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The Corporate Insolvency and Governance Bill 2020: Permanent changes

Introduction

The Bill, published on 20 May 2020, constitutes arguably the most significant change to insolvency law in the UK since the enactment of the Insolvency Act 1986. The Bill introduces temporary changes, such as imposing restrictions on the scope of creditors to rely on the winding up procedure and a suspension of liability for the offence of wrongful trading, and permanent changes, such as the introduction of a new moratorium process. My colleague Ruhi Sethi-Smith has addressed the temporary changes in another article; here I consider the permanent changes. Principally, those changes are:

- The introduction of a new moratorium procedure;
- The introduction of a new restructuring process; and
- New provisions disapplying certain contractual provisions in the case of insolvent companies.

1. The new moratorium procedure

The proposed moratorium process is innovative because it would be freestanding, rather than being associated with a particular insolvency process. In terms of eligibility, this is addressed by a proposed 'Schedule ZA1' to the 1986 Act which is found in paragraph 1 of schedule 1 of the Bill. It is of some complexity, but specifically excludes financial services companies such as insurance companies and banks. The intended provisions detailing the moratorium are themselves complicated, but I have endeavoured to summarise the position below.

Note that there are temporary provisions set out in section 3 and schedule 4 of the Bill that impose modifications on the moratorium procedure during the 'relevant period', which is defined in paragraph 1 of schedule 4 as beginning when the schedule comes into force and ending on 30 June 2020 or a month after the Act comes into force, whichever is later. As I am addressing the permanent changes I have not detailed these provisions, but if a moratorium is envisaged in the short term while the schedule is in force they will need to be considered.

1.1. How is a moratorium obtained, and how long will it last?

The proposed moratorium procedure is dealt with principally in section 1 of the Bill, which inserts a new 'Part A1' into the 1986 Act. Where a company is eligible a moratorium can be obtained in three ways:

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- In the case of a company which is not subject to an outstanding winding up petition and is not an overseas company, by directors by filing specified documents at Court;
- In the case of a company which is subject to an outstanding winding up petition, by directors by making an application to Court accompanied with specified documents; or
- For an overseas company that is not subject to an outstanding winding up petition, by directors by making an application to Court accompanied with specified documents.

Where a Court application is required because the company is subject to an outstanding winding up petition, the test for ordering a moratorium will require the Court to be '*satisfied that a moratorium for the company would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being subject to a moratorium)*'.

Where a moratorium comes into effect, whether administratively or as the result of a Court order, there is a need for a 'monitor' to be in place and for that monitor to notify the fact of the moratorium to Companies House and all known creditors.

The 'initial period' for any moratorium will be 20 business days, beginning with the business day after the moratorium comes into effect, but it can be extended in the following ways:

- Where creditors have not consented, it can be extended administratively for a further 20 business days. After the first 15 business days of the initial period the directors can file specified documents, which include:
  1. A statement from the directors that moratorium and pre-moratorium debts which have fallen due (aside from those which the company as a payment holiday in respect of) have been paid or discharged;
  2. A statement from the directors that the company is, or is likely to become, unable to pay its pre-moratorium debts; and
  3. A statement from the monitor that the moratorium will likely result in the rescue of the company as a going concern.
- Where creditors consent, it can be extended administratively for an agreed period so long as the total moratorium period is a year or less beginning with the first business day of the initial period. After the first 15 business days of the initial period the directors can file specified documents, which include the following:

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1. A statement from the directors that moratorium and pre-moratorium debts which have fallen due (aside from those which the company as a payment holiday in respect of) have been paid or discharged;
2. A statement from the directors that the company is, or is likely to become, unable to pay its pre-moratorium debts;
3. A statement from the monitor that the moratorium will likely result in the rescue of the company as a going concern; and
4. A statement from the directors that creditor consent has been obtained, and the revised date for which consent was obtained.

   Creditors' consent will be determined using the qualifying decision procedure.

- By an application to Court by the directors. After the first 15 business days of the initial period the directors can apply for an order granting an extension. The application must be accompanied by specified documents, which include:
  1. A statement from the directors that moratorium and pre-moratorium debts which have fallen due (aside from those which the company as a payment holiday in respect of) have been paid or discharged;
  2. A statement from the directors that the company is, or is likely to become, unable to pay its pre-moratorium debts;
  3. A statement from the directors as to whether pre-moratorium creditors have been consulted, and if not, why not; and
  4. A statement from the monitor that the moratorium will likely result in the rescue of the company as a going concern.

  In considering an application, the Court is specifically required to consider the interests of pre-moratorium creditors and the likelihood that the extension will result in the rescue of the company as a going concern. Note that if an application is not dealt with at the time the moratorium would end, it is extended to any date ordered by the Court if the application is granted, or to the date when the application is withdrawn or disposed of by the Court.

Where a CVA proposal is put forward, if the moratorium would otherwise have ended it will continue until the proposal is disposed of (as defined in proposed section A14(3)). The proposed section A15 provides a power for the Court to extend the moratorium in the course of any applications under sections 896 or 901C(1) of the Companies Act 2006, which concern arrangements and reconstructions.

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A moratorium can be prematurely terminated by entry into a compromise or arrangement (as defined in the proposed section A16(2)) or by entry into an insolvency procedure (as defined in the proposed section A16(3)), which includes a CVA, administration or winding up.

1.2. What effect will it have?

The effects of a moratorium are set out in the proposed sections A19-A32, which should be read alongside the overview provided in proposed section A18. Some key effects are set out in the proposed section A20:

- No winding up petitions can be presented other than by directors;
- No winding up orders can be made, save for on petitions presented by directors;
- No resolution for a voluntary winding up can be passed under section 84(1)(a) of the 1986 Act, and a special resolution under section 84(1)(b) can only be passed if recommended by the directors; and
- Only directors can make administration applications, and no notices of intention to appoint administrators under schedule B1, paragraphs 14 or 22(1) of the 1986 Act can be filed.

The effects at (a) and (b) above do not apply in the case of 'excepted petitions' (defined in proposed section A20(3)), though this carve out is narrow and is confined to petitions by the Secretary of State and the Financial Conduct Authority.

There are also some key restrictions in the proposed section A21(1):

- Landlords are unable to exercise rights of forfeiture by peaceable re-entry without a Court order;
- Only limited steps can be taken to enforce security over a company's property without the Court's permission;
- Goods provided to the company under hire-purchase agreements can only be repossessed with the Court's permission; and
- No 'legal process' (defined as including legal proceedings, execution, distress or diligence) can be instituted, carried out or continued without the Court's permission, aside from employment tribunal proceedings and legal processes related to those proceedings, and from proceedings involving a claim between an employer and worker.

Proposed section A21(2) specifically provides that an application for permission under proposed section A21(1) cannot be made in respect of the enforcement of a pre-moratorium debt for which

the company has a payment holiday during the moratorium. Note that under proposed section A21(3), applications may not be made regarding the crystallisation of a floating charge or the imposition of restrictions on disposal of the company's assets by virtue of an instrument creating a floating charge. The position concerning floating charges and the enforcement of security is further addressed, and restrictions imposed, in proposed sections A22 and A23.

2. The new restructuring process

This is included in section 7 and schedule 9 of the Bill, which proposes inserting a new 'Part 26A' into the Companies Act 2006. Broadly speaking, the process is intended as another way for companies to restructure their liabilities via a compromise or arrangement with creditors or members. Some key headline points are that:

- The rights of secured creditors can be affected without their consent; and
- The scheme can be sanctioned by the Court even if not all classes of creditors vote for it.

2.1 How is it entered into, and how long will it last?

Under the proposed section 901A, the process can apply where two conditions are met:

1. A company 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
2. A compromise or arrangement is proposed between the company and its creditors (or any class of them) or its members (or any class of them), and the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties mentioned in respect of the first condition.

An application can be made to Court seeking an order for the summoning of a meeting of creditors (or a class of creditors) or of members (or a class of members). The application can be made by the company, any creditor or member of the company, or a liquidator or administrator (if applicable). In terms of participation in the meeting, proposed section 901C(3) provides that '*every creditor or member of the company whose rights are affected by the compromise or arrangement must be permitted to participate*', though there is a carve out in proposed section 901C(4) which allows for an application to exclude the effect of proposed section 901C(3) in relation to a class or creditors or members where none of the members of the class has a '*genuine economic interest in the company*'. Where a meeting is ordered, notices summoning it must be accompanied by a statement which, among other things, must explain the compromise or arrangement.

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Under the proposed section 901F, if a number representing 75% in value of the creditors (or a class of creditors) or members (or a class of members) agree the compromise or arrangement, the Court can, upon an application being made, sanction it (subject to some exceptions referred to in proposed section 901F(2)). Significantly, where the company is in administration or is being wound up, when sanctioning the compromise or arrangement the Court can order the appointment of an administrator or liquidator to cease, stay all proceedings in the administration or winding up or impose any restrictions it thinks appropriate for facilitating the compromise or arrangement.

It is worth noting that under the proposed section 901G (one of the exceptions referred to in proposed section 901F(2)), if a compromise arrangement is not agreed as above, the Court can still sanction it if two conditions are met:

1. If the compromise or arrangement was to be sanctioned under proposed section 901F, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative (defined as whatever the Court considers would be most likely to occur if the compromise or arrangement was not sanctioned); and
2. The compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors or members who would receive a payment or have a genuine economic interest in the company, in the event of the relevant alternative.

It is also worth noting that there are specific provisions in proposed section 901H (another of the exceptions referred to in proposed section 901F(2)) intended to apply if an application is made within three months of a moratorium under Part A1 (above) ending and the compromise or arrangement includes creditors in respect of moratorium debts or pre-moratorium debts for which the company has not had a payment holiday during the moratorium. These creditors will not be able to participate in any meeting under proposed section 901C and the Court is not able to sanction any compromise or arrangement if it includes provision in respect of any of these creditors who have not agreed to it.

2.2. What effect will it have?

As indicated in the Explanatory Notes accompanying the Bill, the introduction of the 'cross-class cram down' feature means that dissenting classes of creditors or members can be bound by the restructuring plan. This, along with the powers available to the Court in the event that it sanctions

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the compromise or arrangement, provides significant assistance to companies in financial difficulty.

3. The disapplication of contractual provisions in the case of insolvent companies

This is included in section 12 of the Bill, which is intended to insert a new section 233B into the 1986 Act.

Broadly speaking, when a company becomes subject to a 'relevant insolvency procedure' (which is defined as including the proposed moratorium process, administration, CVA, liquidation and an order for a meeting under proposed restructuring process), numerous restrictions will apply, including:

- Any provision in a contract for the supply of goods and services to the company will cease to have an effect if and to the extent that under the provision the contract or the supply would terminate, or any other thing would take place as a result of the company becoming subject to the relevant insolvency procedure, or if the supplier would be entitled to terminate the contract or supply, or to do any other thing, because the company becomes subject to the relevant insolvency procedure.
- Where under a provision in a contract for the supply of goods and services an employer is entitled to terminate the contract or supply because of an event occurring before the start of the insolvency period and the entitlement arises before the start of that period, the entitlement cannot be exercised during the period.
- After a company has become subject to a relevant insolvency procedure, a supplier cannot make it a condition of the supply of any goods and services that any outstanding charges in respect of previous supply are paid.

There are routes through which a supplier is permitted to terminate the contract, but they are themselves limited, for example to circumstances in which the company or office holder (as applicable) consents, or if the Court is satisfied that the continuation of the contract would cause the supplier hardship (see proposed section 233B(5)).

3.1 Temporary exclusion for small businesses

The proposed section 13 of the Bill envisages that the proposed section 233B would not apply where the supplier in question is a 'small entity' at the point the company enters into the relevant insolvency procedure. However, this would only apply where the company enters into that insolvency procedure between the date the proposed section 13 comes into force and 30 June

2020 or one month after the section comes into force, whichever is later. It is therefore only a temporary restriction on the scope of the restrictions.

'Small entity' is defined in proposed section 13. In general terms, a supplier will be a small entity if at least two of the following three conditions were met in the most recent financial year:

1. Its turnover was not more than £10.2 million;
2. Its balance sheet totalled not more than £5.1 million;
3. It had no more than 50 employees.

Where the supplier is in its first financial year, it will be a small entity if at least two of the following conditions are met:

1. Its average turnover for each complete month in the first financial year is not more than £850,000;
2. The aggregate of amounts which would be shown in a balance sheet would be no more than £5.1 million;
3. The average number of employees during the first financial year is not more than 50.

4. Conclusions

It remains to be seen how much of the Bill in its present form makes it on to the statute book, but the size of the current government's majority suggests it is likely to enter into the law in relatively similar form.

The permanent changes set out in the bill are likely to provide useful additional options for parties involved in insolvency proceedings and will be of particular assistance to the large number of companies which are likely to struggle as a result of the coronavirus pandemic.

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