The Corporate Insolvency and Governance Act – will it help?

On 26 June 2020 the Corporate Insolvency and Governance Act (Act) came into force after a rapid passage through all Parliamentary stages, in a little over a month. This is a major piece of legislation (stretching to 245 pages). It is a centrepiece of the Government's response to the fallout of the COVID-19 pandemic for businesses and represents the biggest change to corporate insolvency law for 34 years. It will have big implications for the business community during the current crisis and for many years to come. With this in mind we set out our comments below. We are providing separate updates on the corporate governance aspects of the Act.

1. New moratorium

1.1 *Which companies are eligible?* Companies which are not overseas companies and are not subject to a winding up petition may obtain a moratorium by filing the necessary documents at court. If a company is subject to a winding up petition which has not been withdrawn the moratorium will only be granted if the court is satisfied that a moratorium would create a better result for the company's creditors as a whole than would be likely if the company were wound up. Overseas companies can also obtain a moratorium through a court application.

1.2 *Documents to file:* Documents to file in support of the application are:

1.2.1 a notice from the directors that they wish to obtain a moratorium, with a statement that the company is or is likely to become unable to pay its debts;

1.2.2 a statement by an insolvency practitioner (or jointly by more than one person taking this role) consenting to act as "monitor" of the moratorium, confirming the company is not an overseas company or subject to winding up petition and that, in the proposed monitor's view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern. That is equivalent to the first objective of administration but there is no provision for the alternatives in the administration process of achieving better realisations than would be the case in liquidation or facilitating a distribution to secured or preferential creditors; and

1.2.3 for regulated companies, consent of the applicable regulator to the appointment of the proposed monitor is required and the regulator must be kept involved throughout the moratorium.

1.3 *When it starts:* The moratorium comes into force when the necessary documents are filed at court or, for overseas companies or companies subject to a winding up petition, when the court orders it. The monitor is then required to file notice at Companies House and to notify every creditor of the company of which he is aware. There are also requirements to file notice of the moratorium to be posted on a company's website, at its business premises, and on business documents.

1.4 *End of moratorium:* The moratorium ends after 20 business days but can be extended by a further 20 business days if directors file a notice with the court before the end of the first 15 business days stating that (i) all moratorium debts and pre-moratorium debts that do

not have a payment holiday have been discharged (on terminology see paragraph 1.5 below); and (ii) the company is unable to pay its pre-moratorium debts, with a statement from the monitor restating that in his view, the moratorium would be likely to result in a rescue of the company as a going concern. It is also possible, on more than one occasion, for there to be further extensions with consent of a majority of creditors on whom a payment holiday is imposed by the moratorium or by court order. There are provisions to extend a CVA moratorium with a new moratorium. The moratorium ends early on the start of a formal insolvency procedure or scheme of arrangement.

1.5 *What is restricted*? The Act states that the moratorium relates to "pre – moratorium debts" for which a payment holiday is provided. Pre-moratorium debts are, essentially debts incurred before the moratorium which fell due before the moratorium or which fall due after then, other than the monitor's remuneration or expenses, goods or services supplied during the moratorium, rent in respect of a period during the moratorium, wages, salary and redundancy costs, or debts under certain financial services instruments. However, later provisions restrict action by creditors for all debts in a similar manner to that for administrations and restricts other insolvency proceedings, litigation, enforcement of security, lease forfeiture without permission of the court, and whether or not such proceedings relate to pre-moratorium debts. A court application for relief of the moratorium may not, however, be made in respect of pre-moratorium debts in respect of which there is a payment holiday during the moratorium.

1.6 *Other provisions*

1.6.1 It is an offence for a company to obtain credit of more than £500 during the moratorium without disclosing the moratorium.

1.6.2 A company can grant security during the moratorium with consent of the monitor (which he can give if he thinks it will support the rescue of the company as a going concern). There are restrictions on a company entering into certain financial services contracts during the moratorium.

1.6.3 During a moratorium a company may only pay debts of more than £5000 or 1% of total pre-moratorium debts, or dispose of property outside of the ordinary course of its business, with consent of the monitor or a court order.

1.6.4 Secured property can be disposed of with court permission, which the court may grant if the court thinks that it will support the rescue of the company as a going concern.

1.7 The role of the monitor is to monitor the company's affairs for the purpose of forming a view as to whether it remains likely that the moratorium will result in the rescue of the company as a going concern. This is more limited than the statutory objectives of an administrator (essentially to manage the affairs of the company in accordance with proposals made under Insolvency Act 1986).

1.8 There are no provision for secured creditors to block the choice of monitor and no requirements for proposals similar to those in administration.

1.9 **Comment:** The new moratorium takes up more space than other areas in the Act and it is hoped that it will be of assistance to many rescuable businesses. It will allow a company to get some short term protection and perhaps to avoid any stigma attached to administration. However, other than these reputational issues, it seems difficult to see what advantage the new procedure would have over administration, and it would offer a number of disadvantages. The new procedure is possible with only one of the three possible administration objectives and lasts for insufficient time to implement any meaningful restructuring without repeated extensions. Formalities for commencement are broadly similar and so costs of obtaining a new moratorium may be no less than administration. The monitor will have less tasks than an administrator - his role being to monitor rather than manage (as an administrator is required to do) and there are no requirements for administration proposals. However, the requirement for the monitor to underwrite the reasonableness of achieving the narrow statutory objective of the new procedure may also dissuade many insolvency practitioners from recommending this over other procedures.

2. Connected party transactions by administrators

2.1 Temporary and now expired powers in The Insolvency Act 1986 for the Secretary of State to make regulations for transactions between administrators and connected persons are revived, until June 2021.

2.2 **Comment:** This is presumably intended to address popular concern about abuse of pre-packs and preferential deals for shareholders and directors. In our view, while it is, clearly, legitimate to try to prevent abuse which is detrimental to creditors, care needs to be taken in the design of any new regulation to not over-burden businesses with so much red tape and extra cost that it blocks otherwise rescuable businesses from a chance of survival.

3. Wrongful Trading

3.1 In determining the contribution (if any) required from a director in a wrongful trading application, 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 period from 1 March to 30 September 2020. Exclusions are made for certain categories of regulated businesses.

3.2 **Comment:** The government has chosen not to restrict the suspension of wrongful trading to issues caused by COVID-19 simply to a time period. That is clear but risks encouraging irresponsible behaviour by directors to the detriment of creditors. That is a concern, but it seems to us that there are still remedies against delinquent directors. In serious cases, directors will still be vulnerable to attack for fraudulent trading and for breach of general fiduciary duties.

4. Termination clauses in supply contracts

4.1 Other than in circumstances where the company (or the appointed insolvency practitioner) consents or the court otherwise orders for reason of causing the supplier hardship:

4.1.1 a provision in a contract for the supply of goods and services which terminates the contract automatically, or by notice from the supplier, or triggers any other thing to take place on formal insolvency, will not apply; and

4.1.2 a provision giving the supplier the right to terminate due to some event before formal insolvency is unenforceable.

4.2 A requirement to pay outstanding charges as a condition for continuity of supply after formal insolvency is prohibited.

4.3 **Comment:** This is a significant provision which dramatically extends the scope of provisions in insolvency legislation preventing the use of unreasonable ransom demands by suppliers of utilities and other essential services. It extends these provisions to all suppliers without the protections to allow payment for ongoing supplies in the existing provisions for payments to utility and essential services suppliers. The new provisions will necessitate an urgent review of long term supply contracts by all suppliers - an additional task which most businesses would prefer to avoid under current pressures.

5. Arrangements and reconstruction for companies in financial difficulties

5.1 These provisions apply where a company (other than one with a financial services business):

5.1.1 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; and

5.1.2 a compromise or arrangement is proposed between a company and its creditors or a class of them.

5.2 The procedure for approval is similar to (but slightly simpler than) that for schemes of arrangement under Companies Act 2006 (court sanction and vote of creditors) but the court has broad powers to facilitate a reconstruction. If approved by the court the compromise or arrangement will bind all creditors (including those creditors who dissented). A key requirement is that the court is satisfied that, if the compromise or arrangement were to be approved, no dissenters would be any worse off than whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not approved.

5.3 **Comment:** This procedure is a useful addition to the armoury for a company facing distress. Its use is likely to be restricted to larger companies due to the expense of procedures of this nature. The requirement for a company to announce that it is likely to encounter financial difficulties without getting the protections for the company and its directors that would be offered by administration may dissuade companies from using the procedure. The procedure is most likely to be used where the company can be reasonably certain (by liaising with a few of the major creditors) that the threshold of obtaining the approval of 75% in value of creditors can be achieved.

6. Winding up petitions

6.1 No petition for winding up may be presented on or after 27 April 2020 where the statutory demand to which the petition relates was served during the period 1 March to 30 September 2020 (referred to as the **Relevant Period**).

6.2 A creditor may not present a petition for winding up during the Relevant Period unless he has reasonable grounds for believing that (a) coronavirus has not had a financial effect on the company; or (b) the facts by reference to which the relevant ground applies would have arisen even if coronavirus had not had a financial effect on the company. This will be a high hurdle to overcome.

6.3 For petitions presented after 27 April 2020 but before the Act came into force, the court has discretion, if it thinks appropriate, to restore the position to what it would have been if the petition had not been presented. This broad wording is, presumably, intended to allow a reversal of a winding up orders already made and validation of disposals in the Relevant Period.

6.4 **Comment:** These provisions apply to any winding up petitions or statutory demands and are not, as may have been assumed to be the case from the preceding Government announcement, restricted to actions by landlords. This is a further dramatic change and significantly restricts debt collection options for creditors.

General comment

The package as a whole contains some procedures which may well offer a life line to distressed businesses which have an underlying viability. However, some provisions contribute to a dramatic shift of insolvency law in favour of debtors and directors. While this may be understandable in the current pandemic there is a risk that the balance may have gone too far. Business creditors are, in many cases, businesses themselves, and if they are prevented from collecting debts or terminating ongoing contracts will be pushed into difficulty - spreading the misery along the supply chain. There are no easy answers - the decline in overall business activity means that some people must lose out - and the best that insolvency law can do is to slow the process and allow re-organisations where needed.

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