THE INSOLVENCY SERVICE

PROPOSALS FOR A RESTRUCTURING MORATORIUM

- a consultation

PROPOSALS FOR A RESTRUCTURING MORATORIUM

CONSULTATION DOCUMENT

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Foreword

Coming out of the recession, our focus is on setting a path to balanced and sustainable growth across the economy. As part of this picture, the Business Finance Green Paper looks at the challenges and risks faced by businesses in ensuring that they can access the finance they require to support investment and growth. Those challenges include the refinancing and restructuring of existing debts.

Our proposals for a new restructuring moratorium, set out in this consultation document, are intended to help businesses meet this challenge. For otherwise viable businesses where a restructuring is a realistic prospect, the proposals provide the option of a flexible breathing space during which a restructuring can be negotiated and implemented, outside of a formal insolvency procedure. By reducing the risks and costs of restructuring for the businesses involved, the proposals should help safeguard jobs, improve the outcome for creditors, and establish a secure foundation for future growth.

These proposals will help ensure that our company and insolvency law remains fit for purpose, and responsive to business needs. I look forward to hearing your views.

Edward Davey MP
Minister for Employment Relations, Consumer and Postal Affairs
Department for Business Innovation & Skills
July 2010

Executive Summary

(i) Companies seeking a negotiated restructuring of their debts with their creditors face increasing costs and complexity. There is an increased risk that businesses that are otherwise viable could be forced into a formal insolvency process as a result of a failed restructuring. That outcome would be very damaging for the companies affected, putting jobs at risk, and adversely affecting all of their creditors.

(ii) The risks involved in restructuring are greatest for larger companies, whose financial arrangements are more complex, and who may be more highly leveraged. However failure of such a company could affect businesses of all sizes, including suppliers and customers. It could also impact on the prospects for economic growth and recovery.

(iii) To help address these risks the Government is proposing a new restructuring moratorium. The moratorium is intended to help companies where the core business is viable but, in order to avoid the prospect of future financial distress or even insolvency, there is nevertheless the need to reach some form of compromise or restructuring. It would provide those companies with the option of a protected breathing space, during which a restructuring could be negotiated and agreed.

(iv) The option of a restructuring moratorium would be available to companies that are seeking a contractual compromise, or are preparing a statutory compromise proposal – either a Company Voluntary Arrangement or a Scheme of Arrangement.

(v) The moratorium would last initially for up to three months, allowing the company to negotiate and agree the terms of the restructuring or compromise. An extension of this period would be available for more complex negotiations, or where further time was required for the approval of a statutory compromise proposal.

(vi) To benefit from the protection of a moratorium, companies would need to satisfy a set of eligibility tests and qualifying conditions. For companies that were failing or were already insolvent, existing insolvency procedures (including administration or liquidation) would continue to apply.

(vii) In order to help safeguard creditors' interests, the directors' application for a moratorium must be sanctioned at a court hearing during which creditors would be able to be represented. An authorised insolvency practitioner would also be involved at certain key stages of the application process, and in helping to safeguard the interests of creditors whilst the moratorium was in force.

(viii) Although the directors would remain in control of the company's affairs during the moratorium, they would be subject to a range of obligations and possible penalties to deter misconduct or abuse.

(ix) The proposals are expected to result in an estimated quantified annual saving to business of around £16M per year, as well as other non-quantified benefits.

Part 1 : General Information

How to respond

1.1 When responding please state whether you are doing so as an individual or whether you are representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

1.2 This consultation was published on 26 July 2010. The consultation period will run for 12 weeks, and the closing date for responses is 18 October 2010. However, we encourage responses as early as possible to assist us in accelerating the process of considering replies.

1.3 A response can be submitted by letter, fax or email to:

Muhunthan Vaithianathar
Policy Directorate
The Insolvency Service
Zone B, 3rd Floor
21 Bloomsbury Street
London
WC1B 3QW
Tel: 020 7637 6515
Fax: 020 7291 6746

Email: policy.unit@insolvency.gsi.gov.uk

1.4 This consultation will be of interest to: business; trade organisations and advisers; banks and other providers of business finance; representative and regulatory bodies; employees and academics.

1.5 We will be holding a number of consultation events and meetings with interested parties during the consultation period to discuss the proposals. Please contact us if you would like to be involved.

Additional copies

1.6 This consultation can be found at: www.insolvency.gov.uk. You may make additional copies without seeking permission.

Confidentiality and data protection

1.7 Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide, to be treated as

confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidentiality.

1.8 In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic disclaimer generated by your IT system, will not, of itself, be binding on The Insolvency Service.

1.9 The Insolvency Service will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Help with queries

1.10 Questions about the policy issues raised in the document can be addressed to Muhunthan Vaithianathar, The Insolvency Service (contact details as above).

1.11 If you have any comments or complaints about the way this consultation has been conducted, these should be sent to:

Babatunde Idowu
Consultation Co-ordinator
Department for Business, Innovation and Skills
Better Regulation Team
1 Victoria Street
London. SW1H 0ET

Email: Babatunde.Idowu@bis.gsi.gov.uk
Tel: 020 7215 0412
Fax: 020 7215 0235

1.12 A copy of the Government's Code of Practice on Consultation is attached at Annex D.

What happens next?

1.13 The Government will consider the responses received and whether it is necessary to legislate on this matter when Parliamentary time allows.

1.14 Decisions taken in light of the consultation will be published along with a summary of the responses.

1.15 Stakeholders will be able to follow developments on these proposals following the consultation on the Insolvency Service website at www.insolvency.gov.uk.

Part 2 : The Government's Objectives

2.1 The Business Finance Green Paper explores the impact of the recent financial crisis on the availability of finance for business. Over the next few years, businesses that need to access finance to survive and to fund investment and growth face a number of challenges and risks.

2.2 Conditions in credit markets and the economy have changed significantly since the peak of the credit boom in 2007/08. For heavily leveraged sectors and companies, the refinancing of debt obtained during the boom could, over the next few years, be a significant challenge. For example, an estimated £90 Billion in loans to leveraged buy-outs is expected to mature before 2015 (Figure 1). There is a widespread expectation that for a number of heavily indebted companies, the restructuring of their existing borrowings will be a vital part of establishing a sustainable basis for future growth.

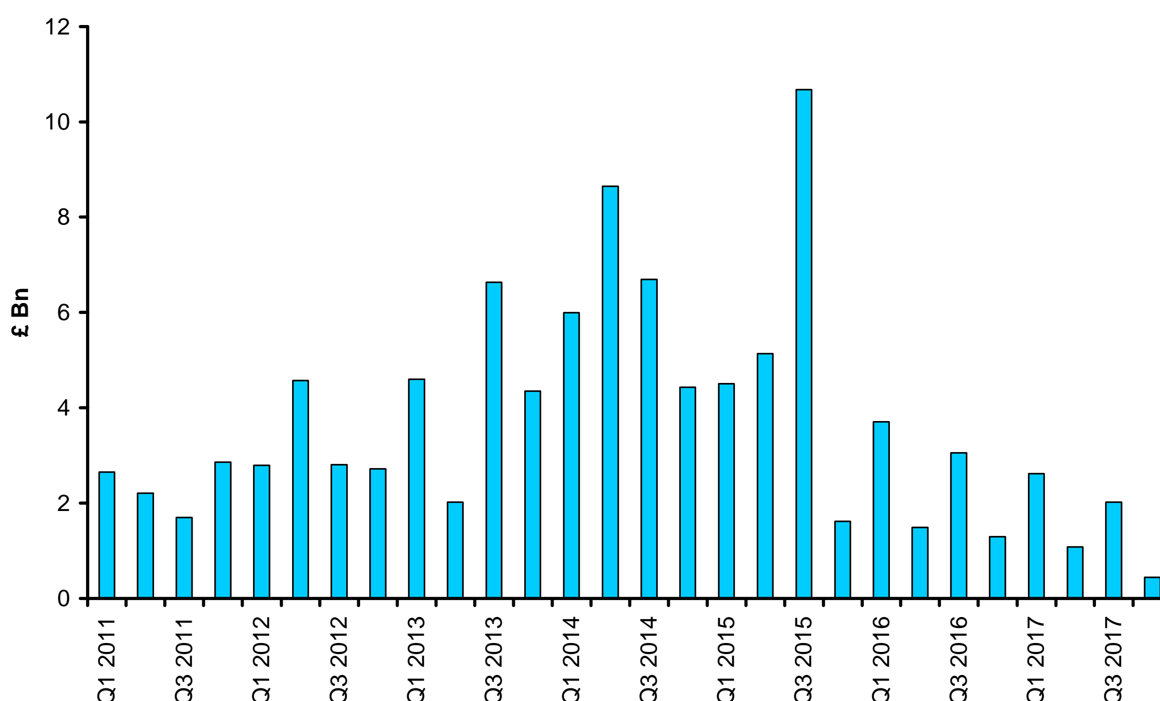

Figure 1 : Projected maturity profile of loans to UK leveraged buy-outs[1]
Source : Dealogic

2.3 There are already a number of options for companies seeking a restructuring. Many will seek to achieve an agreement with their creditors on a private, consensual basis (a "contractual workout"). Where a consensual approach is not possible, legislation provides a number of options for achieving a binding statutory compromise – including a Company Voluntary Arrangement (CVA) under Part 1 of the Insolvency Act 1986, or a Scheme of Arrangement under Part 26 of the Companies Act 2006. These statutory mechanisms are flexible

[1] Data for outstanding volumes of syndicated loans for UK LBOs as at 19 July 2010, converted from USD to GBP at current exchange rates. The projections are based on the amount and maturity date at launch, and do not reflect any subsequent changes (e.g. loans that have been repaid, cancelled, refinanced, or withdrawn).

and well regarded internationally. The Government is not proposing to make any changes to them.

2.4 However the complexity of financing arrangements that underpin the operation of many companies – in particular those which had been subject to a leveraged buyout - poses a number of challenges for the ability of those companies and their creditors to successfully negotiate a compromise. Where the syndication of bank loans has resulted in the dispersal of debt across multiple creditors, it can add significantly to the costs and risks associated with restructuring.

2.5 When a large number of creditors is involved, it becomes more difficult to agree or enforce an informal standstill to provide a breathing space for negotiations. There is a greater risk that individual creditors will threaten to destabilise a negotiation process in the hope of extracting financial gain at the expense of the other creditors. Smaller creditors also have less incentive to participate in the negotiations or respond to compromise offers. In addition, the higher costs and uncertainty associated with extended negotiations can impact negatively on the value of the business.

2.6 These factors mean that where more creditors are involved, and particularly where there are a large number of minority creditors, the risks and costs associated with restructuring are likely to be higher. That means that it is more likely that even a viable business will fail to successfully secure a negotiated restructuring, and be forced into a formal insolvency process – an outcome that is likely to damage the company and put jobs at risk. Even where failure can be avoided, the increased costs of restructuring – which are likely to run into £ Millions[2] – represent a significant additional burden on the company, its shareholders, and its creditors.

2.7 The Government recognises these issues, and their potential impact on companies that may need to restructure their debts over the next few years. It is keen to reduce the costs and risks of restructuring, to help ensure that viable business are not put at risk, and have the opportunity to reach a compromise with their creditors. It also recognises the importance of encouraging directors of companies who may be facing financial distress to act early to address their problems. Both are fundamental in establishing a secure foundation for future growth.

2.8 This consultation sets out our proposals – a restructuring moratorium – that are designed to help address these needs. The moratorium would provide companies that need to restructure their debts with the option of a protected breathing space during which a restructuring deal could be negotiated and implemented – whilst the company remains under the control of its directors.

2.9 We would not expect that all companies needing to restructure their debts would necessarily apply for a moratorium. But for larger businesses with more complex financing structures, for whom the costs and risks of restructuring

[2] Further discussion on the level of costs associated with restructuring can be found in the Impact Assessment, attached at Annex C

without a moratorium are likely to be most significant, we estimate that the option of a restructuring moratorium could result in significant savings for businesses and their creditors, potentially several £ Millions in each case, from faster completion of the restructuring process.

2.10 As well as these quantified savings, we also believe that there should a number of other benefits, including :-

- allowing informal standstills to be more effective : because creditors know that a statutory moratorium can be obtained if required, there will be a reduced incentive on participants in negotiations to adopt tactical approaches aimed at exploiting the threat of delay or disruption for financial gain;
- reducing the need to make ransom payments or other commercial settlements with holdout creditors who could (in the absence of a moratorium) take action to destabilise the company and the negotiation process;
- saving costs, and improving returns to creditors in cases where the company would otherwise have entered administration to obtain the protection of a moratorium; and
- providing a stronger incentive for directors to act early to address their problems, rather than wait for the onset of insolvency - avoiding the damage to the business associated with a further significant deterioration in its financial position.

2.11 A full assessment of estimated costs and benefits is set out in the Impact Assessment attached at Annex C.

Q1 : Do you agree with the expected costs and benefits of the proposals, as set out in the Impact Assessment ? Are there other benefits or costs that you believe should also be considered ?

Part 3 : A Breathing Space for Companies

Introduction

3.1 In part 2, we set out the Government's objectives for a restructuring moratorium: to provide companies that need to restructure their debts with the option of a protected breathing space during which a restructuring deal can be negotiated and implemented, outside of a formal insolvency procedure. In this part, we set out more detail of the proposals and how they would work for companies. In part 4, we will set out how the interests of creditors would be safeguarded.

A Flexible Framework

3.2 Companies seeking a negotiated compromise or restructuring of their debts are likely to go through a number of different stages, and (depending on their circumstances) make use of different compromise mechanisms. In general terms, however, there will typically be an initial stage during which a compromise is negotiated with creditors and a full proposal developed. In some cases this will result in a statutory proposal that is then, in a second stage, put forward for formal approval by creditors, as either a Company Voluntary Arrangement, or a Scheme of Arrangement. When approved, the compromise becomes legally binding on the parties affected.

3.3 Although the legislation that governs the use of Company Voluntary Arrangements and Schemes of Arrangement sets out a process that must be followed (including, in the case of a CVA, the timescales that must be adhered to), there is no such prescription at the initial, pre-proposal stage. Although it will be in the interests of the company to identify and agree a compromise proposal as swiftly as possible, much will depend on the complexity of the case, the number of creditors involved and the diversity of their interests. In larger cases, negotiations can extend for a period of several months before a proposal can be arrived at. In other cases, the duration could be significantly shorter.

3.4 One of the benefits that we anticipate from our proposals is that they will help reduce the time taken to conclude restructuring negotiations, particularly at the initial stage when a proposal is still being developed. But if we are to achieve this objective, it is important that the proposals have sufficient flexibility to accommodate different scenarios. For example, it should be possible for the company to obtain a moratorium either at an early stage (before a restructuring proposal has been developed), or later, to cover the period when a statutory compromise proposal is put to creditors for agreement. Equally, the moratorium needs to be able to accommodate complex cases in which initial negotiations are extended, as well as those which are more straightforward. And it needs to allow for different compromise mechanisms – both contractually agreed restructurings, and the statutory processes described above.

3.5 To provide this flexibility, we propose that the restructuring moratorium :-

- can accommodate different forms of compromise, including a contractual workout, a CVA, or a Scheme of Arrangement; and
- is capable of covering, if required, both initial negotiations aimed at developing a compromise proposal, and (as applicable) the time required for creditor approval of a statutory proposal.

3.6 For companies that enter the moratorium at the initial (i.e. pre-proposal) stage, we propose that the moratorium should be limited, initially, to a maximum of three months. However this period could be extended :-

- if more time was required to agree a proposal – in which case a further three months would be available, with the moratorium automatically coming to an end after six months if no proposal had been agreed. We believe that this extra period would only be likely to be required in a small minority of cases; and / or
- where a statutory compromise proposal had been developed, in which case the moratorium could if required be extended to cover the period required for formal approval in accordance with the relevant statutory procedures.

The Breathing Space

3.7 The fundamental purpose of the moratorium is to provide a protected breathing space for companies in which a restructuring or compromise can be negotiated and agreed with creditors. In line with the existing small company moratorium provisions in Schedule A1 of the Insolvency Act 1986, the moratorium would, in the absence of specific authorisation from the court, prevent :-

- the presentation of a winding-up petition by a creditor, or the making of a winding-up order by a court (except for certain public interest petitions);
- the appointment of an administrator by the directors or a holder of a qualifying floating charge, the appointment of an administrative receiver, or the application for an administration order;
- forfeiture of a lease by peaceable re-entry of business premises by a landlord;
- the enforcement of security over the company's property (or repossession under a hire purchase agreement);
- meetings of the company being held; and
- the commencement or continuation of legal process against the company and its property.

3.8 These protections would remain in place until the moratorium came to an end.

Eligibility and qualifying conditions

3.9 Our proposals are aimed at helping companies where the core business is viable but, in order to avoid the prospect of future financial distress or even insolvency, there is nevertheless a need to restructure their debts.

3.10 For businesses that are not viable, or where the company is already insolvent, our proposals are not intended to take the place of existing insolvency procedures, including administration or (where the business is not capable of being rescued) liquidation. It would not be acceptable if a moratorium was used by a failing business simply to buy time with its creditors, when in practice there was no realistic prospect of a rescue or compromise being reached.

3.11 To achieve this objective, we propose that in order to obtain a moratorium, the directors of the company must :-

- demonstrate that the company satisfies certain eligibility tests; and
- show that it meets certain qualifying conditions.

Eligibility Tests

3.12 The purpose of the eligibility tests is to define the types of company that are in principle able to apply for a moratorium. At present, for example, under the existing Schedule A1 provisions only small companies are eligible to apply for a moratorium. For the restructuring moratorium, we are not proposing to restrict eligibility according to the size of the company. But we would propose to make certain other categories of company ineligible for a moratorium, for example where this is required to ensure consistency with laws governing the operation of financial markets, or where specific sectoral arrangements are in place – such as for banks. Further details of the proposed exclusions are provided at Annex B.

3.13 In addition, we are proposing to limit eligibility for a company that is subject to a winding-up petition, but where the petition has not yet been heard or dismissed. For most creditors, the presentation of a winding-up petition is a step that is taken when other reasonable efforts to recover the debt have failed. We believe that if a petition has been presented, unless the company has a formal compromise proposal that it is able to put to creditors (and which stands a reasonable prospect of success), the company should not be eligible for a moratorium. In those circumstances, the company would have to rely on the existing discretion of the court to dismiss the winding-up petition, or adjourn the hearing. We would not want to see the availability of a moratorium frustrating that process, or weakening the incentives for debtors to ensure their creditors are paid in accordance with contractual commitments.

Q2 : Do you agree that in order to help safeguard creditors' rights, a company should not be eligible for a moratorium if there is an outstanding petition for winding-up unless it has a statutory compromise proposal (a scheme of arrangement or CVA) that it is ready to put to creditors ?

Qualifying Conditions

3.14 The qualifying conditions will also play an important role in determining whether a company can benefit from the protection of the new restructuring moratorium. Reflecting the Government's policy objectives set out above, the main purpose of the qualifying conditions is to ensure that the company applying for a moratorium has a viable business, and that creditors are prepared to back some form of restructuring of the company's debts.

3.15 Whether the business is or is not viable is a commercial judgement that depends on the circumstances in each case. In practice, we believe that the attitude of the creditors is likely to be critical. On the one hand, if creditors do not regard the business as fundamentally viable, or if they have no faith in the ability of the existing directors or management, then they are unlikely to back a restructuring. On the other hand, if the company is judged to be able to meet all its current and future financial commitments in full, then creditors have no incentive to agree any form of compromise. We believe that it is companies that are between these two positions that should be capable of benefiting from a moratorium if required.

3.16 To achieve this result we propose that as part of its application for a moratorium, **the company must be able to demonstrate that there is a reasonable prospect that a compromise or arrangement can be agreed with its creditors.** It may do this, for example, at the initial (pre-proposal) stage by demonstrating support in principle for some form of compromise from its senior secured creditors, even if the details of the compromise have not been fully developed, and it has not been able to enter negotiations with the full range of creditors that may be affected.

3.17 Although the effect of the moratorium is to put pre-existing debts on hold, the company must be able to have the means to continue to trade during the moratorium, including meeting any new obligations that are incurred. Whilst the moratorium is in force, suppliers are likely to require greater safeguards over payment, for example by withdrawing previously available credit. As a second qualifying condition, we therefore propose that **the company must be able to show that it is likely to have sufficient funds to carry on its business during the moratorium**.

3.18 Both qualifying conditions must be met in order for a company to be granted a moratorium at the initial stage, when a compromise proposal is still be negotiated and finalised. As set out in Part 4, we propose that the company would need to satisfy a court that the qualifying conditions were met, drawing on the professional assessment of an insolvency practitioner. If, whilst the moratorium is in force, circumstances were to change such that the company no longer met the qualifying conditions – for example because it was no longer able to meet the obligations incurred whilst running its business, or if negotiations with creditors had irrevocably broken down – the moratorium would come to an end.

Q3 : At the pre-proposal stage, do you agree that the two proposed qualifying conditions provide the right balance in ensuring that a moratorium is only available to companies where the core business is viable but there is nevertheless a need to restructure their debts ?

3.19 As well as covering the time required to negotiate and finalise a compromise proposal, directors would also be able to apply for a moratorium where a statutory compromise proposal – either a CVA or a Scheme of Arrangement – has been developed, but the proposal has yet to be formally approved by creditors in accordance with the relevant statutory procedures. In some cases this could be achieved through an extension of an existing moratorium that has been in force during the pre-proposal stage. But that may not always be the case : for example the directors may only decide that the company needs the protection of a moratorium when they are preparing to enter the formal approval process, and therefore only apply for a moratorium at that stage.

3.20 For a CVA, there are a set of existing statutory tests, assessed by an insolvency practitioner, that must be met in order for the proposal to be put to creditors[3]. These include that the CVA proposal has a reasonable prospect of being approved and implemented. Provided that these tests are met, we propose that in order to obtain a moratorium the company would in addition need to be able to show that it is likely to have sufficient funds to carry on its business during the moratorium.

3.21 For a Scheme of Arrangement, when a proposal has been prepared the court must sanction the holding of meetings of creditors (or members) required for them to vote on the proposal. Provided that a court is willing to sanction the holding of meetings, we propose that a moratorium could also be sanctioned provided that the company can demonstrate that it is likely to have sufficient funds to carry on its business during the moratorium.

Q4 : Where a company has a proposal for a CVA or Scheme of Arrangement and wishes to apply for a moratorium (or extend the existing moratorium), do you agree that provided the existing statutory conditions are met the only additional qualifying condition that should apply is that the company is likely to have sufficient funds to carry on its business ?

[3] Section 2(2), Insolvency Act 1986

Part 4 : Safeguards for Creditors

Introduction

4.1 A company that is successful in obtaining a moratorium is in a privileged position. As described in part 3, the effect of the moratorium is to temporarily suspend many of the normal rights of creditors that would otherwise apply – for example the right to enforce security, or to take action to recover debts – whilst leaving the directors in control of the company's affairs. In this part we set out our proposals for safeguarding the interests of creditors, and deterring abuse by companies or their directors – whilst enabling the Government's policy objectives to be realised.

The role of the court

4.2 We propose that in order for a company to obtain a moratorium, the directors should have to apply to court for formal sanction. Court sanction is not a feature of the existing Schedule A1 moratorium, which can be obtained simply through the filing of documents at the court. Court involvement brings with it additional costs for all parties. But in the case of a restructuring moratorium, we believe that formal court hearing is appropriate. The companies involved are likely to be large, with a significant number of creditors potentially affected by the granting of a moratorium. And it is likely that the directors will be applying for a moratorium at an earlier stage – before a formal compromise proposal has been developed – which brings with it additional potential risks.

4.3 Before it would sanction a moratorium, the court would need to satisfy itself that the company was eligible to apply for a moratorium and that the relevant qualifying conditions were met. The court would not be expected to make commercial judgements itself, but would instead base its assessment on evidence prepared by the directors, and confirmed by an authorised insolvency practitioner.

4.4 The court would be able to hear objections from any creditor – for example where a creditor considered that the moratorium would unfairly prejudice their interests, or where the satisfaction of the qualifying conditions was disputed. And it would have powers to either sanction the moratorium (with or without conditions), decline the application, or make another order – for example an order for administration or winding-up, if it considered that the relevant conditions were met. Importantly, the court would also confirm the appointment of a monitor, whose role would help safeguard creditors' interests during the moratorium – as explained below.

4.5 The court hearing must be a transparent process, at which creditors can represent their interests as they see fit. For this reason, we propose that there should be a requirement for the directors to formally give notice of their intention to apply for a moratorium. An interim moratorium would come into force from the point at which such notice was given, until the court had made a substantive decision on the formal application. To facilitate an expedited court procedure, and to support the development of the relevant expertise, it is

proposed that applications would, for England and Wales, be heard at the High Court and in Scotland, the Court of Session.

4.6 Where the court sanctions the application for a moratorium at the initial, pre-proposal stage, it would be for a maximum of three months – starting from the date on which the directors gave notice of their intention to apply for a moratorium. As we have set out in part 3, it is possible that in a minority of cases the directors may apply for an extension of the moratorium where a restructuring proposal cannot be agreed within this period. In other cases, the directors may wish to apply for an extension to cover the time required for the approval of a statutory compromise proposal.

4.7 We propose that any extension of the moratorium during the initial, pre-proposal stage should in principle require a further court hearing. That should provide a strong incentive on directors to conclude negotiations as quickly as possible, and help minimise the period during which creditors' rights were suspended.

Q5 : Do you agree that any extension of the moratorium during the period when a compromise proposal is still being negotiated should require a further court hearing ?

4.8 Where a statutory compromise proposal has been developed, in the case of a Scheme of Arrangement the initial court hearing in connection with the Scheme can sanction the moratorium. But where the compromise proposal takes the form of a CVA, there is no court hearing at present. Creating the requirement for a new court hearing in order to sanction the moratorium would add significantly to the costs, at a point when it is arguable that because a proposal has been negotiated, and because of the existing statutory tests that any proposal must meet, the risks to creditors are not as high as at the initial, pre-proposal stage.

Q6 : We would welcome views on whether an additional court hearing should be required for the extension of a moratorium to cover the formal approval of a CVA proposal.

The role of the insolvency practitioner

4.9 The directors of the company have the formal responsibility for applying for a moratorium. And during the period that a moratorium remains in force, the directors remain in control of the company's affairs – although subject to certain significant constraints and checks, as detailed below. That is a fundamental distinction between a restructuring moratorium and insolvency procedures such as administration, where control of the company's affairs passes to an insolvency practitioner, acting in the interests of creditors.

4.10 Against this general picture, however, we also propose that there should be a formal statutory role for an insolvency practitioner during the restructuring moratorium, in order to help safeguard creditors' interests and provide a check on the directors' actions at certain key stages.

4.11 At the application stage, the insolvency practitioner will have a number of important roles. They will be responsible for ensuring that creditors and other parties are notified of the start of the moratorium that is triggered by directors giving notice of their intention to apply to court. The practitioner will then have a limited period – no more than seven days – to provide a statement as part of the application confirming that they consider the relevant qualifying conditions are met, together with their reasons. If they are not able to provide such a statement, then the directors will be unable to continue with their application, and the moratorium will come to an end.

4.12 If the court formally sanctions the moratorium, it will confirm the appointment of an insolvency practitioner as "monitor". The monitor will be an officer of the court. Their principal function would be to ensure that the moratorium only remains in force whilst the relevant qualifying conditions are met. If circumstances change - for example if the company is no longer able to meet the obligations incurred whilst running its business, or if negotiations with creditors have irrevocably broken down – the duty of the monitor would be to withdraw, bringing the moratorium to an end without further recourse to the court.

4.13 A decision by the monitor to withdraw would be a significant one, and the court would need to be satisfied that the insolvency practitioner proposed for the role of monitor had adequate depth of experience to be confident in making the judgements required, independently from the interests of any one party. The monitor would be accountable for their actions, which could be challenged by the directors, creditors, or any other person affected.

4.14 In fulfilling their function, the monitor will rely principally on information provided by the directors. The monitor will need to agree with the directors what information is required, and how often it should be provided. This will be reinforced by a statutory obligation on directors to disclose information that may be material to the satisfaction of the qualifying conditions – with the deliberate withholding of such information giving rise to the possibility of criminal sanctions. By ensuring that there is a clear separation of roles and responsibilities between the directors and the monitor, we believe that the monitor will be able to perform their functions in an effective manner that does not result in a disproportionate burden of cost.

Rights for creditors

4.15 Once the directors have given notice of their intention to apply for a moratorium, an interim moratorium comes into force and no creditor or group of creditors would be able to veto or pre-empt their application. However, because we are proposing that a court hearing should be required to sanction the moratorium, there is an opportunity for creditors to represent their interests at that early stage, and raise any objections as they see fit. At that hearing the individual creditors (or classes of creditors) may object to the moratorium on the grounds that it would result in unfair prejudice to their interests. They may also dispute whether the qualifying conditions are met, for example whether there was a reasonable prospect of a compromise being reached.

4.16 We believe that in common with normal practice in restructurings, it would be very unusual for the directors not to consult, as a minimum, with their senior secured lenders before making an application for a moratorium, to ensure that there was support for the principle of a restructuring or compromise. If that support was not forthcoming, it would be questionable whether a compromise was a realistic prospect, as required for the qualifying conditions to be met.

4.17 During the moratorium, the monitor has the role of ensuring that the qualifying conditions continue to be satisfied. Although this helps to safeguard the interests of creditors, the monitor would act on behalf of the court, and would be independent of the interests of any creditor or creditors. It is important, however, that the monitor is a suitable person who commands the respect of creditors.

4.18 Creditors would in addition have the right to challenge in court the actions of an officer of the company (directors or shadow directors), where these unfairly prejudiced the interests of a creditor or creditors.

Obligations on Directors

4.19 Making an application for a moratorium would be a serious step for directors to take, and one which they should consider carefully. As well as the costs directly associated with the procedure, the directors should be aware of the possible commercial consequences of entry into a moratorium, even before insolvency, and will need to have strong relationships with their suppliers and customers in order to mitigate some of the associated risks. They will also be aware that in considering any company's application for a moratorium, the court will have a wide range of powers at its disposal if the application is not approved, including making an order to wind-up the company or place it into administration.

4.20 Directors should also be mindful of the consequences of misuse or abuse of the procedure, and potential harm to creditors' interests that could result from such abuse. To reinforce that consideration, we propose that the restructuring moratorium should have a robust range of provisions that effectively deter any misconduct or abuse by directors. Those measures include the application of fines or criminal sanctions in the event of an officer of the company :-

- concealing the company's assets or debts, removing or disposing of assets (unless authorised to do so), or false or fraudulent record keeping;
- obtaining credit without first disclosing that a moratorium is in force;
- making a payment in respect of a pre-moratorium debt (unless authorised to do so);
- failing to state the existence of the moratorium on invoices and other official company communications;
- failing to supply information required by the monitor, or that is relevant to the monitor's assessment of the qualifying tests; and

- entering into certain financial market transactions whilst the moratorium is in force.

4.21 Other measures will also mitigate against the risk of abuse by directors. We will prevent directors applying for successive moratoria, by making companies that have been subject to a moratorium within the previous twelve months ineligible for a new restructuring moratorium or Schedule A1 moratorium, and by removing the right of directors to appoint an administrator within the same period. In the event that a moratorium is brought to an end prematurely and followed by another insolvency procedure (other than a compromise proposal), the start of the moratorium will be deemed to be the "onset of insolvency", enabling prior transactions to be investigated by an insolvency practitioner.

Q7 : Do you agree that the proposed role of the monitor, together with the rights of creditors and the obligations on the directors, strikes the right balance in safeguarding the interests of creditors and deterring abuse, without imposing disproportionate costs or impeding the objectives of the moratorium ?

Debts arising during the moratorium

4.22 As part of their application for a moratorium, the directors must demonstrate, to the satisfaction of an insolvency practitioner and the court, that they are likely to have sufficient funds to carry on their business for the period whilst the moratorium is in force. Once the moratorium has been sanctioned, failure to satisfy this condition would result in the monitor withdrawing, bringing the moratorium to an end.

4.23 Although the company is likely to be incurring new liabilities in the course of trading whilst the moratorium is in force, the effect of this qualifying condition should be to limit the extent to which new debts are accumulated during the moratorium, on top of the debts that pre-dated its start. However it is possible to envisage circumstances where there could be new debts from the moratorium in existence when the moratorium comes to an end – particularly where new funding has been advanced during the moratorium period. This possibility arises in the context of these proposals because, unlike a Schedule A1 moratorium, a restructuring moratorium could be in force whilst the compromise proposal is being prepared, a period which could last for a number of months. Two issues arise from this.

4.24 First, there is the issue of treatment of any such debts in a subsequent CVA. The possibility of moratorium debts being compromised in a CVA, particularly where the formal voting process is likely to be dominated by much larger pre-moratorium debts, may represent a significant barrier to suppliers and others being willing to trade with the company during the moratorium period. To mitigate this risk, we propose that a CVA prepared whilst a moratorium is in force should not be capable of compromising moratorium debts. Any such debts must be paid in full, and the relevant creditors should not be prevented from enforcing their debts when the CVA is in place, once the moratorium has come to an end.

4.25 Second, there is the issue of the treatment of outstanding moratorium debts where the moratorium has come to an end prematurely. In those circumstances, the most likely scenario is that the moratorium will immediately be followed by the company entering administration or, possibly, liquidation. We propose that in those circumstances any such debts will be given super-priority in any distribution carried out as part of the subsequent procedure, provided that the procedure is entered immediately after the moratorium[4]. Such a provision would provide greater financial security for those trading with the company during the moratorium, and help the company secure funding that may be required to support its business in that period. Where such a distribution is made, the effective date for set-off should be the date of entry to the moratorium (i.e. mutual dealings taking place after the start of the moratorium would not be taken into account in determining the net position for any distribution).

Q8 : Do you agree with the proposals for treatment of moratorium debts in a subsequent CVA, and in any distribution undertaken in an administration or liquidation that immediately follows a moratorium ?

[4] In other words, debts outstanding when the moratorium ends that arose whilst the moratorium was in force would in terms of priority be below any fixed charge on the company's assets, but above other claims including those relating to expenses of the subsequent procedure, and the claims of preferential creditors, floating charge holders, and unsecured creditors. The position would therefore be analogous to the priority of trading expenses in the current administration procedure.

Annex A

Summary of Consultation Questions

Q1 : Do you agree with the expected costs and benefits of the proposals, as set out in the Impact Assessment ? Are there other benefits or costs that you believe should also be considered ?

Q2 : Do you agree that in order to help safeguard creditors' rights, a company should not be eligible for a moratorium if there is an outstanding petition for winding-up unless it has a statutory compromise proposal (a scheme of arrangement or CVA) that it is ready to put to creditors ?

Q3 : At the pre-proposal stage, do you agree that the two proposed qualifying conditions provide the right balance in ensuring that a moratorium is only available to companies where the core business is viable but there is nevertheless a need to restructure their debts ?

Q4 : Where a company has a proposal for a CVA or Scheme of Arrangement and wishes to apply for a moratorium (or extend the existing moratorium), do you agree that provided the existing statutory conditions are met the only additional qualifying condition that should apply is that the company is likely to have sufficient funds to carry on its business ?

Q5 : Do you agree that any extension of the moratorium during the period when a compromise proposal is still being negotiated should require a further court hearing ?

Q6 : We would welcome views on whether an additional court hearing should be required for the extension of a moratorium to cover the formal approval of a CVA proposal.

Q7 : Do you agree that the proposed role of the monitor, together with the rights of creditors and the obligations on the directors, strikes the right balance in safeguarding the interests of creditors and deterring abuse, without imposing disproportionate costs or impeding the objectives of the moratorium ?

Q8 : Do you agree with the proposals for treatment of moratorium debts in a subsequent CVA, and in any distribution undertaken in an administration or liquidation that immediately follows a moratorium ?

Annex B

Eligibility for a moratorium – further details

B.1 In order to be eligible for a restructuring moratorium, a company must be eligible for either a Company Voluntary Arrangement (under Part 1, Section 1 of the Insolvency Act 1986) or a Scheme of Arrangement (under the Part 26 of the Companies Act 2006). If the company is of a type that is not capable of making use of either procedure, it should not be eligible for a restructuring moratorium.

B.2 We also propose that a company should not be eligible for a restructuring moratorium if it is a subsidiary of a company whose centre of main interests (COMI) is in another EU member state and which is in the process of being wound-up under a procedure recognised in the EC Regulation on Insolvency Proceedings No. 1346/2000 or The Cross-Border Insolvency Regulations 2006.

B.3 The companies that are to be expressly excluded from being eligible replicate, for the most part, those companies which are excluded from eligibility for the existing small company moratorium found provided for in Schedule A1 of the Insolvency Act 1986. Broadly speaking, these are insurance companies, banks, and other companies involved in specific financial market transactions, where the obtaining of the proposed moratorium could affect the functioning and integrity of those markets. We propose that the restriction on eligibility of banks should be extended to include bank holding companies. This will help avoid any uncertainty that might be caused by directors negotiating a restructuring without the knowledge of the regulatory authorities.

B.4 In addition, we propose to update the definition of “capital market arrangement” to reflect the changes made in 2003 to Schedule 2A of the Insolvency Act 1986, in order to ensure that cases based on whole business securitisation are caught by the exemption, with the same financial threshold of £50M for this exemption.

B.5 The existing eligibility condition under paragraph 4C of Schedule A1 (“liability under an arrangement”) should not apply to the restructuring moratorium. Given that this test is in effect a further dimension of the restriction of eligibility to small companies only, it is not appropriate for it to apply to the restructuring moratorium, where no such eligibility restriction applies.

B.6 In line with the current Schedule A1 provisions, it is proposed that the Secretary of State would have the power to amend the eligibility conditions of the restructuring moratorium. The modification power would be capable of adding to, modifying or removing existing exclusions, and would be exercised by means of a statutory instrument subject to the affirmative resolution procedure.

Title: Restructuring Moratorium Lead department or agency: **Department for Business, Innovation, and Skills** Other departments or agencies: **The Insolvency Service**	Impact Assessment (IA)
	IA No: BIS0117
	Date: 26/07/2010
	Stage: Consultation
	Source intervention: Domestic
	Type of measure: Primary legislation
	Contact for enquiries: Sarah O'Sullivan 020 7291 6766

Summary: Intervention and Options

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

As the UK and global economy emerges from the recession, some companies - particularly those that are highly leveraged - are expected to continue to face significant financial challenges. Some are likely to need to negotiate a restructuring of their debts, and will seek to do so at an early stage, outside of a formal insolvency process. However the risks and costs currently associated with a restructuring process can undermine the attempt to achieve a successful outcome, adversely affecting returns to creditors and making company failure (or liquidation) more likely, with consequent knock-on effects on growth, jobs and wealth creation more generally. Intervention seeks to address the market failures present (rent seeking and transaction costs), by providing companies with more tools to help address financial difficulty efficiently.

What are the policy objectives and the intended effects?

To facilitate the restructuring of viable but distressed companies that need to take action in order to ensure their survival, by reducing the risks and costs of negotiating a compromise or other arrangement with their creditors.

The intended effect is to help avoid the inefficient liquidation of viable companies, improve returns to creditors, and help preserve jobs in those companies that can be rescued successfully.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Option 1 - Do nothing. At present, directors of companies seeking to negotiate a restructuring must attempt to secure an informal, consensual standstill amongst creditors, or rely on a contractual standstill mechanism (where available).

Option 2 - Extend the existing small company 'Company Voluntary Arrangement' moratorium to companies of all sizes.

Option 3 (preferred option) - the option of a moratorium, outside of administration, for companies seeking to negotiate a compromise or other arrangement with creditors which meet the relevant statutory eligibility and qualifying tests.

Option 3 is most likely to achieve the policy objective of facilitating restructuring and company rescue.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed four years after implementation
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off :

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: .... Date: ....

Summary: Analysis and Evidence   Policy Option 3

Description:

The proposals for a Restructuring Moratorium

Price Base Year	PV Base Year	Time Period Years **10**	Net Benefit (Present Value (PV)) (£m)		
			Low: **£4M**	High: **£323M**	Best Estimate: **£137M**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0		£0.5M	**£4.0M**
High	£0.05		£7.5M	**£65M**
Best Estimate	£0.03		£4M	**£34.5M**

Description and scale of key monetised costs by 'main affected groups'

-Cost to the companies using the moratorium will comprise Insolvency Practitioner fees, monitoring costs and court fees. An initial report to court may cost a company £6K to £50K and the professional fees for a monitor for a moratorium of between 60 and 120 days are likely to range from £30K to £150K per case. Costs associated with court processes are estimated to be between £50K and £300K.
-Minimal one off costs of familiarisation for the insolvency profession, creditors and businesses.
-HMCS may incur one off costs in familiarisation and training which may be absorbed by current processes.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0		£1M	**£9M**
High	0		£45M	**£387M**
Best Estimate	0		£20M	**£172M**

Description and scale of key monetised benefits by 'main affected groups'

The median cost of restructurings is estimated to lie between £2M and £15M, with those costs incurred principally by companies and their creditors. The proposals are expected to save at least 10-20% of that i.e. £200K to £3M for each case due to the reduction in time needed for restructuring and its associated costs.

Other key non-monetised benefits by 'main affected groups'

-Positive effect on restructurings undertaken through an informal standstill.
-Reduced need to make ransom payments to individual creditors.
-Avoidance of administration in some cases.
-Better outcomes for creditors and the company through earlier action taken by the directors.

Key assumptions/sensitivities/risks   **Discount rate (%)** 3.5

Assume that 5 - 15 companies per year will take advantage of the new moratoria provisions. Low and high estimated costs are based on these case numbers. Best estimates are based on an average 10 companies using the provisions in any year.
Risk that moratoria will be underused if costs are too high, directors act too late, insolvency practioners are unwilling to take on a new role or that the cost of credit increases generally if risks to creditors increase.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB:	AB savings: **n/a**	Net:	Policy cost savings: **n/a**	**Yes/No**

Enforcement, Implementation and Wider Impacts

<table>
<tr><td colspan="3">What is the geographic coverage of the policy/option?</td><td colspan="3">Great Britain</td></tr>
<tr><td colspan="3">From what date will the policy be implemented?</td><td colspan="3">n/k</td></tr>
<tr><td colspan="3">Which organisation(s) will enforce the policy?</td><td colspan="3">n/a</td></tr>
<tr><td colspan="3">What is the total annual cost (£m) of enforcement for these</td><td colspan="3">n/a</td></tr>
<tr><td colspan="3">Does enforcement comply with Hampton principles?</td><td colspan="3">Yes</td></tr>
<tr><td colspan="3">Does implementation go beyond minimum EU requirements?</td><td colspan="3">No</td></tr>
<tr><td colspan="3">What is the CO_2 equivalent change in greenhouse gas emissions?
(Million tonnes CO_2 equivalent)</td><td>**Traded:**
n/a</td><td colspan="2">**Non-traded:**
n/a</td></tr>
<tr><td colspan="3">Does the proposal have an impact on competition?</td><td colspan="3">No</td></tr>
<tr><td colspan="3">What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?</td><td>**Costs:**</td><td colspan="2">**Benefits:**</td></tr>
<tr><td>Annual cost (£m) per organisation
(excl. Transition) (Constant Price)</td><td>**Micro**</td><td>**< 20**</td><td>**Small**</td><td>**Medium**</td><td>**Large**</td></tr>
<tr><td>Are any of these organisations exempt?</td><td>No</td><td>No</td><td>No</td><td>No</td><td>No</td></tr>
</table>

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…	Impact	Page ref within IA
Statutory equality duties[5]? Equality and Human Rights Commission: General guidance	No	11
Economic impacts		
Competition? Competition Impact Assessment	No	10
Small firms? Small Firms Impact Test	No	10
Environmental impacts		
Greenhouse gas assessment? http://www.defra.gov.uk/environment/index.htm	No	
Wider environmental issues? Guidance has been created on the Defra site	No	
Social impacts		
Health and well-being? Health: Health Impact Assessment	No	
Human rights? Ministry of Justice: Human Rights	No	
Justice?	No	
Rural proofing? Commission for Rural Communities	No	
Sustainability? Defra: Think sustainable	No	

[5] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Implementation).

No.	Legislation or publication
1	**The Insolvency Act 1986** - http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/cukpga_19860045_en_1

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	0.3	0	0	0	0	0	0	0	0	0
Annual recurring cost	4	3.8	3.7	3.6	3.5	3.4	3.3	3.1	3	2.9
Total annual costs	4.3	3.8	3.7	3.6	3.5	3.4	3.3	3.1	3	2.9
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	20	19.3	18.7	18.0	17.4	16.8	16.3	15.7	15.2	14.7
Total annual benefits	20	19.3	18.7	18.0	17.4	16.8	16.3	15.7	15.2	14.7

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base

Problem under Consideration

Directors seeking to restructure a viable but struggling company are often faced with the need to negotiate a compromise with creditors. There are currently a range of statutory and non-statutory (contractual) mechanisms available to achieve this outcome. However, barriers still exist to achieving a successful restructuring, such as the excessive costs associated with prolonged negotiations, and the difficulty in co-ordinating potentially large numbers of creditors with diverse interests. These barriers increase the chances of a failure to achieve a negotiated restructuring, adversely affecting returns to creditors and making liquidation of the company more likely.

Rationale for Intervention

Statutory mechanisms available to directors seeking to negotiate with the company's creditors include procedures provided for in the Insolvency Act 1986 such as company voluntary arrangements (CVAs), and the schemes of arrangement procedure under the Companies Act 2006. For certain types of restructuring, a private, consensual non-statutory procedure (often known as a "contractual workout") is also an established alternative, particularly where the main parties affected are financial creditors.

However significant barriers to a successful negotiation and the rescue of the company are often experienced. For example the increasing complexity of financing arrangements – particularly the trend towards the syndication of bank debt used to finance leveraged buy-outs between 2001 and 2007 – has increased the difficulties and costs associated with any negotiation process. The relevant barriers include :-

- **coordination problems including rent seeking**[6] – 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) for example by forcing early recovery of their debt, or by delaying response to compromise offers in the hope that others will compromise instead. The second potential difficulty is where smaller creditors, having less financial interest in the outcome, may stall negotiations as there is no incentive to participate. Creditors will act individually and be unaware of the broader impact, that their actions will have on businesses, causing business rescue to become more difficult and therefore worsening the position for creditors as a whole; and
- **transaction costs** - delays and difficulties in initiating and concluding negotiations (particularly in complex multi-creditor scenarios) can increase the costs associated with restructuring and business. 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.

Both of these market failures (coordination problems and transaction costs) are more likely the greater the number of creditors, particularly where there are large numbers of minority creditors. This adversely affects the efficiency of a rescue process, lowering the chances of a successful negotiated restructuring and increasing the risk of inefficient liquidation of viable businesses.

Intervention is necessary in order to address the market failures outlined above. These issues will be particularly prevalant amongst medium and large companies who currently have no access to a moratorium outside of administration. Addressing these barriers to the efficient rescue of viable companies increases the likelihood of a distressed company surviving, and helps to preserve the economic value of the company, providing a better outcome for creditors, and helping to preserve jobs.

[6] seeking to extract value through manipulation as opposed to seeking to earn profit through economic transactions

The scale of the problem is difficult to estimate due to the case specific nature of the moratorium and the dependency, in part, on macro economic factors (recession etc). We later make an assumption around the number of cases in which a moratorium is used (based upon stakeholder feedback) of 5-15 per year.

Policy Objective

To support the rescue of viable but distressed companies that need to take action to restructure in order to ensure their survival, by reducing the risks and costs of negotiating a compromise or other arrangement with its creditors.

Description of options considered (including do nothing)

Option 1 - Do nothing. At present, directors of companies seeking to negotiate a restructuring must attempt to secure an informal, consensual standstill amongst creditors, or rely on a contractual standstill mechanism - if one exists – between different financial creditors. With the exception of small companies seeking agreement to a CVA proposal, there is no option of a statutory moratorium[7] unless the company is put into administration.

Option 2 -Extend the existing small company CVA[8] moratorium to companies of all sizes.

Option 3 (preferred option) - the option of a restructuring moratorium, outside of administration, to provide a period of greater stability and reduced risk, for companies that are seeking to restructure, negotiate a compromise or other arrangement with creditors, and which meet the relevant statutory eligibility and qualifying tests.

Costs and benefits of each option

Option 1 will maintain the current regime and thus no additional costs or benefits will arise.

Option 2: Feedback from stakeholders suggests that the extension to medium and large companies of the existing moratorium provisions available to small companies using the CVA procedure would have limited benefits.

Whilst a moratorium and the protection from creditors that one provides is potentially highly beneficial if extended to the restructurings or negotiations of larger companies, it is unlikely to be used. An approved CVA is binding on unsecured creditors but cannot compromise the rights of secured creditors without their consent. This limits the effectiveness of CVAs, particularly for larger companies and financial restructurings where the compromise of secured creditors' rights is more likely to be an issue. Furthermore the existing CVA moratorium does not cover the earlier period in which the proposals are negotiated. This is likely to represent an issue for larger companies, where more creditors are likely to be involved and the time taken for negotiations is likely to be significantly greater than for a small company.

Because the benefits are considered to be so limited, this option would not fulfil the policy objective. On this basis the costs have not been calculated.

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[7] A moratorium is a period during which creditors and others are prevented from taking action to recover debts owed or enforce other statutory or contractual rights against the company and its property. For further details, see Part 3 of the main consultation document.

[8] A CVA is when a company makes a legally binding agreement with its creditors by proposing a composition in satisfaction of its debts. The Insolvency Act 2000 introduced the option of a moratorium for small companies to have protection for 28 days whilst a CVA proposal is put to creditors.

Option 3

Scope and Limitations

The proposed restructuring moratorium will be available to companies of all sizes, provided they meet the eligibility criteria. However we expect that the use of the moratorium will be principally amongst larger companies, where the anticipated benefits of being able to complete restructuring negotiations more quickly will outweigh the costs associated with obtaining a moratorium.

Benefits

The proposal will have a range of benefits, including both benefits that can be quantified and benefits that cannot be quantified (or where the uncertainties associated with quantification would be disproportionately large).

Quantified Benefits

Feedback from stakeholders suggests the main quantifiable benefit of the proposal is likely to be a reduction in the cost of the restructuring process. Faster completion of the process of negotiating and implementing a restructuring or compromise will result in savings in advisor fees and management time for both the company and creditors involved. In particular :-

- Less time will need to be expended overcoming the co-ordination problems described above; and
- Once the company has entered a moratorium, it will have strong incentives to complete negotiations as quickly as possible because of the constraints (set out elsewhere in this consultation document) on the company's activities that apply whilst the moratorium is in force.

It is most likely that savings will be accrued in the early stages of the negotiation process, rather than (for example) during the later phase of the approval of a statutory compromise proposal. Savings are most likely to accrue for larger and more complex restructurings, where the current costs and risks associated with negotiations are likely to be greatest.

There is no published data or research on the costs of such negotiations at present. They are likely to vary significantly according to the numbers of creditors involved, the complexity of the issues, and whether a formal statutory compromise mechanism (such as a scheme of arrangement) is involved. However from discussions with stakeholders it appears that a baseline cost (which would include transaction and advisor costs) in the range £2M to £15M is a reasonable assumption for the median cost of an individual restructuring.

The total benefit of the proposals relative to these baseline costs is a function of :-

- the number of companies that enter into restructuring negotiations;
- the proportion of those companies that apply for and obtain a moratorium; and
- the expected level of savings in any individual case resulting from the moratorium relative to the baseline restructuring costs.

In terms of the number of cases where companies will make use of the new procedure, it is expected that this is likely to be a small minority of the total number of companies seeking a restructuring. For companies that are able to achieve a restructuring without use of a moratorium – for example on the basis of an informal standstill amongst creditors – this is likely to remain the best option, because it limits the negative commercial impact and costs

associated with a statutory moratorium[9]. Furthermore as creditors will be aware that the option of a moratorium exists, an informal standstill may be more successful.

For the larger, more complex restructurings, the costs and risks associated with a restructuring negotiation are higher. In particular stakeholders confirm that costs rise with time and so the lengthier the process, the costlier it is. Because the benefits of a restructuring moratorium are therefore likely to be more significant for these larger, more complex restructurings, it is expected that use of a moratorium will be concentrated in this area. It is however impossible to forecast the precise number of cases that are likely to fall into the latter category. Our best estimate, based on the current economic outlook, would be in the range 5-15 cases a year.[10]

The level of savings arising from the use of a restructuring moratorium is likely to vary on a case by case basis, making it very hard to quantify. We would not expect a company to apply for a moratorium where the level of savings was marginal, particularly taking into account the costs. It is therefore reasonable to assume that in those cases where an application for a moratorium is made the expected savings compared with the baseline costs would be at least 10-20%.

We estimate that the gross quantified annual benefit from the proposals therefore lies in the range £1M (10% saving on £2M baseline cost, 5 cases per year) to £45M (20% saving on £15M baseline cost, 15 cases per year).

It is anticipated that even if the expected savings on costs in an individual case are lower than the 10-20% estimated, these could still exceed the additional costs of the procedure as described above.

Other benefits

Data is not available to enable us to quantify the following benefits, nor have stakeholders been able to provide estimates. They have however identified these benefits as potentially resulting from the proposals:-

- the indirect benefits to restructurings being undertaken on the basis of an informal standstill, but more quickly as creditors know that a moratorium can otherwise be used, thereby mitigating the incentive on participants in negotiations to adopt tactical approaches aimed at exploiting the threat of delay or disruption for economic gain.
- a reduced need to make ransom payments or other commercial settlements with holdout creditors who could (in the absence of a moratorium) take action to destabilise the negotiation process;
- a saving on costs, and improved returns to creditors in cases where in the absence of the proposals the company would otherwise have entered administration to obtain the protection of a moratorium;
- the benefits to creditors, employees, and the company from directors having a stronger incentive to act early to address their problems (i.e. jobs saved if the company continues as a going concern or avoids the need for more drastic restructuring measures that would be required if its position has deteriorated significantly).

[9] This suggests that the policy has no deadweight cost

[10] Companies House data for 2009 indicates approx 50 schemes of arrangement were registered of which roughly one third related to restructurings. CVAs have varied from 400 to 700 in recent years of which the majority (around 70%) will be small companies who already have access to a moratorium and who are therefore unlikely to make use of the proposed procedure. In addition, the eligibility conditions and qualifying tests for the moratoria will mean that companies that are no longer viable will not be able to benefit from them.

Although potentially significant, these benefits are very difficult to quantify because of the potential range of different cases and scenarios involved. For this reason they have not been quantified as part of this impact assessment.

Costs

The principal costs to companies wishing to use the new proposals are the costs associated with the statutory roles defined for the insolvency practitioner, and the costs associated with the court application and hearing.

A company that is facing temporary difficulties and needs to restructure will usually have sought specialist professional advice, for example from an insolvency practitioner, accountant or lawyer. Equally, creditors entering into a restructuring negotiation will also have sought professional advice, and indeed may have commissioned specific reports on the financial outlook for the company. As set out above, the proposals are expected to result in significant savings in these costs, by facilitating a faster completion of the negotiation process. However in order to safeguard the interests of creditors, the proposals also create a new role for an insolvency practitioner, including :-

- the initial assessment of the qualifying tests, and the preparation of a report on why the qualifying conditions[11] are met (which is then submitted to the court by the directors);
- if a moratorium is granted by the court, the role of monitor in ensuring, based on information supplied by the directors, that the relevant qualifying tests continue to be met.

The contents of the initial report by the insolvency practitioner on the assessment of the qualifying tests will be set out in secondary legislation. The work will have to be carried out quickly, due to the limited period allowed in the proposals for the application to court to be made, once notice of an application has been given. The amount of work involved in the initial assessment of the qualifying tests is likely to vary significantly according to the size and complexity of the company's affairs, and the extent to which these are already familiar to the insolvency practitioner. We estimate the overall cost of the initial report to be in the range £6,000 to £50,000 (although it could be higher) depending on the complexity of the work and the level of fees/disbursements charged by the insolvency practitioner and their staff[12].

The role of the insolvency practitioner in monitoring the qualifying tests whilst the moratorium is in force will be determined by duration of the moratorium, the intensity of the work required, and the hourly rate charged by the insolvency practitioner. The duration of the moratorium is subject to various proposed statutory limits, but will vary according to the complexity of the negotiations, and whether the moratorium also covers the period required for the approval of a statutory compromise proposal. The policy intention is that the monitor should be able to perform their function on the basis of information supplied by the directors (and creditors), rather than through the establishment of new information gathering processes.

Based on an estimated average moratorium duration of between 60 and 120 days we estimate that the monitoring cost is likely to be in the range £35,000 to £150,000 (although could be higher in some cases).

The main costs associated with the court application and hearing will include court fees, and the cost of legal representation to the company and other parties who may participate, including for

[11] The role of the qualifying conditions is explain in part 3 of the main consultation document
[12] Publically available information indicates that hourly rates charged by Insolvency Practitioners and their staff are in the range £100-£600 per hour, depending on the firm involved, and the role and seniority of the individual doing the work.

example creditors who may wish to contest the moratorium application. The extent to which an application is contested is hard to predict, and is likely to vary significantly on a case by case basis. In addition, in some cases there will be a further court hearing either to authorise an extension of the moratorium, or the second stage of the moratorium when a statutory compromise proposal has been prepared. Taking all these factors into account, we estimate that the costs associated with the court application and hearing are likely to be in the range £50,000 to £300,000 (although possibly higher in some cases).

The estimated total quantified cost of the proposals, taking into account both the costs of the insolvency practitioner, and costs associated with the court application, is therefore expected to be in the range £0.1M to £0.5M per case. Based on the estimate of 5-15 cases per annum given above, the expected total annual recurring cost of the proposals is therefore between £0.5M and £7.5M.

Other costs (not quantified)

The proposals may give rise to other costs for companies that apply for a moratorium that we have not sought to quantify here. These costs may include the commercial cost of entering into a statutory moratorium – for example where suppliers change the terms under which they are willing to supply the company whilst the moratorium is in force.

It is inherent in the proposals that the decision on whether to apply for a moratorium, or whether to enter into restructuring negotiations without the benefit of a moratorium, is made by the company and its directors. In making that decision, they will need to weigh up all the likely costs and possible benefits of the moratorium option. By definition, therefore, the moratorium will only be used in cases where there is a positive expected net benefit to the company.

Transitional Costs

Transitional costs are expected to be minimal. The Insolvency Service is able to notify changes to the profession through its Dear IP publication and to wider stakeholders through its website and electronic communication. There will be an amendment to a leaflet but as it is one that exists already, printing and distribution costs will not increase. Some implementation costs may also be incurred by HM Court Service, but given the small number of cases and the limitation on jurisdiction to the High Court these are not expected to exceed £20,000.

Risks and assumptions

The key assumptions underpinning this analysis are set out in the description of costs and benefits above. The key risks are :-

1. Costs associated the moratorium exceed expected benefits, so proposals are not used.
2. Use of the moratorium by directors of failing companies to "buy time" with creditors, when there is no realistic prospect of a rescue.
3. Increased risks for creditors result in a general increase in the cost of credit for business (or a reduction in its availability).
4. Directors act too late to address the need to restructure, so are unable to realise the benefits of the moratorium
5. Insolvency practitioners are reluctant to consider the option of a moratorium, or are unwilling to take on the associated statutory roles.

Risk Mitigation

The numbering below relates to the risks identified above.

1. Proposals ensure that costs associated with the moratorium are kept to a minimum, consistent with safeguarding creditors' rights; restructuring outside of a statutory moratorium will, as at present, remain an option for companies and their directors.

2. Requirement for directors to satisfy an insolvency practitioner and the court that the company satisfies the relevant qualifying and eligibility tests; criminal sanctions for certain forms of abuse; ability of creditors to challenge directors' application for a moratorium.

3. The suspension of creditors' rights during the moratorium to be subject to important safeguards, including the role of the court and the monitor; no change will be made to existing statutory compromise mechanisms.

4. Proposals strengthen incentives for directors to act early, because by doing so they can, with support from key creditors, stay in control of the company's affairs; no requirement for company to be insolvent before it can apply for a moratorium.

5. Consultation with key stakeholders in the detailed design of the proposals; clarification of the respective duties of the directors and the monitor whilst the moratorium is in force.

Administrative burden and policy savings calculations

Not applicable.

Wider impacts

Competition Assessment: Having considered Office of Fair Trading guidance on competition, it is not considered that these proposals will have a significant adverse impact on competition, in that they will not directly or indirectly limit the number or range of suppliers, limit the ability of suppliers to compete or reduce suppliers' incentives to compete vigorously.

Small Firms Impact Assessment: The proposals are principally likely to benefit medium and large businesses, as small businesses already have the option of a moratorium through the existing small company CVA moratorium. However the proposals do include some consequential changes to that procedure that are expected to increase its flexibility and help reduce its costs.

Race Equality, Disability Equality and Gender Equality: We do not believe that there will be an equality impact as the proposals impact on companies rather than individuals.

Summary and preferred option with description of implementation plan

The preferred option, 3, will provide companies with the option of a restructuring moratorium, where that company is seeking to negotiate a compromise or other arrangement with creditors, and meets the relevant statutory eligibility test and qualifying conditions.

The proposals will require amendments to primary and secondary legislation (the Insolvency Rules 1986), prior to their implementation. The timing of any changes is dependent upon the outcome of the current consultation process, and decisions regarding the future legislative programme.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added to provide further information about non-monetary costs and benefits from Specific Impact Tests, if relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their actual costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];

Consistent with its usual approach to evaluation, the Insolvency Service will review the impact of the proposals four years after implementation.

Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]

To ensure that the proposals are effective in reducing the costs and risks associated with a company seeking a negotiated compromise with creditors, and continue to be required.

Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]

Official statistics will indicate uptake of the proposals and any consequent shifts in trends of insolvency type. Given the small expected numbers of moratoria, and the balance between direct and indirect impact, it is expected that a review of the outcomes from individual moratorium cases will be combined with a wider survey of stakeholder views concerning their impact.

Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]

The baseline data on the costs associated with restructuring is set out in this impact assessment. It will be reviewed in the light of any responses to this consultation, and updated as necessary.

Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]

The number of moratoria used under the new proposals and any other evidence that the proposals have been effective in reducing the costs and risks associated with a negotiated compromise with creditors, supporting the rescue of viable companies.

Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]

Corporate insolvency statistics are already maintained and published, based on information lodged with Companies House. The Insolvency Service maintains regular contact with stakeholders in a variety of forums that will support the progressive collection of feedback on the impact of the proposals.

Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here]

Annex D

The Consultation Code of Practice Criteria

The seven consultation criteria are:

1. **When to consult:** Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. **Duration of consultation exercises:** Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. **Clarity of scope and impact:** Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. **Accessibility of consultation exercises:** Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. **The burden of consultation:** Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. **Responsiveness of consultation exercises:** Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. **Capacity to consult:** Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

A full version of the Code of Practice is available at http://www.bis.gov.uk/files/file47158.pdf.