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Insights

CORPORATE INSOLVENCY AND GOVERNANCE BILL - REFORMS TO THE UK CORPORATE RESTRUCTURING & INSOLVENCY FRAMEWORK

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The Corporate Insolvency and Governance Bill introduces the most significant reforms to the UK's corporate restructuring and insolvency framework in over 15 years. The UK government's aim is to provide businesses with the flexibility and breathing space they need to continue trading during the current global pandemic.

The reforms to the restructuring and insolvency framework have been under consideration for a number of years, but the reforms have been expedited to form part of the UK government's response to the economic impact of the coronavirus pandemic.

In addition to these reforms, the Bill also contains temporary measures aimed at providing businesses with short term relief.

Reforms to the Corporate Restructuring and Insolvency Framework

Moratorium

The Bill introduces a moratorium for companies during which they will benefit from a 'payment holiday' in respect of certain pre-moratorium debts and protection from legal action and security enforcement without the court's permission.

Although the moratorium contains a 'payment holiday' in respect of certain pre-moratorium debts, the company will be expected pay those debts incurred whilst the moratorium is in force including the cost of goods and services, employees and rent incurred during the moratorium period, together with all amounts falling due under loan agreements and other financial services contracts. The company therefore needs to evaluate whether it has sufficient available liquidity to cover the cost of trading during the moratorium.

The breathing space afforded by the moratorium should allow the company to look to effect a rescue of the business via:

- a company voluntary arrangement ('CVA'),

- the new restructuring plan, or
- a refinancing or solvent sale.

The explanatory notes to the Bill make it clear that the moratorium is not intended to be used for a rescue by an insolvent sale and it should not be used as a gateway to formal insolvency.

The moratorium lasts for an initial 20 business day period, but can be extended:

- by the directors for an additional 20 business days,
- for up to a year with the consent of creditors, or
- for an unlimited period by court order.

Whilst the moratorium is a debtor-in-possession procedure, meaning that the company remains under the control of the existing management, the moratorium process is overseen by a 'monitor' who must be a licenced insolvency practitioner. The monitor has oversight over certain actions, such as the disposal of assets outside of the 'ordinary way of a company's business' and the grant of security, and will only sanction them if those actions support the rescue of the business as a going concern.

If the monitor thinks that the moratorium is no longer likely to result in the rescue of the company as a going concern or that the company is unable to pay its moratorium debts together with the pre-moratorium debts for which the company does not have a payment holiday during the moratorium, the monitor must terminate the moratorium.

Creditors and shareholders can challenge actions taken by a monitor or the directors during the moratorium to the extent that such actions unfairly harm the interests of the relevant creditor or shareholder.

Restructuring plan

The new restructuring plan allows a company encountering, or which is likely to encounter, financial difficulties to propose a compromise or arrangement to its creditors and/or members to eliminate, reduce or prevent, or mitigate the effect of any of those financial difficulties.

The intention is that the new restructuring plan will be used by companies to avoid having to enter into formal insolvency proceedings. However, it specifically contemplates that it may be used by companies already in administration (and a little more unusually, in liquidation) as an exit route. This gives companies which have been placed into 'light touch' administration as a temporary holding measure in the current crisis another option for restoring the company to solvency.

The new restructuring plan shares many similarities with the existing scheme of arrangement such as the court having the role of convening meetings and ultimately sanctioning the plan. It therefore seems unlikely that we will see any speeding up of the timetable or a reduction in cost.

The new restructuring plan also shares with schemes of arrangement the requirement for class approval of 75% by value of those present and voting. However, the ‘numerosity’ requirement in schemes of arrangement - for a majority in number of creditors present and voting - is not included. This will remove the mischief of claim-splitting and, subject to the court’s discretion at sanction stage, enable the company to focus on the creditors with the largest financial exposure in each class.

The big differentiator is the cross-class cram down, an import from US Chapter 11 plans of arrangement, which has been a central feature of the UK government’s proposals for some time. This removes the requirement that each class of creditor must have approved the restructuring plan in order for the court to sanction it. It will be possible for a restructuring plan to be sanctioned even though there is a dissenting class. Two conditions must be met, however, to safeguard the interests of the dissenting creditors.

- First condition - The court must be satisfied that, if the restructuring plan is sanctioned, none of the dissenting class would be worse off than they would be in the ‘relevant alternative’. The ‘relevant alternative’ is what the court thinks would be most likely to occur in relation to the company if the restructuring plan was not sanctioned.

- Second condition - The scheme has been approved by the requisite majority of a class who would receive a payment, or have a genuine economic interest in the company, in the event of the ‘relevant alternative’.

The inclusion of a cross-class cram down concept is a significant evolution and demonstrates a shift to a more debtor-friendly approach.

Another powerful tool is the inclusion of a provision that a class of creditors or members who do not have a genuine economic interest in the company may, with the court’s permission, be prevented from participating in the meetings even where their rights are affected.

Dealing with out-of-the-money creditors who have contractual hold-out against the company (for example, where their consent is needed for releases under intercreditor agreements) is a common issue in restructurings and this appears to provide a potential solution, albeit through a court process. This ought to make the new restructuring plan much more flexible from the perspective of the company.

Safeguarding the interests of creditors will ultimately fall to the court who will rely on evidence presented to it of the ‘relevant alternative’, when a company is seeking to cram down a dissenting class, and of where the value break is, in determining whether a creditor has a genuine economic interest and should or should not be permitted to participate in the meeting.

Protection of supplies

When a company enters an insolvency procedure, suppliers often refuse to continue to supply and/or seek to exercise commercial leverage to improve their position. This can result in an interruption in supply which may impact on the business and, in particular, on any proposed rescue of the business.

The current insolvency legislation already contains measures to ensure the continuance of certain key supplies, such as utilities and IT services.

The Bill seeks to widen those protections to cover all suppliers, subject to certain exemptions, meaning that suppliers will not be able to terminate a contract as a result of a company going into an insolvency procedure (including the new moratorium and restructuring plan) or make continued supply conditional upon the payment of any outstanding debts.

In order to safeguard suppliers, termination of a contract may occur where:

- an insolvency officeholder (if appointed) consents,
- a company (where no insolvency officeholder is appointed) consents, or
- the court is satisfied that non-termination of the contract would cause the supplier hardship.

Small company suppliers are also temporarily excluded to address hardship concerns.

Temporary measures

Temporary restriction on the use of statutory demands and winding up petitions

The Bill includes temporary provisions to restrict the use of statutory demands and winding-up petitions issued against companies during the current global pandemic where the debt is unpaid for reasons relating to Covid-19. The provisions seek to curtail aggressive creditor action against otherwise viable companies.

A petition cannot be presented by a creditor during the period beginning on 27 April 2020 (note the retrospective effect) until the later of either 30 June 2020 or one month after the coming into force of the legislation, unless the creditor has reasonable grounds for believing that:

- coronavirus has not had a financial effect on the company; or
- the company would have been unable to pay its debts even if coronavirus had not had a financial effect on the company.

Coronavirus has 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.

The Bill also introduces temporary provisions to void statutory demands made from 1 March 2020. No petition for the winding-up of a company can be presented on or after 27 April 2020 on the ground that the company has failed to satisfy a statutory demand if the relevant statutory demand was served during the period beginning on 1 March 2020 and ending on the later of either 30 June 2020 or one month after the coming into force of the legislation.

Temporary suspension of wrongful trading

The Bill provides a temporary suspension of the wrongful trading regime, with retrospective effect from 1 March 2020, to remove the threat of personal liability for directors. The suspension is to apply until 30 June 2020, but the government has made it clear that, in the event that the impact of the pandemic on businesses continues beyond the end of June, the suspension to the wrongful trading regime may be extended for up to a further six months. Certain financial services firms and public-private partnership project companies are excluded from the suspension.

For companies genuinely struggling as a result of the effects of Covid-19, this will provide directors with some valuable reassurance. Directors should be aware, however, that all other checks and balances to ensure directors fulfil their duties properly will remain in force and, in the zone of insolvency, this means that directors must continue to have regard to the interests of creditors

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MEET THE TEAM

Marc Trottier

London

marc.trottier@bclplaw.com
+44 (0) 20 3400 4072

Sophie Taylor

London

sophie.taylor@bclplaw.com
+44 (0) 20 3400 4036
