Dechert LLP

COVID-19: Corporate Insolvency and Governance Bill

4 June 2020

The Government published its Corporate Insolvency and Governance Bill on 20 May 2020, which will implement the most significant reform to the UK's insolvency framework in decades. In addition to permanent landmark changes, including introducing a business rescue moratorium and new restructuring plan, the Bill contains a number of temporary measures to help businesses respond to the COVID-19 crisis.

The Government intends to fast-track these reforms through Parliament to reinvigorate the UK's world-leading insolvency regime and help alleviate the pressure on companies arising from COVID-19. Whilst the timing for implementation is currently unclear, we anticipate that this new framework may be enacted as soon as June 2020.

A. Significant Insolvency Law Reforms

1. Moratorium

The Bill introduces a new standalone moratorium that gives companies in distress formal breathing space to negotiate with their creditors.

Duration

The directors of an eligible company can, broadly speaking, initiate the moratorium by filing the relevant papers at court (although, if there is an outstanding winding-up petition or the company is an overseas company, a court order is needed for the moratorium).

The initial duration of the moratorium on an application by the directors is 20 business days and, subject to the company satisfying certain conditions, this can only be extended by the directors without creditor consent by up to a further 20 business days. This is a tight timeline to conduct restructuring negotiations of any substance.

With creditor support, the moratorium can be extended by the directors by up to a year. The court can also grant a further extension (or multiple further extensions) upon an application by the directors (but any such extensions are also subject to the company satisfying the requisite conditions).

Restrictions on actions

The moratorium prevents creditors from taking enforcement action, restricts insolvency filings and provides a payment holiday in respect of certain types of pre-moratorium debts as well as post-moratorium debts.

As presently drafted, the payment holiday does not extend to pre-moratorium debts arising under a "contract or other instrument involving financial services". This is widely defined and includes, among other things, contracts consisting of lending (including the financing of commercial transactions) or providing guarantees or commitments as well as certain derivatives and capital market arrangements (which is currently drafted to include such arrangements involving a guarantee, financial collateral or grant of security by a party for another's obligations). The exclusion of such contracts from the payment holiday during the moratorium means that the directors will have to confirm that all pre-moratorium debts that have fallen due under such contracts must have been paid before any extension is made to the moratorium (but, during the moratorium, creditors in respect of such debts would still need court permission to take any enforcement action). This appears to significantly limit the breathing space offered by the moratorium.

Whilst the directors remain in control of operations during the moratorium, a licensed insolvency practitioner called a "monitor" is appointed to supervise the moratorium, to protect creditor interests and ensure continued compliance with the moratorium entry requirements and conditions.

Eligibility

The moratorium is available to any company that is, or is likely to become, unable to pay its debts. In addition, the monitor must provide a statement that, in its view, it is likely that the moratorium will result in the rescue of the company as a going concern, which (particularly in the current climate) may be a high bar to overcome. The moratorium can be terminated by the monitor on certain grounds, including if he thinks the moratorium is no longer likely to result in the rescue of the company as a going concern.

Certain companies are not eligible to implement the moratorium, including companies which are subject to an insolvency procedure, companies that have been subject to an insolvency procedure in the past 12 months, and companies which are party to capital market arrangements. The wide definition of capital market arrangements (which includes arrangements relating to debts of more than £10m that involve a party providing security to a trustee/agent or guaranteeing the obligations of another party under a capital market investment) mean that, as currently drafted, many companies that have entered into bond financings may be ineligible to benefit from the moratorium.

Challenges

A creditor, director, member of the company or any other person affected by the moratorium is entitled to challenge the moratorium either on the grounds that an act, omission or decision of the monitor during a moratorium has unfairly harmed the applicant. The Bill also introduces new offences, particularly relating to false representations or fraud committed for the purpose of obtaining the moratorium.

COVID-19

Certain of the moratorium conditions are eased until 30 June 2020 or one month following the entry into force of the Bill as a result of the COVID-19 crisis (and this period can be extended by up to six months). In particular, the usual condition that the moratorium is likely to result in the rescue of the company as a going concern is relaxed (with the ability to disregard any worsening of the company's financial condition for reasons relating to COVID-19).

2. Restructuring Plan

A new "Restructuring Plan" is introduced by the Bill. It is modelled on schemes of arrangements but introduces a new "cross-class cram-down mechanism" that, in addition to allowing the plan to be imposed on dissenting creditors or shareholders in a class (holding less than 25 percent in value of claims in that class), enables the plan to be confirmed by the court and imposed on one or more classes of creditors or shareholders that do not vote in favour (subject to certain protections). Where a plan is approved by the court using the cross-class cram-down mechanism, the dissenting creditors and classes of creditors will be bound by the terms of the plan.

Eligibility

To qualify for a plan, a company must have encountered, or be likely to encounter, financial difficulties that are affecting (or will or may affect) its ability to carry on its business as a going concern. The company must also have a sufficient connection to the UK (as with schemes, we anticipate that an English law choice of law election in the finance documents would provide such a connection). Accordingly, the plan will also be available to overseas companies that fulfil these criteria. Whether the plan is recognisable in overseas jurisdictions will be a major issue in determining the applicability of the plan to cross-border restructurings (there will be no automatic recognition under the European Insolvency Regulation). As with schemes, the court is likely to require evidence as to the recognition of the plan in the relevant overseas jurisdictions.

The plan is designed to be flexible. The compromise or arrangement with the company's creditors or members need only have the purpose of eliminating, reducing or preventing, or mitigating the effect of, any of the financial difficulties that are affecting, or will or may affect, the company's ability to carry on business as a going concern.

Voting

The plan only requires the agreement of 75% in value of each class of creditors (unlike an English law scheme of arrangement, the plan does not require a majority in number of each class to agree to the restructuring proposal).

Every creditor or shareholder whose rights are affected by the plan must be allowed to vote. The early cases will therefore be key in determining the parameters of which creditors or shareholders are affected. There is also a mechanism whereby an application can be made to court to exclude one or more classes of creditors/shareholders from voting, which will be granted if the court is satisfied that such classes have no genuine economic interest in the company.

The plan may be sanctioned even where one or more classes do not vote in favour of the plan, using the cross-class cram-down mechanism (which is not possible in a scheme of arrangement), provided that:

- the court is satisfied that none of the members of the dissenting class would be worse-off under the plan than they would be in the event of the "relevant alternative" (which will differ on a case-by-case basis, depending on what the court considers would most likely occur if the plan were not sanctioned); and
- at least one class who would receive payment or has a genuine economic interest in the company in the event the relevant alternative has voted in favour.

The first plans presented to the English courts will be closely watched for guidance on determining the scope of these provisions.

Procedure

The procedure for a plan will, generally speaking, mirror the process for UK schemes of arrangement, including that the English courts will have the role of ensuring the overall fairness of the plan with absolute discretion as to whether to approve a plan. The Bill provides that the new standalone moratorium terminates upon a plan taking effect (i.e. upon it being sanctioned by the court).

3. Ipso facto clauses

The Bill also introduces measures that prevent suppliers from relying on contractual clauses that allow termination as a result of a counterparty entering an insolvency or restructuring process (including the new moratorium). As anticipated, this significantly extends the existing UK insolvency regime that only requires the continuation of certain "essential supplies".

A supplier may still terminate a contract with the consent of an officer-holder or permission from the court, where the court is satisfied that continuation of the contract will cause undue financial hardship. There is a temporary exclusion for small suppliers.

This approach is inspired by U.S. Chapter 11 proceedings and is in contrast to the usual English law approach of upholding parties' freedom of contract. However, in contrast to Chapter 11, the UK reforms only apply to supplier contracts and not general commercial contracts.

B. Temporary measures in response to COVID-19

1. Suspension of winding-up petitions and statutory demands

Statutory demands served on companies between 1 March 2020 and 30 June 2020* cannot be used as the basis to present a winding-up petition after 27 April 2020, effectively voiding those statutory demands.

From 1 March 2020 to 30 June 2020*, a creditor may not present a winding-up petition unless the creditor has reasonable grounds to believe that COVID-19 has not had a financial effect on the company, or that the company would be unable to pay its debts even if COVID-19 had not had a financial effect on the company. Furthermore, even if a winding-up petition is presented, the Bill restricts the court's jurisdiction to make a winding-up order (essentially, the court can only make a winding-up order if the ground on which the company is deemed unable to pay its debts "would have arisen even if coronavirus had not had a financial effect on the company" and cases will determine how the courts interpret the qualifier of financial effect).

2. Suspension of wrongful trading rules

Following the Government's announcement on 28 March 2020, the draft Bill formally suspends the wrongful trading rules to remove potential personal liability for directors during the period 1 March 2020 to 30 June 2020*. As noted in our previous OnPoint, rules relating to directors' duties, the director disqualification regime and fraudulent trading remain in place and unamended.

The change does not apply to certain excluded companies, including parties to capital market arrangements.

3. Company filings and AGMs

The Bill enables the Secretary of State to extend deadlines for three types of company filings:

1. accounts;
2. confirmation statements (including event-driven filings that are required to be submitted in advance of the confirmation statement); and
3. registrations of charges.

Any extended period for filing made by the Secretary of State must not exceed (i) 42 days, in a case where the existing period is 21 days or fewer, or (ii) 12 months, in a case where the existing period is 3, 6 or 9 months.

In addition, the Bill temporarily allows companies that are under a legal duty to hold an AGM or GM to hold a meeting by other means, even if this is not permitted by the company's articles of association. This relaxation applies to any meeting held from 26 March 2020 to 30 September 2020.

**or one month after the Bill coming into force, whichever is later.*

Key Contacts

Solomon Noh
Partner, Restructuring
London
+44 20 7184 7337
solomon.noh@dechert.com

Giles Belsey
Partner, Restructuring
London
+44 20 7184 7353
giles.belsey@dechert.com

Michelle Gordon
Senior Associate, Restructuring
London
+44 20 7184 7567
michelle.gordon@dechert.com

Alastair Goldrein
Partner, Restructuring
London
+44 20 7184 7456
alastair.goldrein@dechert.com

John McGrath
Partner, Finance
London
+44 20 7184 7874
john.mcgrath@dechert.com

Chris Horrocks
Senior Associate, Restructuring
London
+44 20 7184 7579
chris.horrocks@dechert.com