 372 of the Insolvency Act 1986 contain provisions relating to the supply of gas, electricity, water and communications services to companies and businesses belonging to individuals in certain insolvency proceedings. The sections prevent suppliers from making it a condition of the continued supply that any outstanding charges for supply before an insolvency event occurs are paid. The supplier may, however, make it a condition of the supply that the insolvency office-holder provides a personal guarantee for payment of charges in relation to the supply made during the insolvency.

4.2 The scope of section 233 and 372 is limited to a list of suppliers including statutory undertakers and similar bodies. Articles 2 and 3 of the instrument amend sections 233 and 372 extending the list of private suppliers of utilities (gas, electricity, water and communications services) to whom those sections apply, including supplies from a landlord to a tenant.

4.3 Articles 2 and 3 also add to the present list of utility supplies, to which section 233 and 372 apply, the supply of goods or services that are for the purpose of enabling of facilitating anything done by electronic means ("IT Supplies"). These include goods or services relating to information technology, other than those to which sections 233 and 372 already apply by virtue of being a communications service, such as computer hardware and software.

4.4 Articles 4 and 5 of the instrument insert new sections 233A and 372A into the Act, which apply to companies and businesses carried on by individuals respectively. These new sections cause "insolvency-related terms" in contracts for the supplies identified under sections 233 and 372 to cease to have effect when a company or individual enters administration or a voluntary arrangement takes effect. This will prevent, for example, a supplier from exercising any contractual right to terminate the supply or contract, altering the terms of the contract or compelling higher payments for the supply after the company or individual has entered into insolvency proceedings to which the instrument relates. A supplier may, however, terminate the contract or supply if one of the conditions outlines in subsections (4) and (5) of sections 233A and 372A is met.

5. Territorial Extent and Application

The provisions of this instrument insofar as they relate to corporate insolvency apply to England and Wales and Scotland but only England and Wales insofar as they relate to personal insolvency.

6. European Convention on Human Right

The Parliamentary Under Secretary of State for Employment Relations and Consumer Affairs has made the following statement regarding Human Rights:

> "In my view the provisions of The Insolvency (Protection of Essential Supplies) Order 2015 are compatible with the Convention rights."

7. Policy background

7.1 Many supply contracts include a termination clause that is triggered by the occurrence of an insolvency event, such as entry into administration.

7.2 Where the supplies are essential to the functioning of a business, such as utility or IT supplies, termination of the supply can cause serious problems to the ongoing operation of the business in an insolvency procedure. In turn, this can hamper company rescue, the primary aim of administration, and make continuation of a business following a voluntary arrangement with creditors difficult.

7.3 The intention is to prevent suppliers from terminating the supply of utilities or IT supplies in insolvency procedures in which there is a realistic prospect of a rescue of the business, where the administrator or supervisor of a voluntary arrangement ("the office-holder") considers the supply essential or necessary for the continuation of the business.

7.4 There will be occasions where the office holder will not object to the termination of the supply contract because the supply is not required. Accordingly, the policy is not to prevent suppliers from terminating in any scenario. The intention is to legislate to give office-holders the option to continue supply in contracts with utility and IT suppliers and where the office-holder believes that the continuing operation of the contract is necessary to achieve a better realisation for the creditors as a whole.

7.5 Additionally, contracts frequently contain terms that provide that on entry into insolvency, a supplier may require the customer to make a one-off payment, to move to a higher tariff, or for the current tariff to increase. That too can jeopardise the prospects of a rescue of the business by putting additional pressure on the finances of the distressed business.

7.6 Existing legislation, dating back to 1986, provides some protection for essential utility supplies in an insolvency and probably was intended to ensure continuity of such supplies where required by the office-holder. A utility supplier is prevented from making it a condition that the pre-insolvency debt is paid, but they may require a personal guarantee from the office-holder as surety that the insolvency supply will be paid for.

7.7 However due to the way the utility and telecommunications sectors have deregulated since 1986 that provision no longer provides the office-holder with certainty of supply. The law is also being modernised to ensure essential IT supplies and related support services, which are now invariably critical to business continuity, are added as essential supplies for these purposes. This instrument will build upon and modernise the existing provisions to ensure they work as originally intended in the utilities sector, that they reflect developments in commercial practice such as capturing circumstances where utility supplies are provided through a third party (such as a landlord) and to apply them to the IT services and supplies.

7.8 The policy is that any supplier unable to enforce an insolvency-related clause in their contract, and who is thereby contractually bound to supply the insolvent business, should be paid for supplies made during the insolvency. Several safeguards are therefore provided to protect the supplier. These include the right to terminate the supply if charges for the insolvency supply are not paid for, the right to request a personal guarantee from the office-holder and the right to apply to court to be released from the supply contract on hardship grounds.

Consolidation

7.9 The instrument amends provisions in the Insolvency Act 1986. There are no plans to consolidate that statute.

8. Consultation outcome

8.1 A full public consultation was undertaken as to how the powers in the ERR Act should be exercised. In particular the consultation invited views as to whether the safeguards proposed for suppliers affected are adequate. The consultation ran between July and October 2014 and officials have since held a series of meetings with stakeholders.

8.2 There were 31 responses from utility and IT suppliers, card payment service providers, insolvency practitioners and lawyers. Most respondents expressed support for the aims of the proposals but raised concerns about the adequacy of the safeguards proposed, in particular:

a) introducing a time limit within which a supplier must request a personal guarantee from the insolvency practitioner would put an unnecessary burden on suppliers at a time when they may be struggling to get information from the insolvency practitioner as to what their intentions are in relation to the supply during the administration;

b) it would be unreasonable to prohibit independent electricity suppliers varying their terms of contract where the future supply is unpredictable due to the risk of loss they may incur due to the way electricity is bought and sold on the wholesale market. DECC officials have expressed strong sympathy with this view;

c) an ‘undue hardship’ test required for successful applications to court for the termination of a contract may be ineffective as this could be too high a bar, particularly for larger suppliers.

8.3 The instrument also applies a targeted approach with regard to which utility and IT suppliers are brought within the scope of the legislation. The policy intention is for the proposals to only apply to those who supply businesses directly.

8.4 With regard to utility suppliers, the list only captures those who are in control of such a supply and those who ‘re-sell’ supply to businesses (e.g. landlords). Card payment service providers that allow payment by electronic means (i.e. Merchant Acquirers) are not currently within the ambit of the instrument because of the risks that an acquiring contract carries (i.e. the long term exposure of the merchant to chargebacks).

8.5 In light of these issues the instrument has been revised to:

a) enable an essential supplier affected by the instrument to request a personal guarantee from the insolvency practitioner at any time within the insolvency process;

b) amend the test to be applied by the court to one of ‘hardship’ when an essential supplier makes an application to court for the termination of a contract; and

c) exclude Merchant Acquirers from the scope of the legislation until a review is carried out and to their impact on business rescue and a further instrument made under the power if needed.

9. Guidance

Guidance will be issued for insolvency practitioners and suppliers in the sectors impacted by the instrument. Specifically guidance urging suppliers to ensure they make early contact with suppliers in circumstances where setting out their need to make contact with essential suppliers at the earliest possible time following their appointment to discuss their intentions in relation to the supply.

10. Impact

10.1 The main impact on business will be from higher returns to creditors from increased chances of rescue for insolvent business, estimated to be around £50m per year. There will be a cost to utility suppliers from not being able to collect higher payments for the continuation of the supply, while the creditors of insolvent businesses will receive this benefit by the continuation of the business, estimated to be around £24m per year.

10.2 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the OPSI website.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 Some suppliers of businesses in insolvency rescue procedures are small suppliers and to exempt them from the legislation would be detrimental to the small businesses who are creditors of the business in the rescue procedure. By including all possible suppliers of businesses within the scope of the legislation, there is greater opportunity for businesses to be rescued and therefore small businesses, who may also be creditors of the company, to receive the benefits of the businesses being rescued.

12. Monitoring & review

The Government will monitor this change and will assess after one year to see whether operation of these arrangements continue to be suitable.

13. Contact

Tom Phillips at The Insolvency Service (Tel: 0207 637 6421 or e-mail: tom.phillips@insolvency.gsi.gov.uk) can answer any queries regarding the instrument.