Extension of Insolvency Measures Introduced by the UK Corporate Insolvency and Governance Act 2020

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The Corporate Insolvency and Governance Act 2020 ("**CIGA**"), which came into force on 26 June 2020, introduced a series of new "debtor friendly" procedures and measures to give companies the breathing space and tools required to maximize their chance of survival. The main insolvency related reforms in CIGA (which incorporates both permanent and temporary changes to the UK's laws) include:

1. New moratorium to give companies breathing space from their creditors
2. Prohibition on termination of contracts for the supply of goods and services by reason of insolvency
3. Prohibition on issuing statutory demands and winding up petitions for COVID-19 related debts
4. New restructuring plan for companies in financial distress
5. Temporary removal of the threat of personal liability for wrongful trading from directors (essentially this provided retrospective "suspension" of potential personal liability for directors for wrongful trading for a period from 1 March 2020 to 30 September 2020, and allows directors to continue to trade through the COVID-19 crisis without worrying about their potential personal liability for wrongful trading)

CIGA provided that the temporary provisions introduced by it would automatically expire on 30 September 2020 unless regulations are made to prolong the period within which some or all of the temporary provisions have effect. Due to the on-going COVID-19 pandemic, the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020 ("**CIGA (Extension)**"), which came into force on 29 September 2020, subsequently extended certain of the temporary measures introduced by CIGA until 30 December 2020 or 30 March 2021.

Key takeaways and recommendations for suppliers

For suppliers, the prohibition on terminating contracts on grounds of insolvency will be of concern. Suppliers will need to consider very carefully their termination rights on an insolvency. Ideas like accelerating invoicing and payment schedules on an insolvency do not appear to be mitigation techniques, given the additional restrictions imposed by CIGA on doing "any other thing" to the contract on their counterparty's insolvency. This means that suppliers will need to get comfortable with the concept that should they not terminate due to non-payment prior to an insolvency, they will have to wait to terminate, and then they may be in a challenging position with a customer that is insolvent but still performing.

In terms of practical steps to mitigate/reduce their exposure, suppliers should consider carrying out a risk analysis on current supply contracts to determine whether there are any payment defaults outstanding where they should consider terminating, prior to any insolvency process kicking in on their customers. Furthermore, if a supplier's customer enters a moratorium (as explained in the next

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section), the supplier can contact the relevant customer to seek agreement to terminate the contract. In the event the customer does not agree to termination, and instead requests further supplies (e.g. the customer is using the moratorium period to seek additional finance and the contracted supplies are critical to continued trading), the supplier can apply to court for permission to terminate the contract, if it considers that continuing to supply the customer will cause the supplier hardship. It is worth noting that if the supplier decides to provide the requested supplies (i.e. it decides not to apply to court to terminate the contract), and the supplies are not paid for when they fall due, the supplier is at that point allowed to terminate the contract. This is because payment of ongoing supplies is also a condition of the moratorium, and the monitor must bring the moratorium to an end if for instance, it thinks that the customer is unable to pay any moratorium debts (or any pre-moratorium debts for which the customer does not have a payment holiday during the moratorium) that have fallen due.

Details of the permanent and temporary measures

In view of the CIGA (Extension) and of CIGA generally, we set out in this article the relevant permanent measures, the temporary measures being extended and the effects of both the permanent and temporary measures.

1) New Moratorium

(a) Moratorium: Permanent Measures

CIGA introduced a new standalone moratorium intended to provide companies with breathing space to explore options for survival by preventing creditor enforcement action being taken against a company while it considers and implements a rescue.

Details of this new standalone moratorium are as follows:

Process

Directors of an eligible company can obtain a moratorium by filing relevant documents at court in the UK, unless the company is an overseas company or has a pending winding up petition – in these cases, there will need to be a court hearing.

Duration

The moratorium comes into effect on the date the papers are filed with court (or if an overseas company or there is a pending winding up petition, the date of the court order). The initial moratorium will last for 20 business days and the directors can extend the moratorium for a further 20 business days, although for this the directors will need to confirm that all moratorium debts due or pre-moratorium debts for which the company does not have a payment holiday have been or will be met (amongst other things).

Further extensions require the consent of pre-moratorium creditors, up to a maximum period for the moratorium of one year. The court may also extend the moratorium; and currently there does not appear to be a maximum limit on the duration of the moratorium if the extension is granted by court order.

Effect

The moratorium has the following main effects:

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- a restriction on the enforcement or payment of pre-moratorium debts, being pre-moratorium debts that have fallen due before or that fall due during the moratorium and for which there is a payment holiday. Note however that the payment holiday does not apply to some specified pre-moratorium debts such as the monitor's remuneration or expenses (the monitor is an insolvency practitioner that oversees the company's affairs during the moratorium), salary payable under an employment contract, goods or services supplied during the moratorium, rent payable in respect of a period during the moratorium and redundancy payments;
- no insolvency proceedings may be commenced against the company during the moratorium period, except that directors may initiate insolvency proceedings if they notify the monitor;
- no creditor may enforce security or repossess goods in the company's possession, except with the leave of the court;
- no proceedings or legal process may be commenced or continued, except with the permission of the court; and
- floating charges cannot crystallize, and restrictions cannot be imposed on the disposal of assets.

Eligibility

Companies in general are eligible to use the moratorium if:

- they are incorporated under the Companies Act 2006 or they are unregistered but may be wound up under the Insolvency Act 1986;
- the directors state that the company is, or is likely to become, unable to pay its debts; and
- the monitor is of the view that it is likely a moratorium would result in the rescue of the company as a going concern
- overseas companies would need the consent of the court in order to use the moratorium.

However, a company will be ineligible if:

- it is already subject to a formal insolvency proceeding;
- during the period of 12 months prior to the filing date, it has been subject to a moratorium, unless the court orders otherwise; or
- during the period of 12 months prior to the filing date, it has been subject to a company voluntary arrangement or administration (although for a temporary period ending on 30 March 2021 (previously 30 September 2020) this restriction is lifted to account for the impact of COVID-19).

(b) Moratorium: Temporary Measures

In recognition of the extraordinary and temporary difficulties caused by COVID-19, the Act also introduced a number of temporary modifications to moratoriums, which have been extended by the CIGA (Extension) to 30 March 2021.

These include:

- the relaxation of the normal eligibility criteria to enter into a moratorium (i.e. a company will be eligible (i) even if it has been the subject of a moratorium or an insolvency

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procedure in the preceding 12 months, and (ii) if the monitor is of the view it is likely that the moratorium would result in the rescue of the company as a going concern (disregarding any worsening of the financial position of the company for reasons relating to COVID-19)); and
- the provision of temporary procedural rules to enable the operation of the moratorium (i.e. companies can use the out of court route to obtain a moratorium despite having an outstanding winding-up petition).

2) Prohibition of Termination of Contracts

(a) Prohibition on termination – Permanent Measures

In order to give companies more breathing space to restructure their operations, including to enter into fresh agreements with key suppliers to the business, CIGA prohibits suppliers, for instance, from terminating a contract due to the company going into an insolvency process, and applies to all contracts for the supply of goods and services (however some contracts such as loan agreements and entities such as insurers and deposit taking banks are excluded from the operation of the section, as set out in Schedule 4ZZA of CIGA).

This provisions of CIGA do not permit a supplier to terminate or "do any other thing" (for example, amending payment terms) on the commencement of a relevant insolvency procedure where that action is triggered by the insolvency. Conversely, that supplier will still have the right to terminate or "do any other thing" in relation to any non-insolvency related events contained in the contract that occurs after the commencement of the insolvency procedure. This may include non-payment and also indirect consequences of the insolvency process (e.g. downgraded credit rating), as long as the contractual right to terminate did not arise pre-insolvency and was not exercised. As such, if for example, a recipient company did not pay its supplier and the supplier did not act to terminate the contract, and the recipient subsequently went into insolvency procedures, the supplier would not be able to terminate at that time, neither under any insolvency termination right, nor due to the payment default existing prior to the insolvency. However, if post insolvency proceedings commence, the recipient company then subsequently fails to pay the supplier, the supplier would be able to terminate based on that new payment default. A clause which permits a party to a contract to terminate solely on account of an insolvency event affecting the other party is known as an ipso facto clause, and would generally have been enforceable under English law contracts before the entry into force of CIGA.

A relevant insolvency procedure for the purposes of interpreting this measure is defined to include a moratorium, administrative, administrative receivership, a company voluntary arrangement, liquidation, provisional liquidation or a restructuring plan.

However, please note that a supplier will be able to enforce a termination right while the company is going through an insolvency process (a) with the consent of the company or the office holder, or (b) if the court is satisfied that the continuation of the contract would cause the supplier hardship and the court grants permission for the termination of the contract.

(b) Small business supplier carve-out relating to the prohibition on termination of contracts: Temporary Measure

To help support small business suppliers that are more likely to experience a greater impact from the effects of COVID-19, CIGA included a temporary carve-out to exclude small

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suppliers from the scope of the termination clause measure. The CIGA (Extension) extended this temporary carve-out to 30 March 2021. A supplier is small if in its most recently financial year, at least two of the following conditions were met: (a) the supplier's turnover was not more than £10.2 million, (b) the supplier's balance sheet total was not more than £5.1 million and (c) the average number of supplier's employees was not more than 50.

3) Prohibition on issuing statutory demands and winding up petitions: Temporary Measure[1]

CIGA introduced provisions temporarily preventing certain statutory demands made by creditors being effective and temporarily prohibiting a winding-up petition from being brought against a company on the grounds that it is unable to pay its debts (or a winding-up order being made on those grounds) where the inability to pay is the result of COVID-19. The CIGA (Extension) extended these restrictions to 30 December 2020.

The provisions apply to any statutory demand served between 1 March 2020 and 31 December 2020 (previously 30 September 2020) and prevents them from forming the basis of a winding-up petition presented at any point after 27 April 2020.

In addition, the provisions prohibit a winding-up petition being presented against a company on the basis that it is unable to pay its debts, unless the supplier has reasonable grounds to believe that the inability to pay is not the result of COVID-19. Similarly, a court should not make a winding-up order unless satisfied that the facts by reference to which the relevant ground applies would have arisen even if COVID-19 had not had a direct financial effect on the company.

These provisions are to be regarded as having come into force on 27 April 2020 and apply to all petitions presented from then until 31 December 2020 (previously 30 September 2020).

4) Virtual AGMs: Temporary Measure

Due to the continued prevalence of COVID-19, and the fact that Government-enforced social distancing measures remain, companies and other qualifying bodies with obligations to hold AGMs will continue to have the flexibility to hold these meetings virtually until 30 December 2020 (previously 30 September 2020). What this means in practice is that shareholders can continue to examine company papers and vote on important issues remotely.

5) New restructuring procedure: Permanent Measure

CIGA introduced a new restructuring plan by inserting a new Part 26A into the Companies Act 2006 (Arrangements and Reconstructions for Companies in Financial Difficulties). This new Part26A will apply to any company liable to be wound up under the Insolvency Act 1986 that 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. The provisions provide for the ability of the company to propose and agree a restructuring plan with its creditors (and/or members) for the purpose of eliminating, reducing, preventing or mitigating those financial difficulties.

Any creditor or member whose rights are affected by the plan must be permitted to participate in the process, but those who have no genuine economic interest in the company may be excluded. The voting majority for each class is 75% in value (a majority in number is not

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required). If approved, an application to court for sanction of the plan is made, and the court will assess whether a plan is just and equitable.

The main new provision introduced in Part 26A is the ability for a plan to be sanctioned by the court even where a class (i.e. creditors or members) has voted against it. For a court to be able to sanction such a plan, the following conditions must be satisfied:

- members of the dissenting class would be no worse off under the plan than they would be in the event of the relevant alternative
- at least one class who would receive a payment or would have a genuine economic interest in the company in the event of the relevant alternative voted in favour of the plan (relevant alternative is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned)

Where a plan is proposed within 12 weeks of the end of a new moratorium period, it may not affect the rights of creditors in respect of moratorium debts, or pre-moratorium debts that were not subject to the restrictions imposed by the moratorium.

Concluding remarks

CIGA (and the CIGA (Extension)) introduces and extends a number of measures to assist with the rescue of businesses during the ongoing COVID-19 pandemic. It provides directors with breathing space and a chance to pursue a rescue outside an insolvency process, whilst remaining in control of the company. It signals a move to a more debtor-friendly restructuring process in the UK and provides room for all stakeholders to work together to ensure the survival of the business.

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[1] Since the publication of our article on 21 October 2020, the restrictions on the use of statutory demands and winding up petitions imposed by CIGA have been extended for a second time by the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) (No 2) Regulations 2020 (SI2020/83) made on 8 December 2020. These restrictions will now expire on 31 March 2021.

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