



## BRIEFING PAPER

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# The collapse of Carillion

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## Summary

### Compulsory liquidation

A compulsory liquidation order was made against Carillion, on the petition of the companies' directors, on 15 January 2018. Compulsory liquidation is a court-based procedure through which company assets are realised for the benefit of creditors.

Various business commentators have [suggested](#) that Carillion went into compulsory liquidation rather than administration because it had no real assets left to sell. It had contracts, but they were either too complex or insufficiently valuable for the banks to lend against.

The High Court appointed the Official Receiver as liquidator. The court also appointed 6 executives of PwC as Special Managers to assist the Official Receiver. The liquidator must act in the interests of the body of creditors as a whole.

It is a feature of the Carillion liquidation that the Official Receiver is expected to prioritise the continuity of vital public services while securing the best outcome for creditors. Unless told otherwise, all employees, agents and subcontractors providing public services are being asked to continue to work as normal and they will be paid for the work they do during the liquidations by the Official Receiver. The Government has [undertaken](#) to provide the necessary funding required by the Official Receiver to maintain public services carried on by Carillion staff, subcontractors and suppliers.

Carillion has only been in compulsory liquidation a few days. It is too early to predict what, if anything, creditors will recover. The Special Managers have already said that there is no prospect of any return to Carillion shareholders. The Insolvency Service has also announced that bonuses and severance payments have not been made to directors since the date of the company's collapse.

On 16 January 2018, the Government [announced](#) that the Official Receiver's investigation into the causes of the failure of Carillion is to be fast-tracked. The investigation is to look at the conduct of directors in charge at the time of the company's insolvency and also the conduct of previous directors, to determine whether their actions might have caused detriment to the company's creditors (including detriment to any employees who are owed money or to the pension schemes).

### Financials

On 10 July 2017, Carillion [announced](#) that its profits would be hit to the tune of £845 million. As a consequence, its chief executive resigned and there would be no dividends that year. The [shares](#) lost more than half of their value in the two days that followed the announcement.

Although the July 2017 profit warning marks the beginning of the end for Carillion, it is poor decisions in the years leading up to it that caused the company serious trouble. Of the £845m charge, Carillion said that £375m related to the UK (mostly three PPP projects) and £470m to

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overseas markets (mostly exiting markets in the Middle East and Canada).

On 29 September 2017, Carillion's [half-year financial statements](#) revealed a total hit to the company's worth of £1.2 billion – enough to wipe out the profits from the previous eight years put together.

In the eight years from 2009 to 2016, Carillion paid out £554 million in dividends, almost as much as the cash it made from operations. In the five years from 2012 to 2016, Carillion paid out £217 million more in dividends than it generated in cash from its operations.

Over the eight years from December 2009 to January 2018, the total owed by Carillion in loans increased from £242 million to an estimated £1.3 billion – more than five times the value at the beginning of the decade.

# 1. Compulsory liquidation

A compulsory liquidation order was made against Carillion, on the petition of the companies' directors, on 15 January 2018. Ahead of the collapse, the company had issued three profit warnings between July and November 2017.

Specifically, the High Court appointed the Official Receiver as liquidator of the following companies (collectively referred to as "Carillion"):

- Carillion Plc
- Carillion Construction Limited
- Carillion Services Limited
- Planned Maintenance Engineering Limited
- Carillion Integrated Services Limited
- Carillion Services 2006 Limited

At the same time, the High Court appointed 6 executives of PwC as Special Managers to support the Official Receiver. A Special Manager is an officer of the court with his powers and functions defined by the court.<sup>1</sup>

The company issued a statement in which it said that discussions to secure short-term financial support had not been successful and that the board had "no choice but to take steps to enter into compulsory liquidation with immediate effect". Philip Green, chairman of Carillion, said:

This is a very sad day for Carillion, for our colleagues, suppliers and customers that we have been proud to serve over many years. Over recent months huge efforts have been made to restructure Carillion to deliver its sustainable future and the Board is very grateful for the huge efforts made by Keith Cochrane, our executive team and many others who have worked tirelessly over this period. In recent days however we have been unable to secure the funding to support our business plan and it is therefore with the deepest regret that we have arrived at this decision.<sup>2</sup>

The character of the Carillion liquidation

Insolvency law is complex and events are still unfolding. The Special Managers have said that they will publish more information as it becomes available.<sup>3</sup> However, it should be apparent that in its scale and procedures, the compulsory liquidation of Carillion is not usual.

## 1.1 Why liquidation and not administration?

The starting position is that a company must not trade whilst insolvent. Insolvency is defined as having insufficient assets to meet all debts, or being unable to pay debts as and when they fall. It is the company directors' responsibility to know whether or not the company is trading

<sup>1</sup> Special Managers act as agents of the Official Receiver, without personal liability. As licenced insolvency practitioners they are bound by the [Insolvency Code of Ethics](#)

<sup>2</sup> "[Carillion: Government contractor's liquidation statement in full](#)", Independent, 15 January 2018, [online] (accessed 17 January 2018)

<sup>3</sup> The [PwC website](#) should be monitored for this purpose

whilst insolvent and they can be held legally responsible for continuing to trade in that situation.

Reportedly, Carillion was left with just £29m in cash when it collapsed; it owed more than £1.3bn to its banks, including a £790m credit facility and £349m in private placement notes.<sup>4</sup> It also had £630m of “bonding facilities” and £350m of invoice finance, taking the total exposure of its 13 banks above £2bn.<sup>5</sup> Carillion would apparently have been left with a cash shortfall of £3.5m had it kept operating just a few more days without drawing down further debt facilities.<sup>6</sup>

The two main procedures open to an insolvent company are:

- administration and
- liquidation

The first procedure provides for the potential rescue of the company or its business, while the second does not. Once an administration order is in place, a moratorium protects the company from legal actions whilst a survival plan or an orderly wind-down of the company’s affairs is being achieved.<sup>7</sup> Administration allows a company to continue to operate as the administrator attempts to find a buyer for all or part of the business. In contrast, liquidation means a company stops trading, employees are made redundant, assets are collected in and sold and the proceeds used to pay company debts. At the end of the liquidation, creditors are paid as much as possible and the company ceases to exist.

Various business commentators have suggested that Carillion went into compulsory liquidation rather than administration because it had no real assets left to sell.<sup>8</sup> It had contracts, but they were either too complex or insufficiently valuable for the banks to lend against. With margins too low to cover its liabilities, there was no viable business to sell.<sup>9</sup>

According to press reports, there was so little funding available that the consultants PwC and EY both rejected requests that they be taken on as administrators amid concerns they would not be paid.<sup>10</sup>

### 1.2 Petition to wind-up an insolvent company

A compulsory liquidation order was made against Carillion on the petition of the companies’ directors. This is not in itself unusual.

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<sup>4</sup> [“Carillion held just £29m in cash when it collapsed”](#), Financial Times, 16 January 2018, [online] (accessed 17 January 2018)

<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> The administration procedure was extensively reformed by the [Enterprise Act 2002](#), which came into force in September 2003

<sup>8</sup> [“Why Carillion has gone into liquidation rather than administration”](#), Financial Times, 15 January 2018, [online] (accessed 17 January 2018)

<sup>9</sup> Ibid

<sup>10</sup> [“Carillion held just £29m in cash when it collapsed”](#), Financial Times, 16 January 2018, [online] (accessed 17 January 2018)

All compulsory liquidations start with the presentation of a winding-up petition at court. Often, a company is placed into compulsory liquidation on the petition of one of its creditors. However, any of the parties set out in [section 124](#) of the [Insolvency Act 1986](#) (IA 1986) may present a petition, including the company itself or the directors of the company acting collectively.

Compulsory liquidation is a court-based procedure through which company assets are realised for the benefit of creditors.

At the hearing of a winding up petition, it is for the judge to decide whether to make a liquidation order, dismiss or adjourn the petition.<sup>11</sup> The court will only make a liquidation order if one of the grounds for winding up a company (as set out in [section 122\(1\)](#) of the IA 1986) are met. The most common ground used is that the company is unable to pay its debts. If a liquidation order is made, the liquidation is deemed to start from the date when the petition for winding up was presented.

### 1.3 Role of the liquidator

In the case of Carillion, the High Court appointed the Official Receiver as liquidator. The court also appointed 6 executives of PwC as Special Managers to assist the Official Receiver.

In a compulsory liquidation, it is usual to appoint the Official Receiver as liquidator<sup>12</sup> unless and until creditors' appoint their own liquidator.<sup>13</sup> This is only an option if there are sufficient company assets to pay the fees of a private sector insolvency practitioner.

The liquidator must act in the interests of the body of creditors as a whole.

On taking control of an insolvent company, all liquidators are under a general duty to act in "good faith" and in the interests of the creditors as a whole.<sup>14</sup> The IA 1986 (as amended) confers extensive powers on the liquidator to enable him/her to recover company assets, and to maximise the funds available for distribution to creditors. A summary of the main powers available to a liquidator are set-out in **Box 1** below.

It should be noted that contracts with a liquidated company may not automatically be discharged, but often contractual clauses will allow for termination in the event of insolvency. There may also be "retention of title" clauses which often become of great importance after a liquidation. Briefly, a retention of title clause is a provision in a contract for the sale of goods which means that the seller retains legal ownership of the goods until certain obligations are fulfilled by the buyer – usually payment of the purchase price.

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<sup>11</sup> [Section 125](#), Insolvency Act 1986

<sup>12</sup> [Section 136](#) of the Insolvency Act 1986

<sup>13</sup> [Section 139](#) of the Insolvency Act 1986

<sup>14</sup> [Section 167\(3\)](#) of the Insolvency Act 1986

### Box 1: The main powers available to the liquidator

Sections 165, 167 and [Schedule 4](#) of the IA 1986 sets out the powers available to a liquidator. These powers include:

- Disclaiming onerous property or contracts ([section 178](#) of the IA 1986).
- Bringing or defending legal proceedings on behalf of the insolvent company.
- Carrying on the business of the company as far as is necessary for its beneficial winding up.
- Selling the insolvent company's property and executing documents in the name of the company.
- Challenging antecedent transactions. (Antecedent transactions are specific types of transaction that were made prior to a company's insolvency. They may be reversible by a liquidator if the company was insolvent at the time they were made, or caused the company to become insolvent at a later date).

It is a feature of the Carillion liquidation that the Official Receiver is expected to prioritise the continuity of vital public services while securing the best outcome for creditors. This was made clear in a Statement made by David Lidington, Minister for the Cabinet Office, to the House of Commons on 15 January 2018. An extract from this Statement is reproduced below:

The Official Receiver's role in the liquidation of Carillion.

Today the directors of Carillion concluded that the company is insolvent and that it is going into liquidation. The court has appointed the official receiver as the liquidator. It is regrettable that Carillion has not been able to find suitable financing options with its lenders, and I am disappointed that the company has become insolvent as a result. It is, however, the failure of a private sector company and it is the company's shareholders and lenders who will bear the brunt of the losses; taxpayers should not, and will not, bail out a private sector company for private sector losses or allow rewards for failure.

I fully understand that both members of the public and particularly employees of companies in the Carillion group will have concerns at this time, and the Government are doing everything possible to minimise any impact on employees. Let me be clear that all employees should continue to turn up to work confident in the knowledge that they will be paid for the public services they are providing. Additionally, in order to support staff—and in this instance this will apply to staff working for the private sector as well as for the public sector contracts of the Carillion group—we have established a helpline using Jobcentre Plus through its rapid response service.

The Government are also doing everything they can to minimise the impact on subcontractors and suppliers who, like employees, will continue to be paid through the official receiver. The action we have taken is designed to keep vital public services running, rather than to provide a bail-out on the failure of a commercial company. The role of the Government is to plan and prepare for the continuing delivery of public services that are dependent on these contracts, and that is what we have done.

The cause of Carillion's financial difficulties is, for the most part, connected not with its Government contracts, but with other parts of its business. Private sector contracts account for more than 60% of the company's revenue, and the vast majority of the problems the company has encountered come from these contracts rather than the public sector.

Our top priority is to safeguard the continuity of public services, and we have emphasised that to the official receiver. We are also laying a departmental minute today notifying the House of a contingent liability incurred by my Department in indemnifying the official receiver for his administrative and legal costs. The official receiver will now take over the running of services for a period following the insolvency of the company. The Government will support the official receiver to provide these public services until a suitable alternative is found, either through another contractor or through in-house provision. The court appointment of the official receiver will allow us to protect the uninterrupted delivery of public services—something that would not have been possible under a normal liquidation process.<sup>15</sup>

The whole Statement can be viewed [online](#).

It is clear from this Statement that in addition to reviewing all of Carillion's contracts, the Official Receiver's role is to ensure the continuity of public services while acting in the interests of the body of creditors. The Official Receiver is to be supported in this role by the Government until a suitable alternative is found (either through another contractor or in-house provision). Unless told otherwise, all employees, agents and subcontractors providing public services are being asked to continue to work as normal and they will be paid for the work they do during the liquidations by the Official Receiver. The Government has undertaken to provide the necessary funding required by the Official Receiver to maintain public services carried on by Carillion staff, subcontractors and suppliers. It will also indemnify the official Receiver for his administrative and legal costs.

On 17 January 2018, the Insolvency Service published a statement in which it said that the Official Receiver was pleased with the level of support shown by Carillion's private sector service customers. It said:

Over 90% of these customers have indicated that they want Carillion to continue providing services in the interim until new suppliers can be found and will provide funding which enables the Official Receiver to retain the employees working on those contracts.

Work has paused on construction sites, pending decisions as to how and if they will be restarted.<sup>16</sup>

## 1.4 Investigation of the company's failure

On 16 January 2018, the Government [announced](#) that the Official Receiver's investigation into the causes of the failure of Carillion is to be fast-tracked. The investigation is to look at the conduct of directors in charge at the time of the company's insolvency and also the conduct of previous directors, to determine whether their actions might have caused detriment to the company's creditors (including detriment to any employees who are owed money or to the pension schemes).

In all compulsory liquidations, the Official Receiver is under a statutory duty to investigate the causes of failure of the company. The actions of

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<sup>15</sup> [HC Deb 15 January 2018 c.634-635](#)

<sup>16</sup> "[Update on Carillion contracts](#)", Insolvency Service, Gov.UK, 17 January 2018, [online] (accessed 17 January 2018)

directors come under particular scrutiny. The Official Receiver is also under a duty to report any evidence of wrongdoing under insolvency legislation, or potential misconduct by the directors, to the Secretary of State for [Business, Energy and Industrial Strategy](#) (BEIS).

The [Financial Reporting Council](#) also has powers to investigate circumstances relating to the audit of Carillion. A statement is expected shortly.

### 1.5 Payment of creditors' claims

Carillion has only been in compulsory liquidation a few days. It is too early to predict what, if anything, creditors will recover. Obviously, much will depend on the value of company assets and debts. The Special Managers are in the process of exploring any potential sale of the businesses and assets in whole or part.

The Special Managers have already said that there is no prospect of any return to Carillion shareholders. The Insolvency Service has also announced that bonuses and severance payments have not been made to directors since the date of the company's collapse.<sup>17</sup>

The order in which creditors are paid is prescribed by the [IA 1986](#) (as amended) and is set out in **Box 2** below. The following points should be noted:

- There is no "freeze" on the enforcement of security on the insolvency of a company.
- There is, however, a stay (i.e. a "stop") on the commencement or continuation of legal proceedings against the company without the leave (i.e. permission) of the court.
- This means that unsecured creditors (e.g. trade suppliers) will not be able to pursue or enforce their own claims against the liquidated company. Instead, they will be entitled to share "pari passu"<sup>18</sup> in any distribution made to the unsecured creditors by the liquidator later in the process (subject to any funds being available for them after secured and preferential claims have been taken into account).

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<sup>17</sup> ["Bonuses for Carillion bosses are blocked"](#), BBC News, 17 January 2018, [online] (accessed 17 January 2018)

<sup>18</sup> "Pari passu" means at the same rate or on an equal footing

### Box 1: Hierarchy of creditors in a compulsory liquidation

- **Fixed charge holders** - any creditor holding a fixed charge over an asset.  
Fixed charge security is a lien or mortgage over a specific asset such as land, a building, or machinery which is registered and remains in force until the debt is paid. A characteristic of fixed charge security is that a borrower would need the lender's permission to sell a fixed charge asset. In the event of the borrower's insolvency, the fixed charge holder will be paid out of the proceeds from the sale of the assets subject to the fixed charge.
- **The fees and charges of the liquidation** - expenses of the liquidation have priority over other claims except for those of fixed charge holders.
- **Preferential creditors** – these are unsecured debts which, by statute, are to be paid in priority to all other unsecured debts and debts secured by floating charges. The categories of preferential debts are listed in [Schedule 6](#) to the IA 1986. Importantly, certain employee debts (subject to certain limits) are preferential.  
**Floating charge holders** - any creditor holding a floating charge over an asset (e.g. a debenture). Unlike a fixed charge, which will attach itself to an asset from the point of creation, a floating charge will 'float' above a changing pool of assets (e.g. stock, book debts and work in progress) until a specific event occurs (i.e. insolvency or a default under the loan) when it will attach. At that stage the floating charge is converted into a fixed charge over the assets which it covers at that time. (For certain floating charges there may also be a percentage-based ring-fenced amount set aside for the benefit of unsecured creditors).
- **Unsecured creditors** (also known as ordinary creditors) – any creditors who do not hold any security for the money owed to them.
- **Shareholders** - in most liquidations, company shareholders will not recover anything at all).

## 1.6 At the end of the liquidation

On completion of the winding-up, the liquidator is required to file a final return with [Companies House](#). The company is automatically dissolved 3 months later – it will no longer exist.<sup>19</sup>

It is fair to say that in terms of its scale and procedures, the liquidation of Carillion Plc is not usual. However, as outlined above, many of the effects of Carillion's liquidation will be the same as those seen in other liquidations.

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<sup>19</sup> Unlike administration, where jobs may be saved if a buyer can be found to take over all or part of the business as a "going concern". Employees may be transferred to the buyer with their rights protected under special rules that apply to transfers of undertakings.

## 2. Financials

On 10 July 2017, Carillion [announced](#) that its profits would be hit to the tune of £845 million. As a consequence, its chief executive resigned and there would be no dividends that year. The [shares](#) lost more than half of their value in the two days that followed the announcement.

Although the July 2017 profit warning marks the beginning of the end for Carillion, it is poor decisions in the years leading up to it that caused the company serious trouble. The shock announcement said so, in corporate English:

- Deterioration in cash flows on a select number of construction contracts led the Board to undertake an enhanced review of all of the Group's material contracts, with the support of KPMG and its contracts specialists, as part of the new Group Finance Director's wider balance sheet review.
- This review has resulted in an expected contract provision of £845m at 30 June 2017, of which £375m relates to the UK (majority three PPP projects) and £470m to overseas markets, the majority of which relates to exiting markets in the Middle East and Canada. The associated future net cash outflows in respect of these contracts is £100m-£150m (primarily in 2017 and 2018).

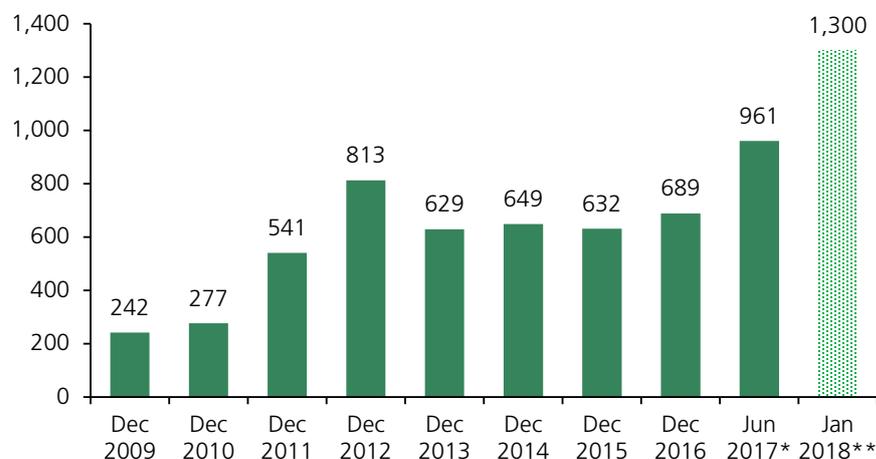
What had happened?

### 2.1 Borrowing multiplied

Over the eight years from December 2009 to January 2018, the total owed by Carillion in loans increased from £242 million to an estimated £1.3 billion – more than five times the value at the beginning of the decade.

#### Carillion's loans

Total owed, £ millions



Source: Carillion's annual [financial statements](#); \* [Interim financial statement](#) for the six months ended 30 June 2017; \*\* [Financial Times](#) (16 Jan 2017)

**Note:** Total loans is the sum of bank overdrafts, bank loans, finance lease obligations and other loans.

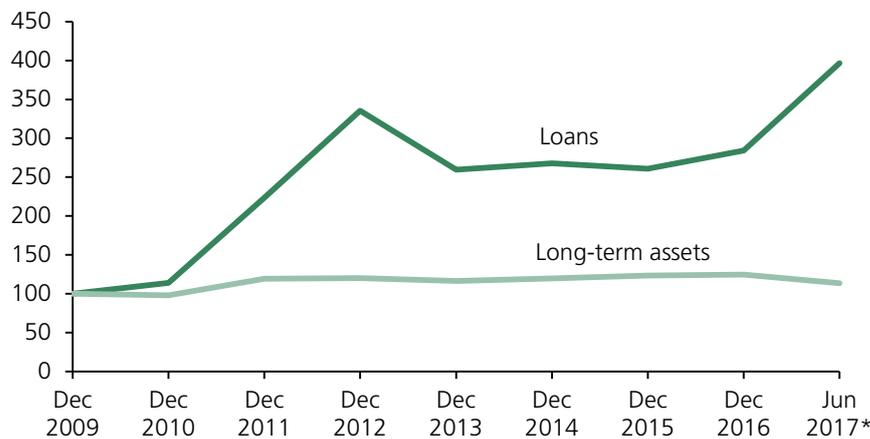
Carillion also ‘borrowed’ large amounts of money in less conventional ways, for example, by [taking longer](#) to pay its invoices. The total owed within a year to unspecified ‘other creditors’ jumped from £212 million at the end of 2009 to £761 million at the end of 2016. This is effectively a form of short-term borrowing. It is risky because it makes the company much more vulnerable to a cash crunch.

## 2.2 Little valuable investment

Carillion’s borrowing was mainly not used to invest in the company. In fact, while Carillion’s debts rose by 297%, the value of its long-term assets grew by just 14% between 2009 and 2017.

### Loans vs value of long-term assets

2009 = 100



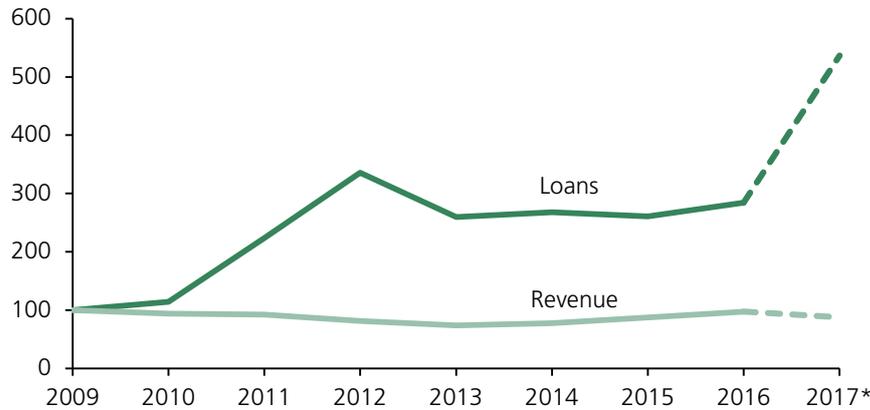
**Source:** Carillion’s annual [financial statements](#); \* [Interim financial statement](#) for the six months ended 30 June 2017

**Note:** Long-term assets is total non-current assets less deferred tax assets

## 2.3 Declining revenue

Nor did Carillion manage to grow its revenue. The group’s revenue actually fell by 2% between 2009 and 2016. Revenue is likely to have fallen further in 2017 – by as much as 12% compared to 2009, if one projects the 2017 interim results linearly. At the lowest point, in 2013, revenue was 26% lower than in 2009.

**Loans vs revenue for the year**  
2009 = 100



**Source:** Carillion’s annual [financial statements](#); \* Loans value reported by [Financial Times](#) (16 Jan 2017) and full-year revenue projected by the Library based on [Interim financial statement](#) for the six months ended 30 June 2017

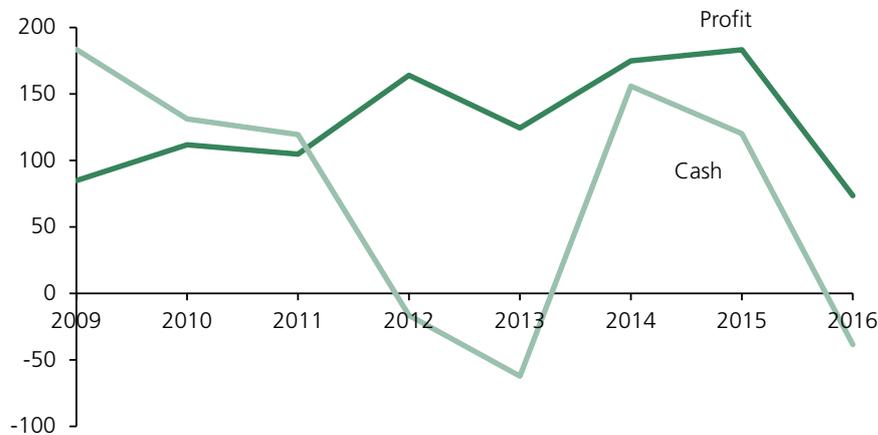
**Note:** Revenue is the group revenue

## 2.4 Aggressive bidding and accounting

Carillion has been [criticised](#) for its aggressive bidding and accounting. ‘Aggressive accounting’ is the practice of declaring revenue and profits based on optimistic forecasts, before the money has actually been made. All is well if the forecasts are correct. But if costs rise and revenues fall (say, because of delays and defects), expected profits turn into actual losses.

Because aggressive accounting means declaring profits before receiving the money, it shows up in company accounts as a fall in the actual cash that the company makes compared with the profits it declares. Carillion’s accounts are a case in point.

**Declared profit vs cash generated**  
From operations, £ millions



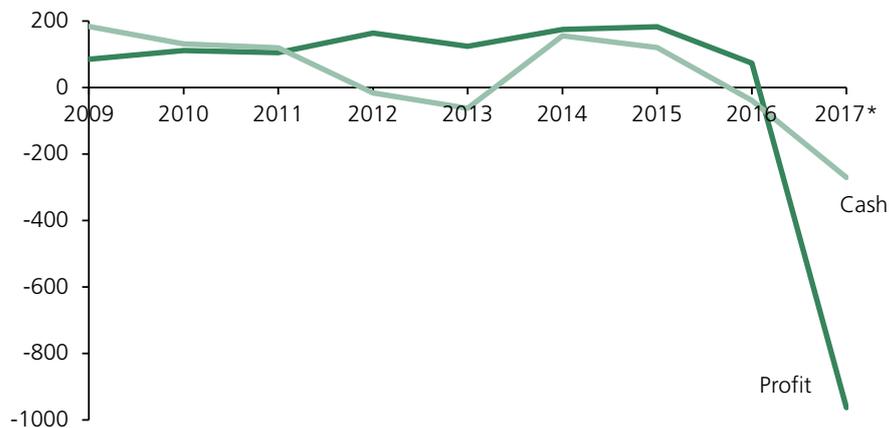
**Source:** Carillion’s annual [financial statements](#) and restated 2016 figures from 2017 [Interim financial statement](#)

**Note:** Profit is group operating profit; Cash is net cash generated from operations

When these projections are not realised, profits can turn into losses very sharply:

### Declared profit vs cash generated

*From operations, £ millions*



**Source:** Carillion's annual [financial statements](#); \* [Interim financial statement](#) for the six months ended 30 June 2017

**Note:** Profit is group operating profit; Cash is net cash generated from operations

In its [10 July 2017 profit warning](#), Carillion announced that it had undertaken 'an enhanced review of all of the Group's material contracts' which resulted in a 'contract provision of £845m at 30 June 2017'. In other words, Carillion had been £845m too optimistic about its contracts.

On 29 September 2017, Carillion's [half-year financial statements](#) revealed a total hit to the company's worth of £1.2 billion – enough to wipe out the profits from the previous eight years put together.

## 2.5 Dividends paid out

Carillion's aggressive accounting also drove up its borrowing. Dividends illustrate this well.

Dividends are a distribution of profits and there are great pressures on companies to, at the very least, maintain dividend payments. While declared profits can be based on expectations, dividends are paid out in hard cash.

When dividends are paid on the basis of *expected* profits, the company is effectively borrowing money to pay its shareholders.

**Dividends vs cash, £ millions**

For the year	Cash from operations	Dividends paid	Cash left
2009	184	53.4	130
2010	131	59.1	72
2011	120	64.6	55
2012	-16	70.4	-87
2013	-62	74.6	-137
2014	156	75.7	80
2015	120	76.8	44
2016	-38	78.9	-117
<i>Total 2009-2016</i>	<i>594</i>	<i>554</i>	<i>40</i>
<i>Total 2012-2016</i>	<i>159</i>	<i>376</i>	<i>-217</i>

**Source:** Carillion's annual [financial statements](#);

**Note:** Cash is net cash generated from operations; dividends is dividends paid to equity holders of the parent

In the eight years from 2009 to 2016, Carillion paid out £554 million in dividends, almost as much as the cash it made from operations. In the five years from 2012 to 2016, Carillion paid out £217 million more in dividends than it generated in cash from its operations.

Dividends is not the only thing that companies need to generate cash for. Net cash from operations also needs to pay for investments and interests on debt (Carillion's interest charge was £30 million in 2016).

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