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To Our Clients and Friends

# Memorandum

June 10, 2020

# *An Overview of the UK Corporate Insolvency and Governance Bill*

**Overview**

On 20 May 2020, the UK Government presented the Corporate Insolvency and Governance Bill (the "**Bill**") to the House of Commons. The Bill is being fast-tracked through Parliament, with the aim of completing all stages and becoming law during July 2020. On 3 June 2020, the Bill was passed by the House of Commons and the Bill is now to be considered by the House of Lords, and if approved, it will require Royal Assent before becoming law. If enacted, the Bill would demonstrate the most significant set of reforms to the UK's restructuring and insolvency regime since the introduction of the Enterprise Act in 2003. The proposals set out in the Bill contain a mixture of permanent reforms designed to update the UK's insolvency framework and temporary measures focused on addressing the impact of the COVID-19 pandemic on UK businesses. This memorandum seeks to provide an overview of the key proposals set out in the Bill.

**Permanent Reforms**

***Moratorium***

The Bill introduces a new, stand-alone moratorium procedure designed to provide breathing space to companies in financial distress. Companies will qualify for the moratorium if they are, or are likely to become, unable to pay their debts when they fall due. A company does not have to be solvent to be eligible for the moratorium, and it can be used on a stand-alone basis, meaning that the process does not need to be used in conjunction with another insolvency or restructuring process.

The moratorium will prevent creditors from taking enforcement action against a company, and grants the company a payment holiday for certain pre-moratorium debts without requiring leave of the court. A company will however remain liable to pay for debts falling due during the moratorium, and there must therefore be sufficient cash in the business during the moratorium to meet key liabilities, which include the remuneration and expenses of the monitor (see below for further information on the role of the monitor), goods and services supplied, rent, wages, redundancy payments and debts involving financial services (including bank facilities and capital market arrangements).

In addition to the prevention of creditors commencing insolvency proceedings (such as presenting a winding-up petition or appointing an administrator), the moratorium will also prevent: (i) landlords exercising any forfeiture rights; (ii) the enforcement of security (other than enforcing financial collateral or collateral security charges or other security granted during the moratorium with the monitor's consent); (iii) the commencement or continuation of legal proceedings against the company (subject to certain exceptions); (iv) the crystallisation of a floating charge or disposal of a floating charge asset; and (v) the repossession of goods under a hire purchase agreement.

Companies can propose and pursue a rescue plan. However, certain types of companies are ineligible from applying for the moratorium, including but not limited to insurance companies, investment banks, investment firms, banks and investment exchanges. Overseas companies may apply, provided that such companies have sufficient connection with the UK (for example, if the debt of the company is governed by English law). Additionally, group companies that have issued notes, bonds or other debt capital market instruments will not be able to use the moratorium. Consequently, the moratorium is more likely to be of use to smaller companies that are aiming to enter into standstill arrangements with their trade creditors, rather than large-scale restructurings.

In order for the moratorium to commence, a company's directors must file the relevant documents with the court. A licenced insolvency practitioner will serve as a monitor who will be responsible for overseeing the moratorium and protecting creditors' interests. At the outset of the process, the monitor must be able to state that the moratorium is likely to result in the rescue of the company of a going concern in order for the moratorium to take effect. If during the moratorium it becomes apparent to the monitor that rescue of the company as a going concern is not possible, the monitor will be required to terminate the moratorium. See below for further information on termination of the moratorium.

The moratorium will initially be available for a period of 20 business days, and may be extended for an additional 20 business days (subject to the approval of the monitor), with the possibility of a further extension of up to one year or more with the consent of the company's creditors or the court. During the moratorium, the directors will continue to run the business (similar to a "debtor-in-possession" procedure), but the monitor's consent will be required for certain transactions (for example, the granting of new security, the disposal of assets of a company outside the ordinary course of business and the payment of certain pre-moratorium debts).

The moratorium will normally terminate upon the conclusion of the moratorium period, unless extended (as detailed above). However, termination of the moratorium will happen earlier if any of the following occur: (i) the company enters into an insolvency procedure (for example, a voluntary arrangement, administration or liquidation); (ii) a restructuring plan, scheme of arrangement or creditors voluntary liquidation becomes effective; or (iii) the moratorium is terminated by the monitor on the basis that: (a) the monitor believes that the moratorium is no longer likely to result in the rescue of the company as a going concern (as noted above); (b) the objective of rescuing the company as a going concern has been achieved; (c) the monitor is unable to carry out their functions; or (d) the company is unable to pay, as they fall due, either: (i) debts falling due during the moratorium; or (ii) pre-moratorium debts in respect of which the company does not have the benefit of the payment holiday.

***Restructuring Plan***

The Bill also introduces a new flexible restructuring plan which is similar to the existing scheme of arrangement. Under the restructuring plan, 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 its business as a going concern has the ability to enter into a compromise or arrangement with its creditors/members in order to restructure its debts. The purpose of the compromise or arrangement must be to eliminate, reduce, prevent, or mitigate the effect of the financial difficulties of the company.

This new procedure (like a scheme of arrangement) enables a company to divide its creditors/members into classes based on the similarity of their rights, and each class of creditor/member is given the opportunity to vote on the plan. Unlike a scheme of arrangement however, the new restructuring plan enables a court to sanction a plan that binds dissenting classes of creditors/members (as opposed to dissenting creditors/members within a class), provided that the following conditions are met: (i) none of the members of the dissenting class would be any worse off than they would be in the event of the next best alternative (i.e. administration or liquidation); and (ii) the arrangement has been agreed to by one creditor class who would receive payment or has a genuine economic interest in the company in the event of the next best alternative outcome. This mechanism of binding dissenting classes of creditors is known as a "cross-class cram-down".

A plan will be passed if it is approved by 75% in value of the creditors/members or class of creditors/members present and voting in person or by proxy. Unlike a scheme of arrangement, there is no requirement for a majority (i.e. over 50%) in number of each class to vote in favour (the so-called "numerosity" requirement).

It was anticipated that the cross-class cram-down mechanism would include an "absolute priority rule" (as is applicable in US Chapter 11 proceedings), meaning that claims of a dissenting class of senior creditors must be satisfied in full prior to the claims of a more junior creditor class. However, this feature was not included in the Bill, and therefore, in theory there could be a junior "cram-up", whereby junior creditors can bind dissenting senior creditors, provided that the senior creditors receive at least what they would receive in the relevant alternative (i.e. administration or liquidation) and the court considers the plan to be fair. This feature demonstrates the flexibility of the plan. However, it places a burden on the court to consider the fairness of a plan when deciding whether to sanction it on a case-by-case basis, and it will be interesting to see how the courts will interpret this new procedure, particularly in relation to the fairness requirement.

***Prohibition of Insolvency Termination Clauses***

Typically, contracts for the supply of goods or services contain clauses which allow a supplier to terminate or threaten to terminate or vary the supply when the counterparty to the contract enters into an insolvency or restructuring procedure, otherwise known as "ipso facto" clauses. The Bill prohibits suppliers from relying on such clauses in contracts for goods or services, which means that subject to certain exceptions (as detailed below), suppliers will be required to continue to supply goods or services to a company in a restructuring or insolvency process, in the hope that this will protect such company's supply chain and enable the company to continue to trade.

An "insolvency procedure" for these purposes includes, but is not limited to, administration, liquidation (or provisional liquidation), the appointment of an administrative receiver, company voluntary arrangements, the new moratorium procedure (as detailed above) or where a court order is made in respect of a restructuring plan (as detailed above). Interestingly, this prohibition of ipso facto clauses does not apply to schemes of arrangement, which creates a significant advantage for the new restructuring plan over old style schemes of arrangement.

The ban on ipso facto clauses does not impact a supplier's right to terminate on non-insolvency grounds (for example non-payment). However, if the supplier had a right to terminate prior to the company entering into an insolvency procedure, but did not exercise such right at the time, the supplier will temporarily lose the right to terminate once the insolvency procedure has commenced, and would instead require a court order or consent from an office holder to terminate the contract.

However, a supplier will not be required to continue to supply if one or more of the following exceptions applies:

1. **Supplier "hardship"**: Where the supplier can demonstrate to the court that the continuation of supply would cause the supplier "hardship". The Bill does not define "hardship", and therefore determining which factors will demonstrate hardship will be a matter of interpretation for the courts.

2. **Small suppliers**: The Bill contains a temporary exemption for small suppliers during the COVID-19 pandemic, being those suppliers with: (i) a turnover of not more than £10.2 million; (ii) a balance sheet of no more than £5.1 million; and (iii) no more than 50 employees.

3. **Financial service contracts/entities**: There is also a broad exclusion under the new regime for financial services contracts (such as a rolling credit facilities) and financial services entities (such as investment banks and insurance companies), and therefore in practice, it is likely that this prohibition on ipso facto clauses will only apply to trade suppliers.

**Temporary Measures**

***Suspension of Wrongful Trading***

Wrongful trading provisions contained in the Insolvency Act 1986 (the "**IA 1986**") are designed to impose the potential for personal liability on directors where a company has gone into insolvent liquidation or insolvent administration and the director in question knew (or ought to have known) that there was no reasonable prospect of avoiding going into insolvent liquidation or insolvent administration and the director failed to take every step to minimise potential losses to creditors. If found guilty of wrongful trading, a court would make a contribution order against such director, based on the additional depletion of a company's assets caused by the director's conduct.

In light of the COVID-19 pandemic, the Government announced plans on 28 March 2020 to amend the wrongful trading provisions to remove the potential liability for directors in situations where a company's financial position has worsened during the COVID-19 pandemic. This measure was taken by Government to discourage directors from placing a company into administration prematurely as a result of concern for their exposure to personal liability for wrongful trading.

The relevant period for these purposes is between 1 March 2020 and one month after the Bill is enacted (subject to any further extension). During this period, the court is required to assume that the directors are not responsible for the worsening of a company's financial position or the financial position of the company's creditors.

The suspension of wrongful trading provisions does not apply to directors of certain "excluded entities" (including, but not limited to, insurance companies, banks, investment firms, securitisation companies and investment exchanges). Additionally, directors of all companies are still required to comply with their other duties set out in the Companies Act 2006, and the Bill does not impact directors' liabilities under the IA 1986 in respect of fraudulent trading, misfeasance and reviewable transactions prior to the onset of insolvency of a company (such as making a preference, embarking on a transaction at an undervalue, executing an extortionate credit bargain, the avoidance of a floating charge or entering into a transaction to defraud creditors). Furthermore, the directors' disqualification regime under the Company Directors Disqualification Act 1986 is unaffected by the amendments proposed in the Bill. Therefore, in practice, the changes to the wrongful trading liability may provide limited comfort to directors dealing with a financially distressed company in light of the COVID-19 pandemic.

***Statutory Demands and Winding-Up Petitions***

A statutory demand is a formal written demand served on a company by a creditor for an outstanding debt (provided the sum demanded exceeds £750) requiring it to be paid within 21 days. Under the statutory demand process, if a debtor company does not pay the amount(s) owed to the creditor within that 21-day period, the creditor can present a petition to the court for a winding-up order, using the statutory demand as evidence of the debtor company's inability to pay its debts as they fall due. If a winding up order is granted, it has a significant impact on the company's ability to continue to trade.

Out of concern that this mechanism might be widely used by creditors during the COVID-19 pandemic, which would likely result in a surge of insolvency processes being initiated, the Government announced on 23 April 2020 (as updated on 25 April 2020) that it would temporarily ban the use of statutory demands and winding-up petitions where a debtor company cannot pay its debts as a result of the COVID-19 pandemic. This measure was taken by Government in the hope that companies in financial distress can use this breathing space to enter into compromises/arrangements with their creditors, without the need for formal insolvency processes being commenced.

Under the provisions of the Bill, all statutory demands will be deemed void if served on a company during the "relevant period", being between 1 March 2020 and one month after the Bill comes into force. Furthermore, no petition for the winding-up of the company can be presented by a creditor during the relevant period in respect of such unpaid statutory demand unless the creditor has reasonable grounds for believing that: (i) COVID-19 has not had a financial effect on the company; or (ii) the grounds for presenting the winding-up petition (i.e. non-payment of the statutory demand) would have arisen even if COVID-19 had not had a financial effect on the company.

Additionally, the Bill prevents a creditor from presenting a winding-up petition against an insolvent company (evidenced by satisfying either the cash flow or balance sheet test) during the relevant period, unless the creditor has reasonable grounds for believing that: (i) COVID-19 has not had a financial effect on the company; or (ii) the company's insolvency would have arisen even if COVID-19 had not had a financial effect on the company.

For these purposes, whether COVID-19 had a "financial effect" on a company will be a question of fact, but will generally be considered to apply if the company's financial position has worsened as a consequence of COVID-19.

Despite the breathing space these measures provide, the Bill does not deal with other potential enforcement methods available to creditors during the relevant period (for example, being able to call upon guarantees or filing a company for administration (where applicable)). Accordingly, in practice, the relief these provisions will provide may be limited.

***Corporate Governance***

The Bill has introduced certain changes to corporate governance processes in light of the COVID-19 pandemic:

1. **General meetings/annual general meetings ("AGMs"):**

   - The Bill temporarily allows those companies that have a duty to hold a general meeting or AGM between 26 March 2020 and 30 September 2020 to hold such meeting towards the end of that period (subject to any further extension).

   - Additionally, in light of social distancing measures introduced by the Government, such meetings can be held by way of electronic means (i.e. on a virtual basis), even if the constitutional documents of the company do not normally allow this.

2. **Companies House filings:**

   - Under the provisions of the Bill, the deadline for those public companies required to file their annual accounts and reports between 25 March 2020 and 30 September 2020 has been automatically extended to the earlier of 30 September 2020 and the date falling 12 months after the end of the relevant accounting reference period.

   - Separately, Companies House has allowed UK companies to apply for a three-month extension to their filing deadlines if they are unable to meet such deadline due to COVID-19.

   - The Bill also grants the Secretary of State the power to extend deadlines for the filing of accounts and other key filing deadlines at Companies House for all companies.

Overall, the changes proposed under the Bill are welcomed and are a reflection of the Government's awareness of both the impact of the COVID-19 pandemic on UK businesses and the benefits that wider reform of the UK's restructuring and insolvency regime will bring. The Bill is proceeding through Parliament on an accelerated timetable, and we continue to track developments and will update this memorandum to the extent required.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:


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