INSIGHT

Monitoring and responding to companies in distress

NAO National Audit Office

Good practice guide

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This guide aims to provide insights and good practice for officials and leaders across government who may be involved in monitoring and responding to companies in distress.

We are the UK's independent public spending watchdog

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Introduction

The government's position is that, in general, private sector companies should be allowed to fail as part of the efficient working of markets and the economy. In some circumstances, however, it will decide it needs to intervene, either to prevent a company from failing, to rescue a company, or to manage the situation so that a company does not fail in a disorderly way.

Failure of a company in a key sector or a strategic government supplier can have serious consequences for the government, taxpayers and service users, especially those who are vulnerable. Many bodies in government and outside may need to be involved to ensure a shared understanding of this kind of risk and a focus on prevention and preparation, in line with the The UK Government Resilience Framework.

When government intervention in a distressed company is needed, it involves complex decision-making at speed; requires access at short notice to specialised skills that are not widely held across government; can be very costly in the short term; and may take a long time to exit.

Purpose of this guide

This guide sets out the elements to consider and some questions to support good practice and value for money in monitoring, preparedness and response to company distress situations.

In 10 practical sections, it is illustrated with real examples, many of which we have examined in previous reports, such as MG Rover, British Energy, Northern Rock, Thomas Cook, Carillion, and Bulb Energy (Bulb).

The guide is intended to help officials and leaders across government to think through their duties and what they need to do to understand the nature and potential impact of company distress, so that they maximise resilience and are ready to respond if necessary. It does not replace expert advice in an emergency situation.

In preparing this paper we have collaborated with the experts within government who can provide direct guidance and support for a department involved in monitoring these risks or intervening in a distressed company. Those experts include UK Government Investments (UKGI), the Department for Business & Trade, HM Treasury, the Department for Transport, the Insolvency Service, the Cabinet Office and Government Commercial Function. We provide links on page 23 and throughout this guide to their guidance materials.

Enablers

Elements to explore:

- Understanding objectives
- Establishing roles, responsibilities and accountabilities
- Ensuring skills, expertise and capacity

Identifying vulnerabilities and building resilience

Elements to explore:

- Identifying risks
- Scenario planning
- Monitoring risks and financial performance
- Making contingency plans

Intervening, evaluating and learning

Elements to explore:

- Appraising options
- Managing the intervention
- Evaluating and embedding learning

Understanding objectives

It is important to be clear about the government's objectives and duties in the sector, and how companies contribute to achieving them

What we expect

In general, we would expect to see:

- clearly articulated objectives setting out the outcomes you want to achieve for the sector, including its resilience, in the short and long term;
- understanding of how the private sector contributes to delivering your policy objectives, and which companies are therefore strategically important for this reason; and
- an understanding of how your objectives relate to other objectives across government, including resilience of the wider economy and society. This includes a recognition of any conflicts or trade-offs between objectives and clarity on how government should manage and resolve these conflicts.

Further resources:

- Our Principles of effective regulation guide sets out how government and regulators can discuss respective priorities and manage any trade-offs in objectives.
- Our Guide to corporate finance in the public sector sets out how government and the public sector have used corporate finance techniques to implement a range of policy objectives. It considers the risks and opportunities of using particular organisations and functions to achieve your objectives.

Questions to consider

Determining your objectives

- What statutory objectives do you have?
- What duties do you have to citizens or vulnerable consumers, for example, protecting them from possible harm?
- What outcome are you trying to achieve in both the short term and long term?
- What policies are the objectives seeking to support?

Understanding the role of companies in your sector in delivering these objectives

- How and to what extent do you rely on companies to achieve your policy objectives?
- Which key companies in your sector are also supplying other government departments or providing their public services?
- Which companies in your sector are providing essential services to society and the economy?
- Which companies in your sector are strategically important to national resilience, including critical supply chains and national security?

Revisiting your objectives and managing trade-offs

- How often do you revisit your objectives?
- How well do they align with wider government objectives and how do you manage any trade-offs?

Understanding objectives *continued*

Case study example

Energy suppliers

Our report on The energy supplier market concluded that Ofgem and the then Department for Business, Energy & Industrial Strategy faced the significant task of managing short-term objectives around stabilising the market, while considering their longer-term objective of transitioning the supplier market to one that works for consumers and supports the achievement of net zero.

We recommended that Ofgem define and agree a set of objectives for its regulation of the retail market against which it should review and report its performance at least annually. This should include measures based on consumer outcomes such as price; quality of service; stability and predictability of tariffs; and delivery of the innovation needed to achieve net zero.

We also recommended it build review points into its current round of changes to the regulation of suppliers, to ensure it is balancing the need for financial resilience and enabling innovative business models to enter the market.

Case study example

Steel company interventions

In 2021, the Business, Energy and Industrial Strategy Committee called on the government to develop a new Sector Deal for the steel industry to address long-running challenges to the sector's competitiveness as part of a cohesive plan for decarbonising the industry. Its report on Liberty Steel and the Future of the UK Steel Industry pointed to a lack of transparency in steel supply chains together with an absence of explicit guidance on how social and environmental considerations should be applied, resulting in broader objectives being missed.

The steel industry has faced a number of crises in recent years but action to support the sector has been taken on a mostly ad hoc, reactive basis. Recent examples include: government funding the Official Receiver as Liquidator to carry out its statutory duties, which involved pursuing the sale of British Steel in 2019; issuing an emergency loan to Celsa Steel in 2020; nationalising Sheffield Forgemasters in 2021; and providing a £500 million grant to Tata Steel in 2023. In 2023, the government announced its intention to introduce the British Industry Supercharger – a package of proposed support for energy-intensive companies including steel.

Establishing roles, responsibilities and accountabilities

It is important to be clear who in government is responsible for monitoring sector resilience and risks of company failure, and acting if necessary

What we expect

In general, we would expect to see:

- an understanding of duties and powers when companies are in distress, including government's principles for providing last-resort support to companies;
- clarity on how accountabilities, roles and responsibilities are allocated between stakeholders (including departments, regulators, insolvency practitioners, auditors, company directors); and
- established governance arrangements and mechanisms for cross-government working where multiple stakeholders are involved, including lead department and senior responsible officers for different sectors.

Further resources:

- Our good practice guidance on the Principles of effective regulation sets out how government should ensure robust accountability arrangements provide a common understanding of the respective roles and responsibilities of government departments, regulators and other bodies. It also highlights the importance of ensuring transparency, by providing public clarity over the respective roles and duties.
- Our Good practice guide on cross-government working sets out the importance of defining responsibilities and accountabilities when setting up cross-government working.
- Our report on Accountability to Parliament for taxpayers' money examines departments' accountabilities for oversight of sectors.
- The UK's Subsidy Control Regime began in January 2023 with the Subsidy Control Act 2022, replacing EU State Aid rules. The regime regulates subsidies given in the UK to prevent any excessively distortive or harmful effects, such as giving recipients an unfair advantage over their competitors or inefficient use of public money.

Questions to consider

Understanding accountabilities

- Who is charged with monitoring risks to each sector and its companies, and threats to national resilience including critical supply chains?
- Which is the lead department responding to threats or company failures when they happen?
- Who is the Senior Responsible Officer for the government in case of any intervention?
- What are your legal and contractual duties and powers? Is there an established model for intervention available to you, such as a Special Administration Regime or supplier of last resort?
- If there is a regulator, what powers and resources does it have to collect data to monitor risks, to communicate with other parts of government, and to take action to mitigate risks when they arise?

Working with other stakeholders

- Have you identified and mapped out all the relevant stakeholders and their roles, responsibilities and statutory duties?
- Are these roles and responsibilities clear and understood by all stakeholders involved? Is there duplication?
- How clear are your approaches to cross-government working, information sharing, and governance of any intervention?
- Is there a single government point of contact for companies in the sector?

Establishing roles, responsibilities and accountabilities *continued*

Case study example

Southern Cross, adult and children's social care markets

The collapse in 2011 of Southern Cross, the UK's largest social care provider at the time, put 31,000 care home residents at risk of eviction. Our report on Oversight of user choice and provider competition in care markets found that the then Department of Health did not have existing arrangements for dealing with the failure of Southern Cross or any other failure of a provider of this size, and had to manage the situation reactively as the financial situation facing the company unfolded. Unlike other regulated sectors, there were no predetermined continuity of supply arrangements for essential services, and no mechanisms for monitoring or intervening in markets that cross local authority boundaries. The Department has since given responsibility for monitoring the financial sustainability of the most 'difficult-to-replace' care providers to the Care Quality Commission (CQC).

In March 2022, the Competition and Markets Authority's (CMA's) Children's social care market study found a high level of indebtedness in some of the largest providers of children's homes, increasing the risk of a disorderly failure which could disrupt the placements of children in care. It recommended a market oversight regime analogous to the CQC model for adult social care, which would assess the financial health of care home providers that are the most difficult to replace, and alert authorities if a failure is likely. The government accepted the recommendation in February 2023.

Case study example

Thomas Cook

Our Investigation into government's response to the collapse of Thomas Cook found that there were at least 14 public organisations involved in responding to the collapse of Thomas Cook in September 2019, supporting the repatriation of customers or dealing with the insolvency and its impacts. Three months prior to Thomas Cook's collapse, the Department for Transport set up a cross-government steering board, including the Cabinet Office, UK Government Investments and the Foreign & Commonwealth Office. Due to the sensitive nature of the issue, departments had been working on their own contingency plans but were not working across government.

The Department for Transport considered the option of keeping Thomas Cook's fleet flying to repatriate customers. However, this would have required agreement of the Official Receiver, and would have gone beyond his normal duties and against his statutory obligation to deliver maximum value to creditors. The Airline Insolvency Review, published in May 2019, concluded that the UK does not currently have the necessary mechanisms in place to enable an orderly repatriation using the fleet of an insolvent airline. The Department and Civil Aviation Authority had to work with the industry and use existing call-off contracts with other airlines to contract commercial planes to stand ready for the insolvency at repatriation locations.

Ensuring skills, expertise and capacity

Departments need to ensure they have, or can access, the skills to appropriately monitor and manage the risks to which they are exposed

What we expect

In general, we would expect to see:

- analysis of the skills, expertise and capacity needed for:

1. resilience and relationship-building, including understanding of markets and critical supply chains, risk monitoring and communication with the sectors;
2. contracting and procurement if required; and
3. the whole lifecycle of any intervention (including preparing for and responding to company distress scenarios);

- assessment of the balance needed between in-house capability and ability to access external skills taking into account the tolerance level for the risks and the value for money of different options; and
- identification of any gaps or deficiencies in skills, expertise or capacity and a plan for how to address and mitigate these.

Further resources:

- Our report on Specialist skills in the civil service examines the progress that government has made in developing specialist skills, focusing on the four areas of: commercial, digital, finance and project delivery.
- The government's career and competency frameworks set out common role types and capabilities. These include the:
  - Government Commercial Function Commercial Career Framework;
  - Government Corporate Finance Profession Competency Framework; and
  - Risk Management Skills and Capabilities Framework.

Questions to consider

Understanding the skills and capacity needed

- Based on the level of risk to your objectives from company distress, what skills and capacity do you need to engage effectively with and understand the market and supply chain?
- What level of skills and capacity do you need to contract with and/or monitor the performance and risks of your suppliers or providers?
- What level of skills and capacity do you need to prepare for, and respond to, the risk of company distress?
  - What specialist skills do you need for preparedness? For handling an intervention?
  - What capacity will you need at each stage of the process?
  - Do you have a flexible resourcing plan in place?

Accessing skills and resources

- Where will you find the skills you need?
- How will you source, appoint and fund these skills and capabilities?
  - Do you need external advice and/or expertise? Why, when and how?
- What, if any, additional training do your staff need?

Ensuring skills, expertise and capacity *continued*

Case study example

Financial crisis interventions

Our 2009 report on Maintaining financial stability across the United Kingdom's banking system found that HM Treasury had to juggle a variety of new roles: as major investor, or owner, of a number of banks; guarantor of borrowings by banks in the wholesale markets; and insurer of assets. The requirement for expertise often arose at short notice and, given the uncertainties, the precise nature and extent of the work was often not initially clear. Between September 2007 and March 2010, the cost of advisers was expected to be £107 million.

As the scale and complexity of the government's investments and partnerships with the private sector grew, a range of public sector bodies had responsibility for different aspects, including Partnerships UK, the Shareholder Executive, the Asset Protection Agency and UK Financial Investments (UKFI). HM Treasury set up UKFI in 2008 as an arm's-length company to manage the taxpayers' shareholders in financial institutions including RBS, Lloyds Banking Group, Northern Rock and Bradford & Bingley. Our report cautioned that potential economies of scale could be missed and that valuable expertise may be being spread too thinly. In 2016, UK Government Investments (UKGI) brought together the functions of the Shareholder Executive and UKFI.

Case study example

Bulb

Our Investigation into Bulb Energy highlighted the expertise and capacity needed to manage the Special Administration Regime (SAR) process for Bulb. While other energy supplier failures had been managed using the Supplier of Last Resort (SOLR) process, whereby customers were moved to an alternative supplier, it was deemed appropriate by government to use a SAR for the first time in order to protect Bulb's 1.5 million customers. The process, from special administration to the transfer of customers, business assets and liabilities to HiveCo (the new energy provider, owned by the Octopus Energy Group), took 13 months overall.

During the operation of the SAR and sale process for Bulb, both the government and private sector organisations appointed advisers. The costs of these advisers were £53 million as of 31 January 2023, which included the costs of five separate firms appointed by the government, by the court and by the energy administrators. As part of its preparations, in 2019 Ofgem carried out a procurement exercise to appoint a firm of licensed insolvency practitioners with knowledge and experience of the energy sector. These advisers supported its preparations for making an administration application in the event of the failure of an energy supply company.

Identifying risks

Departments need to understand where the systems they oversee could be vulnerable to company failure and how that would affect delivery of their objectives

What we expect

In general, we would expect to see:

- systematic horizon scanning by departments to understand the exposure to the risks of failure of critical supply chains, national infrastructure and companies that have been assessed to be strategically important, and identify any changes in that exposure before they crystallise into failure;
- proactive engagement/sharing of intelligence with other government departments, agencies and the sectors, as well as international partners to help identify risks, including systemic and shared risks; and
- robust risk information and reporting, which is up to date, dynamic and reliable.

Further resources:

- The government's Orange Book sets out principles and concepts around the management of risk.
- The Futures toolkit for policy-makers and analysts provides tools and techniques to help officials use long-term strategic thinking in policy-making.
- Our report on The government's preparedness for the COVID-19 pandemic: lessons for government on risk management provides insights to support government's preparations for and handling of whole-system risks.
- The Competition and Markets Authority (CMA) considers the drivers of market resilience in its Market resilience: Discussion paper.
- The Cabinet Office publishes a National Risk Register which includes assessment of risks of system failures such as fuel supply and social care provider failures.
- The Government Commercial Function's Corporate Financial Distress guidance assists in identifying the signs of corporate financial distress and practical steps to take where there are concerns.

Questions to consider

Understanding markets and supply chains

- How well do you understand market structure and vulnerabilities, including fragilities and risks to critical supply chains?
- For public sector contracts, how well do you understand your delivery chain?
- Do you understand in what ways the failure of a particular company could pose a risk to the delivery of your objectives, including for example, service-critical or sensitive data the company might hold? And how quickly this risk would materialise?
- Do you understand in what ways the failure of a particular company could pose a risk to the wider economy, society, critical supply chain, other parts of government or national security?
- How well does your engagement with the sector and companies, both formally and informally, help you understand risks?

Monitoring and reporting risks

- How well do you understand the factors that could lead to failure of a strategically important company, such as external influences/events or market volatility?
- How do you ensure you capture and report on risks relating to company failure?
- How often do you revisit and update these risks?
- Who owns the risks?

Identifying risks *continued*

Case study example

CF Fertilisers

Most of the carbon dioxide (CO_2) supplied in the UK to food and drink, energy, nuclear, fire safety, medical, water and other sectors is a by-product of ammonia or bioethanol production. Its supply is highly concentrated with a small number of suppliers, partly because of historical consolidation through mergers. In 2007 the then Competition Commission cleared a merger/joint venture between two CO_2 producers, on the basis of several remedies, including a commitment not to terminate a contract to supply a key customer from one of its production facilities. The merged company, GrowHow, eventually came to be fully owned by CF Fertilisers.

In 2018 it was reported that around two-thirds of UK-produced CO_2 was sourced from two fertiliser plants in Billingham and Ince, both owned by CF Fertilisers. Between 2005 and 2018, shutdowns of ammonia production facilities had led to several short-term CO_2 supply issues, but did not prompt any government intervention. Following a shortage in 2018, a report by the Food and Drink Federation highlighted a lack of understanding of the CO_2 supply chain by purchasers, government and the public.

In September 2021, CF Fertilisers halted operations at its sites due to high natural gas prices. The remedies associated with the approval of the 2007 joint venture did not prevent the site's closure. The government intervened to prevent supply disruption by providing temporary financial support to CF Fertilisers and temporarily exempting parts of the industry from certain competition law prohibitions, to facilitate industry agreements. In June 2022, CF Fertilisers announced the permanent closure of its plant in Ince. The Competition and Markets Authority's 2023 Market resilience: Discussion paper highlighted wider measures government could take to support supply diversity and reduce the potential harm from future disruptions.

Case study example

Adult social care market

The National Risk Register 2023 identified the failure of a major adult social care provider as a key system failure risk. Local authorities could face challenges in discharging their temporary duty to secure continuity of care if faced with a complex failure affecting a significant number of people.

Since 2015, the Care Quality Commission (CQC) has been responsible for market oversight of potentially 'difficult-to-replace' care providers in England, representing around 30% of the overall market. CQC has a six-stage process for oversight, and it has a statutory duty to notify relevant local authorities (a Stage 6 notification) if it believes that a provider is likely to fail and service cessation is likely as a result. The first issuing of a Stage 6 notification at a corporate level was in November 2018 for Allied Healthcare, which affected 84 local authorities.

Scenario planning

Identifying risks is not enough – departments need to show imagination and attention to detail when working through scenarios

What we expect

In general, we would expect to see:

- clear and consistent assessment of risks through scenario testing, both short and long term;
- systematic testing of a range of possible scenarios and the implications for industry, customers and citizens; and
- identification and mitigation of any gaps in government's ability to respond to different possible scenarios.

Further resources:

- Our work on The government's preparedness for the COVID-19 pandemic: lessons for government on risk management sets out the lessons learned from national government's approach to risk management, planning and mitigation strategies before COVID-19.
- The National Risk Register includes the methodology it uses to assess the likelihood of risks and their possible impact, as well as its assessment of the risks in the register to help government plan for a broad range of scenarios.
- The UK Government Resilience Framework sets out the government's action plans on risk, including risk assessment tools and resources it has developed to inform decision-making and planning.
- The UK Resilience Lessons Digest synthesises lessons identified from major exercises and emergencies, part of the government's commitment to strengthening whole-society resilience.

Questions to consider

Testing risk

- What tools and resources (for example, from the Cabinet Office national resilience team) have you used to help you assess and manage risks?
- What scenario planning have you done to assess how events could precipitate company or supply chain failure, in the short, medium or long term?
- What support/encouragement have you given to companies to stress-test their resilience for various scenarios?

Testing impact

- What testing have you done to assess different scenarios resulting from company or supply chain failure and their effect on objectives?
- What have you done to test the sector implications of a company or supply chain failure?
- How do you ensure you are being sufficiently imaginative about potential scenarios, for example where several risks could materialise together?
- How do you ensure you are challenging assumptions, and trying to identify 'unknown unknowns'?
- How well do you understand the impact of different scenarios on customers and vulnerable users?

Testing responses

- Have you identified which stakeholders you would need to engage for different scenarios?
- Have you identified gaps in your ability to respond?
- Have you considered what action it is appropriate to take (see making contingency plans)?

Scenario planning *continued*

Case study example

Community Rehabilitation Companies and Working Links

In 2019 we highlighted the importance of scenario testing and sensitivity analysis when we reported on the Ministry of Justice's decision to terminate early its contracts with community rehabilitation companies (CRCs), to avoid facing multiple provider failures.

Our Transforming Rehabilitation: Progress review found that the Ministry had designed and implemented its Transforming Rehabilitation reforms too quickly and without sufficient testing of how the transformed system might work before letting contracts. At that time, in 2015, it did not have a good understanding of probation trusts' delivery models, working practices and governance, and relied heavily on their information about costs. The Ministry sought to transfer the risk of lower volumes of work to CRCs but only modelled a 2% reduction in volumes – in reality, these were between 16% and 48% lower than anticipated. The CRCs experienced financial pressures created by lower volumes of work, and exacerbated by the payment-by-results mechanism that the Ministry had put in place to manage the contracts. At the same time the delivery specifications were too light to allow the Ministry to hold providers to account for poorly performing services. In February 2019, Working Links and its three CRCs went into administration. The Ministry was aware of Working Links' financial situation and implemented its contingency plan to transfer supplier staff and services to another CRC owned by Seetec.

In May 2019, the Ministry announced its decision to unify probation services and create a new public sector Probation Service. In response to the Committee of Public Accounts, the Ministry confirmed that its new model would take account of the Committee's conclusion that CRCs had taken on excessive volume risk.

Case study example

Bulb

A Special Administration Regime (SAR) for energy supply companies was introduced in the Energy Act 2011 to provide an administrator with the special objective to ensure the continuity of critical services. In 2023, we reported in our Investigation into Bulb Energy on the process of taking Bulb Energy into a SAR, including the then Department for Business, Energy & Industrial Strategy's (BEIS's) preparations for a SAR.

Between 2018 and 2020, BEIS, HM Treasury and Ofgem tested various scenarios for the failure of a large energy supplier, to identify how a SAR might work in practice. They developed an operational handbook which provided guidance and templates for the documents needed to start a SAR, such as court applications and a funding agreement. It did not establish policy or provide guidance for some areas of running a SAR, such as the energy purchasing strategy an administrator should follow during a SAR, which was developed in November 2021 by the energy administrators for approval by BEIS. An independent 'critical friend' review of the 2021 preparations by BEIS and others to deliver a SAR gave an amber-green rating.

Monitoring risks and financial performance

Departments will need sources of ongoing data on failure risks they are tracking, whether they have a relationship with companies or not

What we expect

In general, we would expect to see:

- appropriate oversight for ongoing and regular monitoring of critical supply chains, the financial performance of strategically important companies or key suppliers, and any underlying risks to the company or sector;
- use of a broad range of methods and sources to obtain knowledge about the sector and the market, and to detect early warning signs of financial distress or failure of a company; and
- the level of monitoring is proportionate to the level of risk and responsive to any changes in this.

Further resources:

- Our principles paper on Managing provider failure set out the mechanisms that departments can use to monitor risks and identify early warning signs of failure. This includes proactive monitoring (where the department asks for information) as well as reactive monitoring (where the department creates channels for people to raise concerns). Departments are also better placed to spot emerging risks if they are able to monitor prospectively as well as retrospectively. This includes monitoring the projected financial performance of providers by examining income and cash flow projections, as well as the past performance of providers through financial accounts.
- The CMA's Market resilience: Discussion paper sets out a framework to help monitor and assess criticality of inputs or services, supply diversity, and financial risks to suppliers.

Questions to consider

- How well are you monitoring underlying risks to companies and the sector, such as its level of exposure to external shocks, or the vulnerability of supplies that are critical to the sector?
- How do you monitor the financial performance of key companies?
- What combination of monitoring methods do you use to receive signals?
  - Does this include proactive monitoring as well as reactive monitoring?
  - Do you monitor the projected financial performance as well as the past financial performance of key companies?
  - How have you built relationships across companies and other stakeholders to enable you to receive ongoing market intelligence?
- Do you have the data and information you need, including a wide range of financial and non-financial indicators to monitor the resilience of the sector and relevant companies' financial health?
- Do you apply an appropriate degree of scepticism when analysing the information you receive?
- Do your strategic suppliers undergo regular financial stress testing?
  - Have you identified key warning signs that would trigger further action, including enhanced monitoring?
- Where there are known financial difficulties in a company, how well do you understand the causes – is it governance, management, or financing?
  - Do you understand the company's ownership structure and governance arrangements?
  - Do you understand the risks to the company from its parent company?

Monitoring risks and financial performance *continued*

Case study example

Water companies

In our 2015 report The economic regulation of the water sector we found that the information gathered by Ofwat to understand the corporate and financial resilience of the sector was limited. We recommended it strengthen its monitoring of water companies.

Ofwat told us that it has since stepped up its monitoring and activities in respect of the financial resilience of water companies. For example, it publishes an annual Monitoring Financial Resilience report on companies' financing arrangements and carries out targeted engagement with companies on their financial resilience. It has also modified the ring-fencing licence conditions of companies to strengthen the protections of the regulatory ring-fence to incentivise companies to maintain adequate levels of financial resilience. In Ofwat's 2021 discussion paper on Financial resilience in the water sector it uses the case study of Southern Water. Ofwat raised concerns with Southern Water's board over several years regarding the financial resilience of the regulated company itself and its holding company, including: reductions in its credit rating; the impacts of poor operational performance; and its use of swaps to manage its short-term cash flows. Following Ofwat's engagement there was a change in ownership of Southern Water in August 2021, which was accompanied by the investment of new equity into Southern Water and its holding companies. The company has underperformed in a range of service standards and Ofwat anticipates that it will take some time to improve services to the levels expected.

Case study example

British Energy

During the privatisation of British Energy in 1996, the company took responsibility for meeting the costs of handling nuclear fuel and of decommissioning stations. However, the then Department for Trade & Industry was ultimately accountable for nuclear safety and security to Parliament, and minimising the risk that British Energy's nuclear liabilities would revert to the taxpayer if unable to meet its obligations. In Risk Management: The Nuclear Liabilities of British Energy plc (2004) we found that the Department did not monitor and manage this changing risk actively. When introducing major changes to the electricity industry to increase competition, the Department did not specifically evaluate the effect on British Energy.

When the company first approached the government in 2000 with concerns about its future, major changes affecting British Energy's solvency had already been implemented or were well advanced in design. The Department continued to rely mainly on publicly available information for its monitoring, until 2002 when the company offered open access to its books. We recommended that in future transactions where performance of an obligation on government is transferred to the private sector, departments should consider arrangements for the provision of and access to information on a timely basis.

Making contingency plans

Detailed scenario testing and good-quality data will help departments know when to move to contingency planning

What we expect

In general, we would expect to see:

- contingency plans in place to maintain service delivery, critical supply chains, data security and access, and to limit the impact on service users in the event of failure of a key supplier or public service provider;
- contingency plans which set out actions to take where there is a risk of company failure that could affect society or the economy; and
- contingency plans coordinated across government, tested with stakeholders and updated as more information becomes available.

Further resources:

- The Cabinet Office's guidance on Corporate financial distress provides information on developing and maintaining contingency plans in the event of supplier insolvency.
- The Cabinet Office's Sourcing Playbook sets out guidance for making sourcing decisions for the delivery of public services, including on putting in place contingency plans for critical services contracts. The Resolution planning guidance note explains how Contracting Authorities can reduce the risks of interruption to UK public services arising from supplier insolvency by requiring the supplier to provide Resolution Planning Information.
- Our Good practice guidance: Managing the commercial lifecycle (Section 10: Review, transition and exit) highlights expectations for the end of a contract or transition to alternative arrangements, including that capabilities and data are effectively transferred and contingency plans are put in place for supplier failure.
- Our *Guide to corporate finance in the public sector* (page 25 on Commercial functions and regulators).

Questions to consider

- Do you have contingency plans in place in case of company or supplier failure?
- When will you develop contingency plans?
  - What are the trigger points?
- Do your plans take into account:
  - all the elements needed to maintain your supply chain or continuity of services, including customer information and data flows?
  - the totality of a company's arrangements with government and other public bodies?
- Do all parts of government affected by company or supply failure have coordinated contingency plans?
  - For example, have you engaged with the Department for Work & Pensions' Rapid Response Service where there is a risk of large-scale redundancies?
- Do you know if the company has its own contingency plans?
  - How can you encourage the company to do its own contingency planning?
- Have you conducted any joined-up testing of your contingency plans with other government departments, the company and other stakeholders, for example, external stakeholders which you may rely on for particular skills?
- Do you already have the powers you would need to enact your contingency plan?

Making contingency plans *continued*

Case study example

MG Rover

In The Closure of MG Rover we found that the Department for Trade & Industry had prepared contingency plans which focused mainly on how to respond to the company's closure. Although this was seen as the major possibility, the Department paid less attention to other possibilities, some of which materialised. This included long periods of negotiation and the company entering administration with few liquid assets.

In late 2004, the Department established a joint planning group to carry out an economic analysis of the impact of closure of the Longbridge factory and undertake detailed contingency planning. The Department and its local partners had to manage the risk of initiating contingency planning carefully to avoid it becoming widely known and undermining the company's position during negotiations with the potential buyer. There were no pre-set criteria among central government departments on when discretionary support might be appropriate in the aftermath of a company collapse. In total £176 million was allocated to a package of support made available to former employees, suppliers, retailers and the local community.

Case study example

Carillion

Our Investigation into the government's handling of the collapse of Carillion found that the Cabinet Office oversaw the coordination of contingency plans following the company's profit warning in July 2017, but first had to carry out additional work to establish a complete list of government contracts. It faced more difficulty persuading Carillion to do its own contingency planning. The Cabinet Office produced a weekly dashboard assessing the progress of contingency planning across government. Almost all services continued uninterrupted when Carillion went into liquidation.

However, the contingency planning had focused on operational service contracts to ensure that services to the public continued, and not on Carillion's construction projects. Our Investigation into the rescue of Carillion's PFI hospital contracts found that when Carillion collapsed in 2018, neither the government nor the private finance initiative (PFI) companies involved had contingency plans in place to ensure that the hospitals were completed as planned. The government terminated the PFI schemes and had to bring in new contractors at additional cost to the taxpayer and the completion of the hospitals was significantly delayed.

Appraising options

If intervention is being considered, the government will need to understand the costs and benefits of all its options, and clearly document its decisions

What we expect

In general, we would expect to see:

- consideration and analysis of a range of feasible options against policy objectives and evidence of what works from past evaluations;
- early engagement with the relevant stakeholders to assess the corporate finance mechanisms available and the viability of these options, and to build consensus around the right option;
- robust analysis of the costs, benefits and risks associated with different options, including consideration of any unintended consequences and how risks will be mitigated;
- explicit consideration of long-term affordability and value for money when deciding on the option to take; and
- consideration, from the outset, of exit options, which are prepared for appropriately and in a timely fashion.

Further resources:

- Our Guide to corporate finance in the public sector provides guidance on the types of corporate finance transactions that can be used and considerations about how to ensure they are value for money for the taxpayer.
- Managing public money sets out guidance and principles about financial management, accounting officer duties and how to handle public funds.

On how to do options appraisal successfully:

- Our good practice guide on Option Appraisal: Making informed decisions in government.
- The government's Green Book outlines principles and methods for options appraisal, which can be applied even where formal business cases and regulatory decisions are not required.

Questions to consider

Initial considerations

- Have all other avenues been exhausted? For example: is there a regulatory solution? Is there a pre-existing support scheme available? Is there a market or industry approach?
- Do you understand the available corporate finance mechanisms (for example, guarantee, loan, equity stake, acquisition)?
- Have you drawn on evaluations of past interventions for evidence of what works?
- Have you identified a sufficiently wide range of feasible options?

When carrying out an options appraisal

- Have you analysed your options against your objectives, critical success factors and evidence of likely support from key stakeholders?
- Have you identified all relevant costs and benefits of your options over an appropriate time horizon? Have you considered any contingent liabilities?
- What are the risks associated with different options and how will these be mitigated?
- Have you considered any likely unintended consequences, such as impact on particular groups in society or changes in behaviour as a result of an intervention, including *moral hazard* or *free rider* risks (see Part Three of Lessons learned: Monitoring and responding to companies in distress)?

When making decisions

- Have you sought advice on and considered compliance with regulatory and legal obligations?
- Do you understand what might happen to the company once under the control of an administrator or liquidator?
- Did you take into account affordability, value for money and the results of the options appraisal, in line with the duties of accounting officers under *Managing Public Money*?
- Have you considered the exit options for an intervention?

Appraising options *continued*

Case study example

Northern Rock sale

In our report on The creation and sale of Northern Rock plc we looked at the creation of Northern Rock plc, its financial performance while in public ownership, whether the sale of Northern Rock plc was the best available option and whether its sale was well handled.

We found that HM Treasury and UK Financial Investments' choice of exit strategy was soundly based. After consultation with the European Commission, they had decided that the choice of exit strategy would need to be based on financial value. This was because accepting a lower-value bid could have been regarded as providing State Aid to the new owners.

Case study example

Carillion

Between 31 December 2017 and 14 January 2018, Carillion approached the UK government for short- and long-term in-kind and financial support, which Carillion considered essential to its restructuring plans. The Committee of Public Accounts subsequently described a culture in which companies such as Carillion believed until the end that they were too big to fail.

Our 2018 Investigation into the government's handling of the collapse of Carillion found that the Cabinet Office, with the help of PwC, undertook an options analysis to decide whether to support Carillion. It considered the options of: trading liquidation, unsupported insolvency, potential (pre) sale of assets, and a bridging investment. The investment option was rejected as the Cabinet Office lacked confidence in Carillion's business case, and the pre-sale of assets was considered not possible in the timescales available. Ultimately it decided upon a trading liquidation as it met the government's objectives, including to maintain as many public services as possible and avoid setting an unhelpful precedent of government bail-out for other companies.

Managing the intervention

Principles of effective project management will apply, and departments will likely need to be ready to adapt as they go, to ensure taxpayers' money and the interests of vulnerable groups are protected

What we expect

In general, we would expect to see:

- plans for how the department will manage the intervention, including clarity on arrangements for oversight, roles and responsibilities, strategic communications and objectives of the intervention;
- use of appropriate data and information to monitor compliance with any terms and conditions set, and to understand the effectiveness of the intervention; and
- flexibility to adapt the response, including to any new information or data received.

Further resources:

- Our Guide to corporate finance in the public sector brings together insights for senior decision-makers to consider when overseeing corporate finance activities.
- Managing public money sets out guidance and principles about financial management and how to handle public funds.
- The Portfolio Risk Management Guide provides guidance on the management of risk in relation to cross-departmental initiatives of scale where significant risk levels could have a significant impact over the longer term, or where significant risk levels associated with cross-departmental crisis situations can be immediate and acute.

Questions to consider

Delivering the intervention

- What are the plans for managing the intervention and delivering the objectives?
- How clear and well understood are the governance and oversight arrangements?
- Who do you need to engage with across government and within your department?
- If you are using external parties to manage the intervention, how will you oversee this to ensure taxpayer money is protected?
- How effective are the risk management arrangements, including risk ownership, mitigation and monitoring?
- If appropriate, how are you developing and updating your exit strategy in response to new information?

Monitoring the intervention

- How do you know whether the intervention is working and how will you adapt your response if necessary?
- What data/information do you need to monitor progress, ensure compliance by all parties and assess the effectiveness of the intervention?
- In what circumstances would you need to take further action? What would trigger that?

Managing the intervention *continued*

Case study example

Celsa Steel

In 2020, the government provided a bespoke emergency loan to Celsa Steel to enable the company to continue trading.

As part of the loan, the government negotiated a series of legally binding conditions, including commitments to protect jobs, climate change and net zero targets, improved corporate governance, such as restraints on executive pay and bonuses, and tax obligations. The Department for Business, Energy & Industrial Strategy, now the Department for Business & Trade, monitored compliance with the conditions.

In June 2023, the loan was repaid in full, with the company making additional payments to the government triggered by its strong economic performance following the loan.

Case study example

Sheffield Forgemasters

In 2021, the Ministry of Defence acquired the defence manufacturer Sheffield Forgemasters in a £2.6 million deal, allowing the government to secure the continued supply of defence-critical components through refinancing the company. This followed commercial difficulties for the company as a result of cheaper steel competitors and decline in steel processing work.

The government has published a Framework Document between the Secretary of State for Defence (the 'Shareholder') and Sheffield Forgemasters International Ltd (the 'Company'). UK Government Investments (UKGI) is responsible for fulfilling the shareholder team responsibilities on behalf of the Ministry of Defence. UKGI liaises with the company to review performance against plans, achievement against targets and expenditure against its allocations. The Framework summarises the strategic objectives of the company, which include delivering a sustainable and resilient long-term business by ensuring profitable income streams, continuously improving the efficiency and performance of the company, and delivering its capital investment programme successfully and efficiently, demonstrating value for money for the UK taxpayer.

The government intends to return the company to the private sector, but there are currently no timescales for this.

Evaluating and embedding learning

Departments are expected to evaluate their interventions for the purposes of accountability, decision-making and learning for future scenarios

What we expect

In general, we would expect to see:

- a plan to carry out evaluation and incorporate evaluation evidence and ongoing learning throughout the policy cycle or life cycle of the intervention(s);
- lessons learned exercises which capture what has worked well and what has not in relation to the intervention; and
- transparency and dissemination as widely as possible of the findings of evaluation and the lessons for the future.

Further resources:

- Our 2021 report Evaluating government spending identifies areas of good practice and common challenges for effectively providing and using evaluation evidence to improve outcomes. Evaluating government spending: an audit framework sets out what we look for in terms of evaluation in different stages of the policy cycle.
- Our principles paper on Managing provider failure sets out the importance of departments sharing what they have learned as widely as practicably possible, to avoid government paying several times to learn the same lesson.
- Government's Magenta Book provides guidance on what to consider when designing an evaluation.
- The Government Commercial Function's Commercial Continuous Improvement Assessment Framework helps organisations to benchmark their commercial activities against good practice.

Questions to consider

Planning evaluation

- How are you using evaluation evidence and any lessons from previous interventions, including international examples, to inform your decisions?
- How do you plan to embed continuous learning during the lifecycle of the intervention?
- How clear is your recording of decisions that have been made, for the audit trail?
- How and when will you evaluate whether the intervention achieved its intended outcomes?

Embedding and sharing learning

- What will you do differently as a result of your evaluation?
- Have you considered whether there is anything in the legislative framework that might need changing?
- How will you ensure you are able to retain the learning from this intervention in corporate memory for the future?
- How will you share the evaluation findings or lessons learned across government and across the sector?
- How do you create the right environment in which to share lessons?

Evaluating and embedding learning *continued*

Case study example

National Express East Coast Franchise

Our 2011 report on The Intercity East Coast Passenger Rail Franchise showed that the Department for Transport was able to build ongoing learning and knowledge management into the project to terminate the National Express East Coast franchise and mobilise a replacement operator. Throughout the project, the Department and its consultants maintained journals to record their experiences and inform the revision of future guidance on franchise termination.

To ensure corporate memory was maintained, we recommended that the Department disseminate its lessons learned papers and updated guidance, and maintain and refresh appropriate in-house skills by ensuring staff have industry experience.

Case study example

Northern Rock and financial crisis interventions

From our work on Maintaining financial stability across the United Kingdom's banking system during the financial crisis we found that HM Treasury was able to apply lessons from its handling of Northern Rock to enable it to better manage the subsequent bank failures and respond to the wider crisis that erupted in autumn 2008.

In The nationalisation of Northern Rock we found that HM Treasury applied lessons from its experience of Northern Rock to the handling of Bradford & Bingley, despite differences in the two cases. Its consideration of different options when responding to Northern Rock's failure enabled HM Treasury to take a course of action to protect financial stability, without having to put large sums of taxpayers' money at stake in a company it did not own.

Appendix One

List of other National Audit Office (NAO) insights and government guidance

Other relevant NAO insight

Guide to corporate finance in the public sector

Principles of effective regulation

Principles paper: Managing provider failure

Evaluating government spending

Evaluating government spending: an audit framework

Option Appraisal: Making informed decisions in government

Good practice guidance: Managing the commercial lifecycle

The government's preparedness for the COVID-19 pandemic: Lessons for government on risk management

Specialist skills in the civil service

Accountability to Parliament for taxpayers' money

Departmental Overview: Commercial and Contracting 2017-18

Good practice guide on cross-government working

Cross-government working: lessons learned

Lessons learned: competition in public procurement

Managing uncertainty: Questions for decision-makers to ask in an uncertain environment

Government guidance

- The Cabinet Office and Government Commercial Function produce key policies and guidance for making sourcing decisions for the delivery of public services.
  - The Sourcing Playbook and the accompanying guidance notes on: Assessing and monitoring the economic and financial standing of suppliers and Resolution Planning
  - Guidance on Corporate Financial Distress, which supports the identification of corporate financial distress and provides practical steps to take where there are concerns over a supplier's financial health
  - Commercial Continuous Improvement Assessment Framework for best practice in commercial operations
- The Competition and Markets Authority's (CMA's) Market Resilience: Discussion paper considers the drivers of market resilience and includes examples from its market studies and investigations.
- Other government guidance on evaluation, appraisal, risk and financial management is referenced throughout this report, including:
  - Managing public money
  - Magenta Book and Green Book
  - Orange Book; Futures toolkit for policy-makers and analysts; National Risk Register; The UK Government Resilience Framework; UK Resilience Lessons Digest; Portfolio Risk Management Guide

The government's career and competency frameworks set out common role types and capabilities: Government Commercial Function Commercial Career Framework; Government Corporate Finance Profession Competency Framework; Risk Management Skills and Capabilities Framework

Appendix Two

Government intervention options when a company is in distress

Companies that have a contract with government to supply products and services or to provide a taxpayer-funded service, and some companies in public sector markets

- Include provisions in public sector contracts, such as business continuity, financial distress remediation, insolvency continuity provisions, which can be implemented if required
- Terminate contract/contract novation/transfer provision of services to an alternative provider
- Government takes over the delivery of a service through a government-owned company (GovCo)

Companies in private markets that may be strategically important for achieving government's policy objectives, or part of a critical supply chain for a sector

- Do nothing/market solution
- Intervention or signals to improve the functioning of a market, for example price signals or instruction to maintain an increased supply
- Bespoke financial support, including grants, loans, guarantees, tax relief
- Nationalisation/public ownership
- Facilitated administration, for example supporting sale of the company
- Trading/supported liquidation, for example indemnifying and funding the Official Receiver to carry out their statutory duties and alternative liquidation activities during a compulsory liquidation
- Supplier, consumer or employee support
- Competition law exemptions/exemptions from merger control

Companies in private regulated markets that provide an essential or critical service with a high potential for harm in the event of company failure and some companies in public sector markets

- Supplier of last resort regime may be triggered
- Special Administration/Resolution Regime may be in place for some critical services, including water, sewerage, rail transport, air traffic control, education, postal, investment and banking services
- Mutual/insurance model may be available, for example Air Travel Organiser's Licence (ATOL) scheme, Financial Services Compensation Scheme (FSCS)

Note

1 This figure sets out some of the options available to government when a company is in distress but is not an exhaustive list.

Source: National Audit Office analysis of previous National Audit Office reports, documents published by the government departments and interviews with their officials

Appendix Three

Government's guiding principles for providing last-resort support to companies

In 2020 the government set out publicly when it will consider providing support to distressed companies.

The government set out that it will consider providing last-resort business support to:

- companies that can reasonably be expected to have a long-term viable future;
- whose failure or distress could cause disproportionate harm to the UK economy or society; and
- which have exhausted all other options before being considered.

It also specified that:

- any support given is on terms that protect the taxpayer, with existing lenders and shareholders expected to contribute to, and share in, the financial burden; and
- companies receiving support need to agree to appropriate conditions, including those relating to tax, supplier payment terms, climate change and corporate governance.

Subsequently, HM Treasury has told us that it has added a further principle that:

- the company is facing time-limited difficulties due to exogenous disruption.

Source: National Audit Office analysis of HM Treasury A Plan for Jobs 2020, July 2020 and discussions with HM Treasury

Appendix Four

Our scope and methodological approach

Definitions and scope

This paper is relevant to government interventions in companies that may be public service providers, strategic suppliers to government, or private sector trading companies that are strategically important such as banks, transport and utilities. They may be in regulated sectors or not.

We distinguish between financial failure and delivery failure. An organisation fails financially when it ceases to be a going concern. This paper does not address failure to deliver services to minimum standards without failing financially, which is a matter for regulators, inspectors and so forth. We also do not cover failure, financial or otherwise, of local authorities, hospital trusts or other local public service providers in the public sector.

In discussing government interventions we do not include wider support schemes open to application from companies (for example, COVID-19 business loan schemes) although these may help to manage the risk of failure and may provide monitoring information.

This report includes specific examples from our published work and other examples in the public domain. These are illustrative examples and not indicative of the overall performance of specific departments. This report does not set out all the actions government may have taken or changes implemented since the relevant National Audit Office reports were published.

Methodological approach

See Appendix One of accompanying report – Lessons learned: Monitoring and responding to companies in distress.