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Corporate Insolvency and Governance Bill: An overview of the significant reforms to the UK's restructuring and insolvency regime

On 20 May 2020, the UK government published the long-awaited Corporate Insolvency and Governance Bill (the Bill) to implement the temporary measures announced by the Business Secretary on 28 March 2020 and the long planned measures contained in the government's consultation in August 2018.

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Please note: the information contained in this legal update is correct as of the original date of publication

On 20 May 2020, the UK government published the long-awaited Corporate Insolvency and Governance Bill (the Bill) to implement the temporary measures announced by the Business Secretary on 28 March 2020 and the long planned measures contained in the government's consultation in August 2018. The measures are to help companies deal with the immediate impact of the coronavirus pandemic and to provide new corporate restructuring tools to the insolvency regime to give companies in financial difficulties the time they need to maximise their chance of survival. The Bill is being fast tracked and is due to have its second and third readings in parliament on 3 June 2020 and is expected to be implemented into law in short order.

The key measure which are discussed in more detail below include:

Temporary measures

1. Restrictions on statutory demands and winding up petitions
2. Suspension of liability for wrongful trading
3. Changes to meetings and company filings

Permanent measures

4. A free-standing moratorium
5. A new restructuring plan with cross-class cram down
6. Restrictions on termination (ipso facto) clauses in supply contracts

Restrictions on statutory demands and winding up petitions

The Bill provides a number of restrictions on the presenting of petitions to wind-up companies during the "relevant period" being 1 March 2020 to 30 June 2020 (or one month after the coming into force of the Bill, whichever is later). No winding up petitions can be presented to court on or after 27 April 2020 where it is based on a statutory demand served during the relevant period.

Further, a winding up petition cannot be presented during the relevant period based on a statutory demand or another basis (save for winding up petitions in the public interest) unless the creditor has reasonable grounds for believing that: (a) coronavirus has not had a "financial effect" on the company; or (b) the company would have been unable to pay its debts even if coronavirus had not had a financial effect on the company. These provisions are to be regarded as having come into force on 27 April 2020.

In relation to winding up petitions already presented to court on or after 27 April 2020 which do not satisfy these requirements, the court may make such order as it thinks appropriate to restore the position to what it would have been if the petition had not been presented. Similarly, in relation to winding up orders made on or after 27 April 2020 which do not satisfy these requirements, the order is regarded as void but neither the official receiver nor liquidator or provisional liquidator is liable in any civil or criminal proceedings for anything done pursuant to the order.

Coronavirus is defined as having a “financial effect” on a company if (and only if) the company’s financial position worsens in consequence of, or for reasons relating to, coronavirus. Given this broad definition, it seems likely that any winding up petition presented on or after 27 April 2020 will be disputed. Therefore, creditor’s will no doubt wait until the end of the relevant period before proceeding with a winding up petition particularly given the burden on the creditor of showing reasonable grounds for believing that coronavirus has not had a financial effect and the risk of any winding-up order being voided.

Suspension of liability for wrongful trading

Under existing provisions of the Insolvency Act 1986, directors can potentially become personally liable to make a contribution to the company’s assets if, before the commencement of the winding up of a company or it entering administration, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation or insolvent administration. Arguably, amendments to the existing provisions were not necessary given the wrongful trading claims are not that common and the court has a wide discretion.

The Bill does not really suspend the existing wrongful trading provisions but alters how they are applied. It provides that for the purposes of determining the contribution a director is to make to the company’s assets, the court is “to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period”. Unhelpfully, the guidance published with the Bill does not make clear if the assumption is intended to be a rebuttable one.

Certain financial services firms and public-private partnership project companies are excluded from the suspension but, interestingly, this provision applies irrespective of whether it can be shown that the worsening of the company’s financial position was a result of the coronavirus.

If the point at which the director knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation or insolvent administration was sometime prior to the relevant period, it could be a difficult exercise for the court to determine by how much the company’s financial position has worsened during the relevant period in order to calculate a director’s contribution.

Directors should note that they can still incur liability for fraudulent trading, breach of their directors’ duties and misfeasance or be disqualified as a director.

Changes to meetings and company filings

The Bill introduces measures to ease pressure on companies to comply with filing obligations and to provide greater flexibility in relation to meetings given the restrictions of the lockdown and social distancing.

In relation to meetings including a general meeting or a meeting of any class of member which take place between 26 March 2020 and 30 September 2020, they need not be held at any particular place and may be held electronically. Votes may be cast by electronic or any other means. At such a meeting members do not have the right to: (1) attend the meeting in person; (2) participate in the meeting other than by voting; or (3) vote by particular means. If a company is under a duty to hold an annual general meeting between 26 March 2020 and 30 September 2020, it may do so at any time until 30 September 2020.

In relation to public companies, where accounts and reports are required to be filed between 25 March 2020 and 30 September 2020, the period is extended to the earlier of 30 September or 12 months following the end of the relevant accounting reference period.

A free-standing moratorium

The Bill enables a company to seek a new moratorium which does not require the company to go into an insolvency procedure. The directors will remain in charge of running the business on a day-to-day basis (known as debtor-in-possession) but will be overseen by an insolvency practitioner acting as a monitor. The aim of the moratorium is to allow a company in financial distress a breathing space in which to explore its rescue and restructuring options free from creditor action. This rescue could be via a company voluntary arrangement

(CVA), the new restructuring plan introduced by the Bill (see below), scheme of arrangement or a sale and/or refinance outside of insolvency. The moratorium is free-standing and is not a gateway to a particular insolvency procedure.

The moratorium allows the company a payment holiday in relation to its pre-moratorium debts that have fallen due before the moratorium or during, save for a number of exceptions. These exceptions include the monitor's remuneration or expenses, goods and services supplied during the moratorium, rent in respect of the period during the moratorium, wages and salary arising during the moratorium, redundancy payments or debts or other liabilities arising under a contract or other instrument involving financial services.

The company will also have the protection from insolvency proceedings including the appointment of an administrator by a floating charge holder and the protection from enforcement and legal proceedings unless in certain circumstances permission of the court is obtained, for instance, to repossess goods in the possession of the company or for a landlord to exercise a right of forfeiture.

During the moratorium the directors will be subject to certain restrictions which, if breached, could be an offence. These include limits on the obtaining of credit, granting of security, entering into certain transactions, disposing of property and the amount to be paid to a particular creditor.

The directors can obtain a moratorium by filing the requisite documents at court which include a notice that the directors wish to obtain a moratorium; a statement from the directors that the company is, or is unlikely to become, unable to pay its debts and a statement from the proposed monitor confirming the monitor consents to act, the company is eligible and the moratorium would result in the rescue of the company as a going concern. If the company is subject to a winding up petition, the permission of the court will be needed in order to seek a moratorium. However, if the company has been in formal insolvency proceedings or subject to a moratorium in the previous 12 months a moratorium will not be available.

Once obtained, the moratorium will last an initial period of 20 business days but this can be extended by a further 20 business days without creditor approval by filing a notice at court with further statements from the directors and monitor as were filed when the moratorium was obtained but with confirmation by the directors that the debts for which no payment holiday is available have been paid. A longer extension for up to a year can be obtained with creditors' consent or by the directors applying to court for an order.

Given that the moratorium is free-standing and does not require the company to go into an insolvency procedure, it may not be covered by the termination provisions of existing contracts. Accordingly, contracting parties may wish to review the impact of the new measure in relation to existing contracts as well as the wording of the termination clause in new contracts. However, as a result of the new measures in relation to supply contracts (see below), if the contract is for the supply of goods and services, any clause which seeks to terminate the contract or do another thing because the company becomes subject to an insolvency procedure, will cease to have effect unless the supplier is exempted.

A new restructuring plan with cross-class cram down

A new restructuring plan has been introduced by the Bill which is to complement the existing regime governing schemes of arrangement under the Companies Act 2006 but with the addition of the ability to cram down across classes of creditors (a feature of US Chapter 11 bankruptcies) and bind both secured (with exeptions) and unsecured creditors.

The new restructuring plan will be available to a company that *"has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern"*. The company will be able to propose a compromise or arrangement between its creditors and/or members or any class of them, if it is to "eliminate, reduce or prevent, or mitigate" the effect of the financial difficulties.

An application is first made to the court which can be made by the company, a creditor or member or a liquidator or administrator. The court may order a meeting of the creditors/members or class of creditor/member for the purpose of voting on the compromise or arrangement. Those creditors/members whose rights are affected by the compromise or arrangement will be permitted to participate in the meeting unless the court is satisfied that the class of creditor/member has no genuine economic interest in the company.

If 75% in value of the creditors/members or class of creditor/member vote to agree a compromise or arrangement, the court may sanction it. If a class has dissented, the court can still sanction the compromise or arrangement if: (1) the dissenting class would not be any worse off under the arrangement than whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned; and (2) 75% in value of at least one class of creditors or members who would receive a payment or have a genuine economic interest in the company in the event of the alternative situation, voted in favour of the compromise or arrangement.

If there was a moratorium in the previous 12 weeks, the court cannot sanction the compromise or arrangement if it includes provision in respect of any creditor, unless they consent, whose debt arose during the moratorium or before the moratorium but was not subject to the payment holiday in respect of a moratorium debt (see above).

Given that the provisions do not include a super-priority for debtor-in-possession financing (DIP Financing) such as in the US debtor-in-possession proceedings, companies in financial difficulties may find it difficult to obtain new funding.

Restrictions on termination (ipso facto) clauses in supply contracts

The Bill makes provision for a new section 233B of the Insolvency Act 1986 which complements the existing sections 233 and 233A preventing essential suppliers such as utility companies and IT providers stopping supplies only by reason of the company's insolvency. The new provision provides that a contractual term of a contract to supply goods and services will cease to have effect if it would terminate or entitle the supplier to terminate the supply or do "any other thing" (e.g. amending payment terms) because the company becomes subject to an insolvency procedure. The relevant insolvency procedure includes the new free-standing moratorium and restructuring plan (see above) but also liquidations which are not included in the existing provisions in relation to essential suppliers.

If the contractual term ceases to have effect, the supplier can only terminate the supply of goods and services if: (1) the office-holder consents; (2) in any other case, the company consents; or (3) the court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission for the termination of the contract.

If the supplier is prohibited from terminating the contract, the supplier cannot make the supply of goods and services conditional on the payment of outstanding debts. Furthermore, there is no provision, as there is under the existing provisions for essential supplies, to make it a condition that the office-holder personally guarantees payment of the supply.

Exemptions apply to the suppliers of financial services and those already protected under the existing provisions. However, the Bill provides that small suppliers are temporarily excluded from these provisions until 30 June 2020 or one month after the coming into force of these provisions, whichever is later. For a supplier not in its first financial year, it will be a small supplier if two of the following conditions are met: (1) turnover was not more than £10.2m; (2) balance sheet total was not more than £5.1m; (3) the number of employees is not more than 50.

These new provisions, although designed to assist with the rescue of companies by maintaining supply, represent an interference with the principle of freedom of contract. It will be interesting to see how the drafting of termination clauses develops in response. In addition, it will be interesting to see how the courts will develop the provision regarding the requirement for a supplier to show "hardship" in order to terminate an agreement so that suppliers also have sufficient protection.

Conclusion

The Bill contains the long awaited permanent changes to the corporate insolvency regime and the hastily drafted temporary measures which in the short term should prevent aggressive action by creditors before companies can take advantage of the new permanent measures such as the free-standing moratorium and restructuring plan in order to seek to rescue the business. These new measures are similar to Chapter 11 proceedings in the US and are likely to lead to more debtor friendly restructuring in the UK. However, it will remain to be seen how they will operate in practice and how the provisions, in whatever form they end up in after they are debated in parliament, will be interpreted and developed by the courts.

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