CharlesRussell Speechlys

Briefing Note - Corporate Insolvency and Governance Act 2020

November 2020

The Corporate Insolvency and Governance Act 2020 (CIGA) covers significant changes to UK insolvency law which have been introduced as a result of COVID-19 and which have been extensively documented in the press.

The CIGA introduced changes to laws and additional laws in the following areas:

- **Temporary changes**
  - Wrongful Trading suspension
  - Winding up petitions
  - Annual General Meetings
  - Companies House filing requirements
- **Permanent Changes**
  - Moratoriums
  - New restructuring plan
  - Supplier termination clauses

The Act was granted Royal Asset on 25 June and came into force on 26 June 2020. The temporary measures were originally intended to expire on 30 September 2020. However, the Government announced on 24 September 2020 that a number of the temporary measures will be extended due to the ongoing impact of COVID-19. These have been extended until 31 December 2020 (for the temporary winding-up petition measures) and 30 March 2021 (for the temporary Part A1 moratorium measures).

Some of the changes introduced by the CIGA, and the time periods to which these relate, are discussed in more detail below.

Wrongful Trading

When a company enters administration or (insolvent) liquidation, an administrator or liquidator may pursue a director for a court order requiring that director to contribute to the company's assets where at some point prior to the commencement of the administration or liquidation, that director "*knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or administration*".

Section 214 of the Insolvency Act 1986 provides that if the directors allow the company to trade after the point at which they know or ought to know that the company has no reasonable prospect of returning to solvent trading, then they can be held personally liable. The Court has a wide discretion when quantifying the level of any such compensation to be made to the company by the relevant director. However, ordinarily the director would be held liable for the increase in the deficiency to creditors that occurred between the date the directors should have ceased trading and the date the company actually ceased trading.

Under s12 of the CIGA, the wrongful trading provisions of s214 of the Insolvency Act 1986 (IA 1986) were temporarily suspended such that the court was to assume that the director was not responsible for any worsening of the company's financial position arising during the relevant period (i.e. any loss arising from 1 March 2020 to 30 September 2020). The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 introduced a second suspension to the s214 IA 1986 wrongful trading provisions, to apply from 26 November 2020 to 30 April 20201. It remains unclear what impact the new provisions will have on any wrongful trading which occurred during the 8 week gap from the end of the previous suspension (30 September) and the start of the new suspension (26 November).

There is no requirement for the loss to arise as a result of coronavirus so this blanket suspension will help directors regardless of the reasons that the company became insolvent.

We continue to advise directors against a material change in conduct because wrongful trading cases are often difficult to pursue (for various evidential reasons). Furthermore, CIGA, and the subsequent regulations, do not introduce any relaxation to directors' fiduciary and statutory duties to the company and/or its creditors, nor to the rules on fraudulent trading. Consequently, administrators and liquidators will continue to focus on these duties and will be able to pursue directors for any breaches accordingly. This is irrespective of whether they can pursue a wrongful trading claim or not.

Boards of directors of companies in difficulty should continue to meet regularly to consider the company's finances and carefully document meetings, particularly if there are any dissenting directors. They should take early professional advice (from insolvency practitioners and/or solicitors) and ensure that the advice is documented and followed (and if it is not followed, to document the reasons for that) to ensure that they put themselves in the best possible position to avoid claims being brought against them personally.

Winding up Petitions

Schedule 10 of the CIGA contains a number of temporary provisions in relation to winding-up petitions in Great Britain. These restrictions have been extended so that the 'relevant period' relates to the period from 1 March 2020 to 31 December 2020. The measures provide that:

1. No winding up petitions are to be presented on or after 27 April 2020 which rely on an unpaid statutory demand served during the relevant period (schedule 10, para 1);

2. No winding up petitions are to be presented during the relevant period unless the creditor has reasonable grounds for believing that coronavirus has not had a financial effect on the company or that the company would have become unable to pay its debts even if coronavirus had not had a financial effect on the company (schedule 10, para 2). As to the meaning of "financial effect", this is a low threshold. Coronavirus has a "financial effect" on a debtor company if the debtor's financial position worsens as a result of, or for reasons relating to, coronavirus (this is known as the coronavirus test);

3. Even if the petitioning creditor can overcome the grounds set out in (2) above, the court may only wind up the company if the court is satisfied

that the company would have become unable to pay its debts even if coronavirus had not had a financial effect on the company;

4. To the extent that there is a petition presented during the relevant period and the petition is still pending and if the petitioner cannot show the grounds set out in (2) above, then the court can make any order necessary to remedy that.

There is no restriction or prohibition on presentation of a public interest petition.

Finally, there is provision that any winding up order made in circumstances where it should not have been, for the reasons set out above (and noting the provisions have retrospective effect back to the beginning of March) will be void (schedule 10, para 4).

Even before the CIGA came into force, we saw evidence of the courts acting in the spirit of the proposals and dismissing petitions which fall into the above categories. However, the Insolvency Practice Direction (IPD) was subsequently introduced to supplement the provisions under the CIGA. The IPD provides that winding-up petitions presented to court are to be kept private unless and until the court has determined whether the company would have become unable to pay its debts even if coronavirus had not had a financial effect on the company. The intention behind this is to avoid the potentially damaging consequences of the presentation of a winding up petition on a company, which would ordinarily be searchable in the public register.

Under the IPD, the petition must still be served on the company but will initially be listed for a non-attendance pre-trial review at least 28 days after presentation. The court will consider the petition at the review and, if appropriate, list the matter for a preliminary hearing to consider the above financial test. Prior to any preliminary hearing, both parties will have the opportunity to file evidence and they will be entitled to appear at the hearing to make representations.

If the Court determines that the petition should not have been presented for the reasons set out above, it will dismiss the petition. If the petitioner is able to show that the debt passes the coronavirus test, then it will be advertised and heard in the usual way.

Moratoriums

The provisions in the CIGA for the “Gateway Moratorium” are a permanent change to legislation. The purpose of the moratorium is to allow companies breathing space to consider and implement rescue options while enforcement or other legal action is restricted.

The eligibility criteria for a company wishing to obtain a moratorium are contained in Schedule 1 and are wide ranging. However, primarily, the companies who will *not* be eligible are financial services companies or those who have been in a formal insolvency procedure or sought a moratorium in the last 12 months.

The process of obtaining a moratorium involves an application to court. The directors must make a statement that the company is, or is likely to become, unable to pay its debts. The CIGA introduces the role of a “monitor”, who must be a licenced insolvency practitioner, and who must make a statement that it is

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CharlesRussell
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likely that a moratorium for the company would result in the rescue of the company as a going concern. The moratorium takes effect from the time that the application is filed.

The role of the monitor is to ensure that the company complies with the terms of the moratorium, but he or she is not be in charge of the company's affairs or management. The monitor will, however, also have to approve sales of assets outside the normal course of business and approve any grant of new security over the company's assets. The directors will remain in charge of running the business on a day-to-day basis.

The moratorium will bind both secured and unsecured creditors, but it is open to a creditor to challenge the actions of the monitor and the directors, if he or she thinks that their actions have unfairly harmed their interest(s).

The moratorium lasts for 20 business days ("the initial period"). This period can be extended in a number of ways at any time after the first 15 business days of the initial period:

1. Without creditor consent (note that only one extension of a further 20 business days can be achieved without creditor consent)

2. With creditor consent (by a qualifying decision procedure)

3. By court order

4. If CVA proposals are still pending (and in this instance, the extension is automatic)

Options 1 to 3 mentioned can only be achieved if all the moratorium debts have been paid in full. This includes any pre-moratorium debts which were not subject to the so-called "payment holiday".

The effect of the moratorium is that there will be a payment holiday for any debts incurred pre-moratorium except for the following six categories of debt:

- The monitor's remuneration and expenses
- Goods and services supplied during the moratorium
- Rent for the period of the moratorium
- Wages and salary
- Redundancy payments
- Financial services contracts, including bank loans.

Importantly, applying for the moratorium does not mean that the company has entered into any form of insolvency proceedings. However, there is an obligation to notify Companies House and all creditors of the moratorium so that it is a matter of public record, even if it is not a 'formal' insolvency procedure. The inclusion of financial services contracts in the list of liabilities that will not attract a payment holiday means that companies will likely have to garner their lenders' support for a moratorium before seeking one.

New Restructuring Plan

The CIGA introduces new provisions into the existing Companies Act 2006 regime relating to schemes of arrangement. Schemes generally divide members and creditors into different voting classes and historically, each class of creditor would have to vote in favour of the scheme for it to be approved. The main advantage of this procedure, particularly over a company voluntary arrangement, is that this scheme can bind secured and unsecured creditors and allows companies to "cram down" (i.e. overrule) a dissenting class of creditors (with the court's permission). This is akin to the US Chapter 11 procedure concept of cross-class cramdown.

The company files its proposal at court and defines the classes of creditors. The creditors and members can then challenge the way the classes are formalised. If the court is satisfied with the classes, then the company can summon a meeting of creditors. Each class must approve the arrangement (with a majority of 75%).

After voting has taken place, the matter goes back to court. If there is a dissenting class, the court has the power to override the vote and "cram down" that class.

If the court approves the proposals, then they are binding on all creditors except if there was a moratorium in the last 12 weeks before the application to court was made. In these circumstances, it will not be binding on creditors whose debts arose during the moratorium and creditors who were not subject to the payment holiday without those creditors' consent (e.g. you cannot cram down employees in respect of their salary).

Supplier Termination Clauses

The CIGA introduced a permanent provision into the Insolvency Act 1986, which provides that no supplier may stop supplying their services / goods by virtue of a company's insolvency if the relevant supply is still being paid for. This effectively deems redundant any clause in a contract which provides for the automatic termination of a contract on a company's insolvency.

There are exceptions though, including supply contracts in favour of smaller companies, i.e. those who fulfil at least two of three conditions being: a turnover of less than £10.2m; a balance sheet of not more than £5.1m; and less than 50 employees. This small supplier exemption was originally drafted to last until 30 September 2020, although it has now been extended to 30 March 2021.

Additionally, the provisions do not apply to contracts for the supply of goods and services where either the company or the supplier is involved in financial services, including where the company or supplier is an insurer, bank, investment bank / firm, or payment institution.