UK INSOLVENCY REFORMS

A Blueprint for Reform in Offshore Jurisdictions?

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INTRODUCTION

The Corporate Insolvency and Governance Bill (the "**Bill**") is an ambitious blend of both *temporary* legislation - reacting to COVID-19's impact on business viability – and *permanent* legislation. A key aim of the latter is to address what administrations are widely perceived as having failed to deliver - a mechanism for rescue.

The passage of the Bill is being expedited. It is now due to be considered by the House of Lords (where more amendments are likely) and is expected to become law around the end of June 2020.

The Bill, together with its 14 schedules, covers much ground in over 230 pages. As commentary started to appear the afternoon the Bill was published, the clever software apparently able to estimate our reading speed labelled it a quick "392 minute" read. More than 6 hours, to save you the maths. The separate explanatory notes themselves are 64 pages long (but certainly help make the legislation itself more digestible). They state that the primary objective of the proposed legislation is:

> *"to provide businesses with the flexibility and breathing space they need to continue trading during this difficult time… helping them avoid insolvency during this period of economic uncertainty".*

It has been said that Oscar Wilde stole the first half of his famous witticism "*imitation is the sincerest form of flattery that mediocrity can pay to greatness*" from Charles Caleb Colton.

Jurisdictions generally known as International Financial Centres, such as the Big Three (the British Virgin Islands, Cayman, and Bermuda) have an international reputation not even remotely akin to "mediocre". (For anyone doubting that, look closely at the jurisdictions outside of the United States that saw most activity post-Madoff (the British Virgin Islands and Bermuda) and havoc on hedge fund liquidity in the wake of the last financial crisis and related arguments in respect of so-called "loss of substratum" (Cayman)).

However, such jurisdictions have built established reputations and vibrant economies using bespoke aspects of UK legislation since the 1980s. They continue to watch the UK's efforts to grapple with issues of creditor protection and are likely to be influenced by the Bill (and of course the finished product). Therefore, understanding the position under English law can provide local practitioners with real insight into what may or should materialise in their own markets.

Moreover, because such jurisdictions boast a significant impact in international finance, this is not just a theoretical issue in comparative law.

Lesser-known jurisdictions and themselves British Overseas Territories, such as the Turks & Caicos Islands (the "TCI") and Anguilla, face looming insolvency issues of a different variety; much more related to domestic hotels and resorts than complex, offshore structures. They are also studying the Bill with a view to making changes.

As is so often the case with fiduciaries, the watchwords are proper records; both of decisions made and the *reasons* for those decisions. The content of the Bill is such that there is a rational basis for thinking that interaction with an insolvency professional can be the beginning of a process of rescue rather than akin to a measuring up by the undertaker.

Before diving into some of the detail of the Bill, in summary it divides as follows:

Permanent:

- Statutory moratorium via use of a monitor;
- A new restructuring plan that can involve "cross-class cram down" (sounds painful, but is simply use of approval by one class of creditors to force on to a separate class – even senior to the approving class – a company restructuring). Unlike a scheme of arrangement, it requires the company to be in financial difficulty;
- Nullification of termination clauses in supply contracts (the so-called *ipso facto* provisions).

Temporary:

- Ban on presentation of statutory demands and winding up petitions;
- Suspension of *liability for* wrongful trading;
- Company meetings taking place electronically, irrespective of wording to the contrary;
- Deadlines for filings required by statute.

MORATORIUM

The purpose of the statutory moratorium ("**Moratorium"**) is to facilitate rescue of the company, for the benefit of all stakeholders.

The effect of a Moratorium in terms of enforcement of legal rights is similar to that of administration (which was never brought into force in the British Virgin Islands, but which exists in Part IV of the TCI legislation).

In broad terms, the form of statutory 'breathing-space' does not alleviate the need to pay debts falling due *during* the Moratorium, but before. In particular, the Moratorium provides a "payment holiday" in relation to (most of) a company's "pre-moratorium debt". However, there are some important exceptions: debts or liabilities arising under an instrument involving financial services, rent and goods and services supplied during the Moratorium, wages and salaries, redundancy payments and the Monitor's remuneration and expenses. By way of contrast, "moratorium debt" is any debt or liability arising during the Moratorium (unless it arises due to a pre-existing obligation).

In a significant change to existing priorities, if a company enters liquidation or administration within 12 weeks of the end of the Moratorium, pre-moratorium debts that do not qualify for a payment holiday and moratorium debts rank behind fixed charge creditors but ahead of expenses, floating charge security and preferential creditors.

If the Monitor consents, the Bill allows for, during the Moratorium, the grant of security over company property. Not only would such debt qualify as moratorium debt (which must be paid during the moratorium), but it would also be enforceable during the Moratorium.

Therefore, while the Bill does not provide for super priority Debtor-In-Possession ("DIP") financing, it facilitates financing. With supportive lenders it could provide improved scope for a company voluntary arrangement ("CVA") or other restructuring.

While it is likely that the House of Lords will give particular scrutiny to the proposed change to priorities, at the time of writing this article, it is also anticipated that further amendment allowing for super priority DIP financing will be considered in the future.

As long as the company is an English company and is not already subject to a winding up petition, the directors obtain a Moratorium by simply filing with the court "relevant documents". Of note, these include a statement that the company is or is likely to become unable to pay its debts, and that in the proposed Monitor's view, *it is likely that the Moratorium would result in rescue of the company as a going concern*.

The reason for the high threshold in the Bill is to protect abuse. However, at the second reading of the Bill, it was mooted that the threshold be amended so that the Monitor need only be satisfied that the Moratorium "could" result in rescue as a going concern. This is unsurprising in light of many insolvency practitioners' lack of enthusiasm for a requirement to declare rescue *likely*.

If a company is already subject to a winding-up petition or is an overseas company, a Moratorium is obtained by an application by directors. The court may only grant the Moratorium if it would achieve a better result for the creditors as a whole than is likely to be the case if the company was wound up.

The commencement of a Moratorium must be notified to both all known creditors and Companies House. Similar notification processes exist in the TCI context.

Like a Chapter 11 DIP process, during the lifetime of the Moratorium the directors remain in place. However, the directors are subject to supervision by a Monitor. The Monitor's most important obligation is to "*monitor the company's affairs for the purpose of forming the view as to whether it remains likely that the Moratorium will result in the rescue of the company as a going concern*".

The use of a Monitor is not intended to be expensive and something akin to the appointment of an inspector; not least because the Monitor is expressly able to rely on information provided by the company, unless he has reason to doubt its accuracy. Further, the directors are required to give the Monitor the information he requires as soon as practicable. If the Monitor forms the view that a breach of this means he is unable to carry out his duties, he must end the Moratorium. One would therefore hope that in most cases, the directors will do a lot of the heavy lifting.

In its current form, the Moratorium is subject to a wide range of exceptions. A key exception is that it does not apply to a company that is party to a capital market arrangement (e.g. bond financing), which necessarily excludes many large companies. Other jurisdictions may wish to consider whether access to such a moratorium should be so limited.

NEW RESTRUCTURING PLAN

The substance of this change is to be found in Schedule 9, at page 182 of the Bill and as an amendment (intended as Part 26A, sections 901A-901L of the Companies Act 2006).

Many see this new flexibility, in respect of companies which have encountered or are likely to encounter financial difficulties affecting their ability to trade as going concerns, as amongst the most important aspects of the Bill.

Of relevance in an international context, the plan is available to any company with a *sufficient connection* to the UK, although the orders of the English Court will not have extra-territorial effect (subject to any application for recognition).

This type of arrangement is not to be confused with its near-neighbour in the Companies Act 2006 of the scheme of arrangement (which does not *require* financial difficulty).

As with a scheme of arrangement, this part of the Bill allows the company to propose a restructuring plan to its creditors and members.

If 75% (the % may be changed by the Secretary of State) in value of the creditors or members in each class have approved the plan, the court may exercise its discretion to sanction the plan. However, in the absence of a consensual plan, the plan can still be sanctioned by the court:

(a) if the plan is approved by at least 75% in value of a class of creditors or members that would receive payment or have a "genuine economic interest in the company" in the event of the relevant alternative (whatever the court considers in its discretion would be most likely to occur if the plan is not sanctioned). As such, only one class need approve the plan; *and*

(b) if sanctioned, no members of any dissenting class would be worse off in the relevant alternative;

As this can bring about a cross-class cram down, even of the senior creditor, close scrutiny by the court should be expected. A high level of judicial sophistication and experience is likely to be needed.

Offshore, so-called "light-touch" restructuring has recently been seen within provisional liquidation (for example Ocean Rig in Cayman and Constellation Oil Services Holdings). However, this is far more dependent on cooperation amongst creditors.

IPSO FACTO CLAUSE RESTRICTIONS

These typical 'trigger' clauses allow termination of contracts on the basis of an insolvency procedure. In broad terms, the Bill provides for a ban on enforcement of such clauses, the obvious aim being to

allow a company to continue to operate during a restructuring (thus complementing the provisions regarding the Moratorium and the new restructuring plan).

So far, so simple. However, the wording of the Bill also prohibits clauses permitting one party from "doing any other thing" on the basis of an insolvency event. "Any other thing" is undefined, although presumably this includes charging default interest rates, acceleration of amounts due and any claim under a guarantee.

Another issue that springs to mind is that it seems that the enforcement of these provisions would require an insolvent company to seek a mandatory injunction (not least if the threat of a hefty damages claim is unsuccessful). Query, therefore, how effective the provisions will be in rescuing a company, in reality.

Such provisions are less significant in the offshore context for the simple reason that operating companies with supply contract obligations are far less prevalent. There is not yet an equivalent enforcement ban to what many see as the UK playing "catch-up" with much of the onshore insolvency world.

TEMPORARY BAN ON PRESENTATION OF STATUTORY DEMANDS AND WINDING UP PETITIONS

We see the most important aspects of this temporary ban as the following.

Firstly, the creditor may not present a winding up petition:

(a) on the ground that it has not satisfied a statutory demand if the demand was served during the "relevant period" (between 1 March 2020 and the latter of 30 June and one month after the Bill comes into force);

(b) on any ground under s.123(1)(a) to (d) Insolvency Act 1986 between 27 April 2020 and the latter of 30 June 2020 and one month after the Bill comes into force *unless* it has reasonable grounds for believing that Covid-19 has not had a financial effect on the company (obviously Covid-19 has had an financial impact on most businesses), *or* (more helpful to some creditors) the company would have been unable to pay its debts even if Covid-19 had not had a financial effect on the company.

Secondly, the date of the commencement of the winding up will be the date of the order rather than the date of presentation. Therefore, dispositions of a company's property will not be void (under

s.127 Insolvency Act 1986). Without this Bill, a disposition could be validated if in the interests of creditors overall. In view of this and the narrow circumstances in which a company can be wound up under the temporary ban, it is unsurprising that some are arguing that the inability to void such dispositions may be to the unnecessary detriment of creditors.

Thirdly, the Bill proposes restrictions with retrospective effect. It voids any winding up orders made between 27 April 2020 and the latter of 30 June 2020 and one month after the coming into force of the Bill. This raises thorny issues such as "an Order is an Order until it isn't" per Isaacs v. Robertson [1984] 3 W.L.R 795, and who will bear the costs of the voided orders. However, mercifully, there have apparently been very few such winding up orders made since then, so the scale of that problem is at least manageable.

The Bill is not yet in force, and there are bound to be some modifications. Therefore, how will the court treat petitions that could not have been presented if the Bill had been in force?

In short, it seems that the court is unconcerned that the Bill is not yet in force. The very recent case of Re A Company (Injunction to Restrain Presentation of Petition) [2020] EWHC 406 (Ch) concerned an application to restrain a winding up petition; Morgan J found that *"when the court is deciding whether to grant relief, and, in particular relief which involves the court controlling or managing its own processes,... it can take into account its assessment of the likelihood of a change in the law which would be relevant to its decision"*. The injunction was granted on the basis (among other things) that this was powerfully supported by the clear policy objectives of the Bill.

WRONGFUL TRADING

The Bill's wrongful trading provisions are directly relevant to sections 256 of the BVI Insolvency Act 203 and 268 of the TCI Insolvency Ordinance 2017, which are near-identical equivalents to s.214 Insolvency Act 1986.

So, what does the Bill say about wrongful trading?

First, and contrary to expectations, the Bill does not suspend the wrongful trading legislation.

Instead, in determining for the purposes of section 214 or 246ZB of the Insolvency Act 1986, the *contribution* (if any) to a company's assets that a target person should make, the court is to *assume* that the person is not responsible for any worsening of the financial position of the company or its

creditors that occurs during the "relevant period". The "relevant period" is from 1 March 2020 to the latter of 30 June or one month after the coming into force of the Bill.

The assumption does not appear to be rebuttable (which might seem rather counter-intuitive if the director's conduct was particularly egregious). However, and of note:

(a) There are numerous exceptions, including those in the financial services sector and parties to a capital market arrangement;

(b) A director is still liable for wrongful trading before and after the relevant period. The impact of the Bill is merely to "insulate" the director from a liability *to contribute* to the assets of the company in respect of deterioration of the company's or creditors' financial position during the relevant period;

(c) The Bill does not prevent the use of other remedies, say under s.212 (e.g. misfeasance, breach of duty), s.213 (fraudulent trading), s.238 (transaction at an undervalue) and/or s.239 (preference). In particular, and crucially, the Bill does not remove the duty of a director to act in the best interests of creditors when he knows or ought to know that the company is or is likely to become insolvent – which may well include winding up the company.

Therefore, directors should not see these provisions as giving them *carte blanche* to carry on trading through Covid-19 without considering the consequences.

TO CONCLUDE

We are unable to do justice to the breadth and depth of the Bill in an article of this length (modest in comparison to the legislation it attempts to explain). However, of one thing we are sure; the legislation will have reverberations around the world, and particularly in jurisdictions that follow the English common law model.

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Links to materials relevant to the Bill can be found here:
https://services.parliament.uk/Bills/2019-21/corporateinsolvencyandgovernance/documents.html

Saaman Pourghadiri of Outer Temple Chambers has also written on the Bill:

- Click here to read 'The Corporate Insolvency and Governance Bill – What it means for Directors and Creditors'.
- Click here to read 'Suspension of wrongful trading provisions to ease COVID-19 fallout – not a panacea for directors'.

To find out more about Outer Temple Chamber's Insolvency and Restructuring expertise, please click here.