

# UK CORPORATE INSOLVENCY AND GOVERNANCE ACT

## IN THIS ISSUE:

### Permanent Insolvency Changes

A New Standalone Moratorium

A New Restructuring Plan

*Ipsa Facto* Termination Clauses

### Temporary Insolvency Changes

Modification of Wrongful

Trading Liability

Statutory Demands

Winding Up Petitions

Winding Up Orders

### Further Changes

### Governance Changes

Company Meetings

Company Filings

### Final Thoughts

On 26 June 2020, the Corporate Insolvency and Governance Act 2020 (the “Act”)<sup>i</sup> introduced the biggest reforms in a generation of U.K. insolvency law. It also implemented several temporary changes to both insolvency and company law to deal with solvency and governance pressures resulting from the coronavirus pandemic (“COVID-19”). These reforms were fast-tracked through the legislative process in the U.K., representing a clear move towards a more debtor-friendly, “rescue culture” for companies facing financial difficulty. In some respects they align U.K. insolvency law more closely with U.S. insolvency law, in particular Chapter 11 proceedings under the U.S. Bankruptcy Code. Our earlier briefing, [COVID-19 Changes Announced to U.K. Insolvency Law and for AGMs](#), provided some background to these new reforms.

This note looks first at the three permanent insolvency law reforms made by the Act. These reforms were originally consulted on by the Government over the period 2016–2018, culminating with the publication of final proposals in August 2018<sup>ii</sup>. As noted below, the reforms as now implemented by the Act differ in some respects from those earlier final proposals. They are not time-limited by reference to the COVID-19 crisis:

- a new “standalone” moratorium;
- a new restructuring plan; and
- the dis-application of *ipso facto* termination clauses.

We also consider the Act’s temporary COVID-19 insolvency and corporate governance changes. These are intended to remain in place until 30 September 2020, unless extended:

- the modification of wrongful trading liability;

i See Corporate Insolvency and Governance Act 2020 and its associated explanatory notes

ii See Insolvency and Corporate Governance—Government Response, 26 August 2018

- temporary bans on winding up petitions and orders; and
- changes to company meetings and filings.

## Permanent Insolvency Changes

### A New Standalone Moratorium

The moratorium introduced by the Act in a new Part A1 of the Insolvency Act 1986 (“IA”) is a new standalone tool for companies in financial distress, forming part of the Government’s move towards making the U.K. insolvency regime more rescue-oriented. It is intended to be a short, light-touch and debtor-friendly procedure, giving companies breathing space from creditor action to enable directors to focus on pursuing restructuring options. It will initially last for 20 business days, extendable without court or creditor consent by a further 20 business days. A previously proposed requirement that a company wishing to apply for a moratorium had to be “financially viable” (which featured in the original Government consultation on insolvency reforms in 2018) has been dropped, thereby lowering the entry barrier to potentially any company which is simply “unable to pay its debts” or likely to become so (with some exceptions as to eligibility and subject to meeting other criteria). As such, it is capable of being utilised by a company’s directors without first invoking an insolvency proceeding such as administration or company voluntary arrangement (“CVA”). Indeed, the existing small company moratorium available in a CVA context has been repealed in light of this new standalone moratorium. As we will see, the moratorium is not intended to be used to simply delay the inevitable insolvency of a company.

### Commencing a Moratorium

Practically all companies can avail of the moratorium, unless excluded from eligibility. Those excluded from eligibility include securitisation vehicles, public-private partnership project companies, companies party to market contracts or subject to market charges, companies party to a capital market arrangement (subject to a de minimis threshold), banks, insurers, payment and investment firms and other financial institutions.

For eligible companies, the moratorium must be proposed by the company’s directors, either:

- *Out of court* – available only to U.K. companies and LLPs which are neither the subject of an outstanding winding up petition nor have been subject to a moratorium or other insolvency proceeding within the last 12 months. The moratorium commences when directors file the requisite papers at court (endorsed by a proposed monitor, which we discuss below); or
- *By application to court* – a court order must be sought in the case of an overseas company seeking a moratorium in the U.K., or in the case of a U.K. company or LLP, where there is an outstanding winding up petition or where the company has been subject to a moratorium or an insolvency proceeding within the last 12 months (although these are relaxed in favour of an out-of-court process until 30 September 2020). In considering whether or not to order a moratorium, the court will consider whether it will result in a better outcome for creditors as a whole than winding up without a moratorium. The moratorium commences when the court order is granted.

An “overseas company” is one which is incorporated outside of the U.K.. There is no qualifying requirement by reference to place of incorporation or centre of main interests (as is the case for insolvency proceedings falling under the EU Recast Insolvency Regulation<sup>iii</sup>, such as administrations and CVAs). However, the court will need to establish that it has

<sup>iii</sup> See Regulation (EU) 2015/848

jurisdiction to wind up the overseas company before granting the moratorium. It is likely to exercise the same discretion as currently required under Part 5 of the IA in respect of winding up overseas companies, by requiring there be a sufficient connection with the U.K..

In the papers filed at court (whether for an out of court process or an application to the court), the directors must state that in their view the company is, or is likely to become, unable to pay its debts. An analysis similar to a directors' out-of-court appointment of an administrator, using a cash flow or balance sheet test, would likely be deployed.

### *The Monitor*

A proposed monitor, who will oversee the moratorium, confirms at this stage that the company is eligible for the moratorium and that in their view, it is likely that the moratorium would result in a rescue of the company as a going concern (or, until 30 September 2020, that it would do so if it were not for any worsening of the company's financial position due to COVID-19). As a debtor-in-possession process, the directors remain in charge of day-to-day management of the company and its business during the moratorium. However, a monitor supervises the moratorium to ensure that its aims can continue to be met. Although there is no need to show that a particular restructuring plan has been identified at the outset, any proposed monitor will want to see clear indications that the rescue of the company as a going concern is likely to be achievable, involving any of a CVA, solvent sale, scheme of arrangement or other restructuring plan. It is unlikely that a pre-pack administration or other insolvent process would be pursued as they do not typically result in the survival of the company as a going concern.

The monitor is an insolvency practitioner and an officer of the court who is appointed throughout the moratorium, and whose job it is to ascertain if the moratorium is likely to result in the rescue of the company as a going concern. As such, the monitor can also bring a moratorium to an (early) end if it becomes apparent that the company is unlikely to be rescued. In carrying out its role, the monitor has power to require the directors to provide pertinent information and may apply to court for directions. Once the moratorium has started, the monitor must notify the Registrar of Companies and all known creditors. Where the company is an employer in respect of an occupational pension scheme, the monitor must also notify the Pensions Regulator and Pension Protection Fund. The Insolvency Service has published guidance to assist insolvency practitioners in fulfilling this new statutory role<sup>iv</sup>, but we will have to wait until later in the year to see revised Insolvency Rules that apply to the moratorium; in the meantime, temporary rules made under the Act will apply. A creditor, director, member of the company or any person affected by the moratorium can challenge the actions of the monitor through an application to court. The moratorium itself can also be challenged on the grounds that the eligibility criteria and qualifying conditions have not been met, or that the moratorium would result in unfair harm to the applicant's interests.

### *Protection from Creditor Action*

During the moratorium, the company is protected from creditor action, being:

- enforcement of security, except where security constitutes a security financial collateral arrangement; and
- crystallisation of a floating charge or imposition of any restrictions on disposal of a floating charge asset. If a floating charge holder's ability to crystallise its charge is time-limited and expires during the moratorium, that time is extended by statute to as soon as reasonably practicable after the end of the moratorium or (if later) the day on which the floating charge holder is notified of the moratorium's end.

As well as protection from enforcement, the company is also shielded from insolvency processes, such as:

<sup>iv</sup> See Insolvency Act 1986 part A1: moratorium - guidance for monitors, 26 June 2020

- presentation of a winding up petition and the courts' making of a winding-up order, unless presented by the directors or for limited public interest petitions;
- passing of a resolution for the voluntary winding up by company, unless recommended by the directors; and
- appointment of an administrator or administrative receiver, or application for an administration order, unless made by the directors.

Other legal processes against the company which cannot proceed include forfeiture of leases, repossession of goods under a hire-purchase arrangement and commencement or continuation of any other legal process against the company and its property (with limited exceptions).

### *Payment Holiday – But Not for All Debts*

As well as the protections outlined above, the company is relieved from having to pay certain debts during the moratorium. In this regard, debts are categorised as one of the following:

- *pre-moratorium debts (being debts and other liabilities which have fallen due prior to the moratorium, or during the moratorium (but incurred prior to the moratorium)) for which the company has a payment holiday:* the company is relieved from paying any debts during the moratorium, other than those that are specifically excluded from being subject to a payment holiday (see below). (Indeed, the company is actually prevented from paying such debt if it exceeds £5,000 or 1% in aggregate of the total owed to unsecured creditors at the start of the moratorium, unless the monitor consents or the court orders otherwise);
- *pre-moratorium debts for which the company does not have a payment holiday:* as the name suggests, the company must continue to pay these debts as they fall due during the moratorium. These are:
  - the monitor's remuneration or expenses;
  - payment for goods or services supplied during the moratorium;
  - rent apportioned to the moratorium period;
  - wages or salary and redundancy payments that have fallen due before or during the moratorium period; and
  - contractual debts or liabilities relating to financial services that have fallen due before or during the moratorium period—this will include loan facilities, ISDA agreements, capital markets transactions and other financial markets contracts, factoring arrangements, finance leases and guarantee liabilities arising under obligations incurred before the commencement of the moratorium (even if they fall due during the moratorium). In short, acceleration of financial indebtedness will be permitted during the moratorium; and
- *moratorium debts (being debts and other liabilities which the company has incurred or which become due during the moratorium (other than by reason of an obligation entered into prior to the moratorium)):* these must continue to be paid during the moratorium.

If payments cannot be made, when due, in respect of moratorium debts and pre-moratorium debts for which the company does not have a payment holiday, the monitor will be required to end the moratorium, likely triggering the start of an insolvency process. Accordingly, smaller or operating companies with little financial indebtedness (as opposed to trade debt or rent) will likely benefit the most from this new moratorium. Companies with complex financing arrangements will find that the commencement of a moratorium will likely trigger a series of defaults under the relevant finance documents. While secured creditors will be prevented from enforcing their security (except under security financial collateral arrangements), they will still be entitled to call the default, accelerate their loans or demand repayment of amounts owed and terminate the contract (see also "*Ipso facto Termination clauses*" below). For these companies, simply commencing a moratorium may not provide sufficient breathing space.

### Duration

The moratorium lasts for an initial 20 business days, which is counted from the business day after the day the moratorium comes into force. If certain conditions are met it can be extended, but only while it is still in effect (once expired, the moratorium cannot be resurrected):

- without creditor consent once, for a further 20 business days;
- with creditor consent up to a year in total (including the initial period). The moratorium is extendable more than once by creditors but may not exceed a year in total;
- by the court, upon application by the directors, to a date set at its discretion;
- in connection with a CVA, until the proposal is implemented, accepted or rejected by creditors or withdrawn by the company;
- in connection with a scheme or restructuring plan, at the court's discretion.

To extend the moratorium, creditor consent must be obtained from qualifying majorities in value of both voting secured and unsecured pre-moratorium creditors in respect of whose debts the company has a payment holiday, but whose debts have fallen due or may fall due before the proposed revised end date of the moratorium. In short, only creditors who have not been paid will have a vote; those with excluded contracts (for example, financial creditors) will not have consent rights. The vote fails if a majority in number of unconnected secured or unsecured creditors vote against the extension. In addition, the directors must confirm that all moratorium debts and pre-moratorium debts that are not subject to a payment holiday have been paid as and when they became due and payable. The monitor must also continue to confirm that the moratorium is likely to result in the rescue of the company as a going concern.

We can see that the maximum duration of any moratorium which is possible without engaging with creditors or the court is short—some two months. Directors must, therefore, fully engage with the task at hand and actively work through the company's financial difficulties as quickly as possible. Of course, it would be advisable for the directors to continue their dialogue with the company's creditors. The monitor's oversight throughout this time means that they can (and indeed, must) terminate a moratorium at any time if they consider that it is no longer likely for the company to be rescued as a going concern.

For the duration of the moratorium, the company may only conduct its business in the ordinary course. It may not enter into certain new transactions, including:

- obtaining credit of more than £500, unless the would-be creditor has been informed that a moratorium is in force;
- entering into a market contract or financial collateral arrangement or grant security; or
- disposing of certain property,

unless the monitor has consented or in some instances, only with the permission of the court.

### Ending the Moratorium

*Automatic:* A moratorium will naturally terminate at the end of its stated duration. It will also terminate at the point that a CVA is approved or a court sanctions a scheme of arrangement or a new restructuring plan. This is also the case when a company goes into administration or liquidation, although the usual moratorium and stay that apply in those cases will then come into effect.

*Directors:* During a moratorium, the directors can still petition for the company to be wound up or put the company into administration (whether by an out-of-court or in-court process), having first notified the monitor, thus ending the

moratorium. The directors must also notify the monitor if they recommend a company resolution for voluntary winding up.

*Court:* The court can order the moratorium to end on application by the directors.

*Monitor:* The monitor must end the moratorium by filing a notice with the court, if, at any time, they consider that:

- the moratorium is no longer likely to result in the rescue of the company as a going concern;
- the objective of rescuing the company as a going concern has been reached;
- the monitor cannot carry out his/her functions because the directors have not provided the monitor with the necessary information; or
- the company is unable to pay moratorium debts that have fallen due or pre-moratorium debts not subject to a payment holiday.

*Creditors:* In theory, it will also be possible for lenders who do not support the moratorium to bring it to an end, albeit through the monitor. They could do this by exercising their contractual rights to accelerate payments due under their loan or other finance agreements and call for sums due to be repaid; equally, a lender could issue a demand under their on-demand facilities - such rights are not caught by the restrictions on termination of contracts upon insolvency (see *Ipsa Facto* Termination Clauses below). This would likely mean that an already distressed company is unable to pay its debts when due, which would force the monitor to terminate the moratorium – in this scenario, the financial creditors have been calling the shots. For the moratorium to be fully effective, therefore, the company will need to have its lenders and noteholders on-side and potentially supplement the moratorium with a standstill agreement with them.

### **Priority of Certain Debts**

Fees and expenses of the official receiver, unpaid moratorium debts and unpaid pre-moratorium debts that the company was required to pay during the moratorium are given priority over “all other claims” in the distribution of insolvency proceeds where proceedings for the winding up of the company are begun, or the company enters administration, within 12 weeks after the end of a moratorium. An exception to this “super-priority” status is any financial indebtedness falling due during the moratorium because it was accelerated or its financing arrangements were terminated early. Fixed charge creditors retain their absolute priority.

This super-priority is intended to level the playing field for certain creditors, such as the monitor in respect of their fees, employees, landlords and suppliers for the duration of the moratorium. An unintended loophole in the Bill which would have enabled financial creditors to jump to the front of the distribution line by accelerating their debt during the moratorium (so that the debt becomes a “pre-moratorium debt not subject to a payment holiday” with potential super-priority status) was closed off during the Bill’s passage through the House of Lords with the introduction of a new class of “priority pre-moratorium debt,” which expressly excludes “relevant accelerated debt” from the category of debts enjoying super-priority.

If new money is lent to the company during the moratorium and remains unpaid, then this too will have super-priority. In cases where there are substantial moratorium and pre-moratorium debts without a payment holiday (such as new short-term financing and property rents), these new priority arrangements may not leave much in the pot for distribution to other creditors in any subsequent administration or liquidation.

The effect of these changes, therefore, is to pay moratorium debts and certain pre-moratorium debts for which the company did not have a payment holiday in priority to insolvency practitioners’ remuneration and other expenses of the liquidation, preferential creditors, the prescribed part ring-fenced for unsecured creditors and floating charge holders in



any subsequent liquidation. In the context of a CVA, scheme of arrangement or restructuring plan proposed within this 12-week period, the proposal cannot compromise moratorium-related debts except with the relevant creditors' consent.

## A New Restructuring Plan (the “Plan”)

For a long time U.K. company law has enabled a company to propose to its creditors or shareholders a compromise or arrangement of their rights which, if approved by the requisite majority of creditors or shareholders and then by the court, will become binding on all of the relevant creditors or shareholders. This process—a scheme of arrangement under Part 26 of the Companies Act 2006 (“CA”) (a “scheme”)—has been heavily used by companies (including those non-U.K. companies that fall within the winding up jurisdiction of the English courts, to whom the court’s scheme jurisdiction extends) to implement a wide variety of different forms of financial restructuring, although it is not actually an “insolvency proceeding” for the purposes of the Recast EU Insolvency Regulation.

In its 2018 Insolvency and Corporate Governance Response, the Government recognised the need for a new form of restructuring plan that would sit alongside schemes and would be focused on the needs of companies facing financial difficulties. One of the most significant and distinctive features of this new restructuring plan and a novelty in U.K. restructuring law (discussed below) is the ability it will offer companies and classes of creditors to “cram down” another class (or classes) of creditor, potentially even a senior class, that does not support the plan.

### Availability of the Plan - Companies

The Act introduces the Plan as a new restructuring tool by inserting a new Part 26A into the CA. The Plan will be available to the same type of companies as can presently make use of schemes and this will therefore include non-U.K. companies which have a “sufficient connection” to the U.K. (see “*A new Standalone Moratorium—Commencing a moratorium*” above). It will also be available to certain other entities such as limited liability partnerships.

However, two key requirements for making use of the Plan procedure (which distinguish it from the scheme process) are that: (i) the company must have or be likely to have *financial difficulties* affecting its ability to carry on business as a going concern, and (ii) the purpose of the Plan must be to address those *financial difficulties*. Since the concept of “financial difficulty” is very broad—potentially much broader than the insolvency concept of “inability to pay debts”—there will inevitably be some uncertainty until the courts give rulings on how onerous a requirement this will be for a company wanting to make use of the plan (and especially its “cross-class cram down” facility).

Certain “regulated financial entities” may be restricted in their use of the Plan. Entities that are regulated by the Prudential Regulation Authority will require its consent before applying to the court to initiate the Plan process and regulations may be made under the Act excluding certain financial services entities that are authorized under the Financial Services and Markets Act 2000 and certain other companies or creditors from making use of a Plan.

### Availability of the Plan - Creditors or Members

Certain creditors or members are also excluded from participation in the Plan. Firstly, if the court is satisfied that a class of creditor or shareholder does not have a genuine economic interest in the company (i.e. is out of the money) it will not have the right to participate in the meetings called to approve the Plan.

Secondly, creditors in respect of moratorium or pre-moratorium debts without a payment holiday under a Moratorium (see “*A new Standalone Moratorium—Payment holiday—but not for all debts*” above) which has ended less than 12 weeks before an application is made to the court to propose a Plan will have an effective veto over the Plan since the court cannot sanction a Plan that includes provision in respect of these creditors who have not agreed to it. Inevitably, this will likely result in any court application for a Plan that is proposed following a Moratorium being delayed until after the expiry of this 12 week period.

### *Process for Implementing a Plan*

The new Plan procedure will operate in a very similar way to the way in which schemes operate. This means that, apart from the basic legal requirement of having to involve some form of compromise of rights as opposed to their mere confiscation, there will be few limits on the types of restructuring in its Plan that a company may propose to its creditors or members for their approval. A Plan may also make provision for the reconstruction or amalgamation of companies under which the whole or part of the undertaking or property of the “Plan” company is transferred to another company. An application to the court will be required, both to convene meetings of creditors or members to approve the Plan and to seek the court’s sanction of the Plan once it has been approved. The Plan will bind all affected creditors or members, whether or not they voted in favour of the Plan.

### *Meetings to Approve the Plan*

A company wishing to initiate a Plan must apply to the court for an order convening a meeting or meetings of creditors or members to approve the Plan. An application may also be made by a creditor or member of the company, as well as by its liquidator or administrator, although, as with schemes, there would likely be significant practical as well as legal difficulties for a creditor or member who wished to propose a Plan without the support of the company concerned.

The court will determine the requirements for, and composition of, any separate classes of creditors or members that are required to approve the Plan, on the basis of the well-established principles that the court applies in the case of scheme meetings. A new Practice Statement<sup>v</sup> has been issued by the courts setting out the process to be followed when applying to initiate a scheme or a Plan.

Except where the “cross-class cram down” rule applies (see below), approval of the Plan will require the vote in favour of 75% in value of the creditors or members in each class present and voting. Unlike the approval requirements for a scheme, there is no additional “numerosity” requirement that the vote also comprises a majority in number of the relevant creditors or members voting. However, neither is there a requirement—as was promised in the Government’s 2018 proposals—that more than half of the total value of unconnected creditors vote in support of the Plan.

Where the company proposing the Plan is regulated by the PRA or FCA, its regulator will be entitled to be heard by the court at any application to convene meetings and to seek the court’s sanction to the Plan.

### *Cross-class cram down*

Perhaps the most novel and important feature of the Plan when compared to a scheme is that whereas a scheme requires the approval of each separate class of creditors or members voting on the scheme, it will be possible, in certain circumstances, for a Plan to be approved even when it fails to obtain a 75% vote in favour from one of the classes voting on it. This will provide a very useful tool for a company that is faced with “hold out” or “ransom” creditors since those creditors will be denied the effective veto right that they would have under a scheme as a dissenting class of creditors.

This so-called “cross-class cram down”—forcing a whole class of creditor to accept and to be bound by a Plan once it is sanctioned by the court, even though the class itself (by a 26% in value or more vote) has not approved it—will require two conditions to be satisfied.

The first condition is that none of the dissentient class would be “any worse off than they would be under the relevant alternative.” For these purposes the “relevant alternative” is whatever the court considers would be most likely to occur if the Plan is not sanctioned. In many cases this might be an insolvent liquidation. The second condition is that the Plan

<sup>v</sup> See [Practice Statement \(Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006\)](#)



has been approved by one class that would receive a payment or have a genuine economic interest in the company, under the relevant alternative. Regulations may be made under the Act adding to, removing or varying these conditions.

### *Court Sanction of the Plan*

Once approved, a further application must be made to seek the court's sanction of the Plan. The usual and well understood principles underpinning the court's discretion to approve schemes will apply here, albeit with the added complications of satisfying the court that any cross-class cram down has been properly operated. Primary issues for the court will be whether it is just and equitable for the Plan to be made effective and whether the voting in the various classes was fairly representative of the class as a whole.

Following the court's sanction, the Plan will become effective and bind all the classes of creditors and members who are a party to it (including any class that was "crammed down" and any individual creditor or member who voted against it).

### *Issues to Consider*

Where Plans make use of the new cross-class cram down provisions the court, at least initially, will have to resolve arguments as to whether the provisions have been properly applied, especially as regards valuation issues surrounding the "relevant alternative." This will inevitably invite greater scrutiny of the Plan by the court when considering whether it is just and equitable to sanction it.

In addition, since the Plan may include provision for both creditors and members of the company, it may be possible for the Plan to include provisions for shareholders that will involve a reduction in their equity interest in the company and which, provided that these provisions involve more than just a confiscation of their interest and so still represent a "compromise" of their rights, will be capable of being imposed on them under the cross-class cram down procedure. It is notable that among the amendments to the CA that the Act makes to facilitate the implementation of Plans, there is included a disapplication of pre-emption rights.

The cram down process could also help facilitate restructurings that use a Plan by avoiding, as is common with some creditor schemes, having to couple with the Plan, a pre-pack administration sale of the company's viable business to a "newco" owned by the creditors, so as to give the creditors, in place of the shareholders, an ownership interest in the surviving business.

One significant qualification or restriction on cram down processes that is missing from the Act but which was proposed by the Government in 2018 and is seen in Chapter 11 proceedings under the U.S. Bankruptcy Code, as well as in a number of other foreign restructuring processes, is the operation of the so-called absolute (or modified) priority rule. Under this rule, a class of dissenting creditors must be paid in full before any class of creditors junior to that class receives or retains any distribution or return in the restructuring. Sometimes exceptions are allowed where the more senior class of creditors consents to the rule not being followed and in 2018 the Government proposed that the priority rule should not apply where the court considered that this was necessary to achieve the aims of the restructuring and would be just and equitable in the circumstances.

The absence of any priority rule in the Act's provisions dealing with the Plan may raise the technical possibility of a more senior class of creditors being bound by a Plan under which a junior class would receive more than it would have been permitted to do under a priority rule, i.e. being "crammed up." Unless such a rule is introduced to the Act at a later date by the regulations mentioned below, the senior creditors' protection here would seem to lie in the court's discretion not to sanction a Plan if it would not be just and equitable to do that.

If any of the issues discussed above do end up creating problems for companies or creditors making use of the Plan, the Act allows the Secretary of State to address these by issuing regulations that will make necessary amendments to legislation, as appropriate.

## ***Ipsa Facto* Termination Clauses**

The third permanent insolvency law change introduced by the Act is to prohibit the automatic termination of contracts for the supply of goods or services to companies that enter into an insolvency procedure under so-called “*ipso facto*” termination clauses.

The IA already imposes restrictions on the termination of contracts for the supply of essential goods and services, such as utilities and certain IT services, if the company receiving the supply goes into administration or enters into a CVA. The supply cannot be terminated unless the relevant insolvency office holder either consents to the termination or declines to provide a personal guarantee in respect of charges for the supply following the entry into administration or a CVA or the court is satisfied that continuation of the supply would cause the supplier hardship and so allows the termination.

## ***The New Prohibition***

The Act now extends the IA termination of supply restrictions to all contracts for the supply of goods or services to companies entering into any insolvency procedure. The Act prevents *ipso facto* termination clauses and also clauses providing for “any other thing” to take place (such as imposed amendments to the supply contract, including increased pricing or shorter payment periods) being triggered by the insolvency procedure. This is a particularly broad expression that could cover a wide range of contractual rights or provisions that are unrelated to the termination of the contract. It also prohibits the exercise of any termination right under such contracts during the insolvency period that arose as a result of an event occurring before the start of the insolvency period. A supplier is also not permitted to make it a condition of any supply after the company has entered into an insolvency procedure that any outstanding charges owed to it in respect of supplies made before the insolvency procedure are paid.

## ***Exclusions***

There are two important sets of exclusions from the application of this new prohibition. The first is a temporary exclusion from the prohibition that will apply to the supply contracts of small suppliers and allow *ipso facto* termination clauses in those contracts to operate when their counterparty enters an insolvency procedure. The exclusion will, unless extended by regulations made under the Act, end on 30 September 2020. It applies to companies that are subject to the small companies accounting regime, i.e. that satisfy two of the following tests: (i) turnover of not more than £10.1 million, (ii) balance sheet total of not more than £5.1 million, and (iii) no more than 50 employees.

The second exclusion is not time limited and applies to a wide range of financial services suppliers and financial services companies receiving supplies (e.g. insurers, banks (including investment banks and firms, electronic money institutions, payment providers, recognised investment exchanges and securitization companies). It also applies to a wide range of financial services contracts (whether or not the parties to them fall within the preceding list of excluded financial services entities). These “excluded” contracts include those concerned with lending, financial leasing, securities, commodities, futures, swaps, derivatives, capital market arrangements and PPP contracts, etc. Therefore, drawstops under loan facilities based on insolvency events of default may continue to be called. Regulations may be made under the Act removing, amending or adding to, these financial services exclusions.

## ***Insolvency Procedure Triggers***

Entering into the following insolvency procedures will trigger the operation of this prohibition: the new moratorium, administration, the appointment of an administrative receiver, a CVA taking effect, entering into liquidation and the summoning of a meeting to consider a restructuring Plan. Again, regulations may be made under the Act removing any of these insolvency procedures as a trigger for the prohibition.

### *Protection for Suppliers*

Contracts caught by the prohibition may nevertheless be terminated where the company or its insolvency office holder consents or where the court is satisfied that the continuation of the contract would cause the supplier “hardship” and allows the contract to be terminated. The Act does not, however, include any definition or guidance as to what would be judged to amount to “hardship” for these purposes.

It is also important to note that the prohibition does not prevent the termination of a supply contract for a “non-insolvency related” event, such as non-payment for supplies made during the insolvency procedure. However, if the termination right arose as a result of any breach (e.g. non-payment) occurring before the start of the insolvency procedure, it will not be possible to exercise that right once the procedure has started.

### *Issues to Consider*

This additional protection for companies facing insolvency forms a part of the enhanced “rescue culture” that lies behind the insolvency reforms introduced by the Act. However, there must also be a risk going forward that this new protection may have the opposite effect by encouraging some suppliers who are dealing with companies nearing insolvency to exercise termination rights in their contracts, sooner than they may otherwise have done, to avoid losing those rights once the insolvency procedure has started.

There are also a number of uncertainties as to how the prohibition will apply in practice. For example, in addition to the question of “supplier hardship” (see above) there is no definition in the Act of what a “supply of goods or services” covers. We will have to wait and see what tests the courts apply when considering these uncertainties.

## **Temporary Insolvency Changes**

Some of the temporary changes made by the Act have retrospective effect and all will expire on 30 September 2020 (unless shortened or extended by up to six months under the Act). With the exception of the wrongful trading modification, all companies will be able to take advantage of them.

### **Modification of Wrongful Trading Liability**

Under the IA, a liquidator or an administrator can apply to the court for an order requiring such contribution from a director or past director of a company as the court thinks proper where it finds that that person: (i) knew or ought to have concluded that there was no reasonable prospect that the company would avoid becoming insolvent, and (ii) failed to take every step that should have been taken to minimize the potential loss to the company’s creditors.

The Government announced in March 2020 that legislation would suspend that provision. However, rather than suspending it the Act modifies its application with respect to the company’s position during a relevant period of 1 March 2020 until 30 September 2020. The court is required to assume that the director is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period. There is no need for the court to be satisfied that COVID-19 contributed in any way to any worsening of the company’s position.

Regulations may be made under the Act extending the relevant period by up to six months (as well as reducing it).

This modification to wrongful trading liability during the relevant period will not apply to certain companies. These include certain financial services firms (essentially those which are also excluded from the new standalone moratorium), other regulated entities and friendly societies, building societies and credit unions. It will, however, not only apply to companies but also to other entities subject to IA wrongful trading liability provisions, such as LLPs.

### Issues to Consider

Since the wrongful trading liability provisions of the IA are not suspended during the relevant period, it may still be possible in certain circumstances for an application to be made to the court that results in a contribution order being made against a director, even if the likelihood of this happening must be considerably reduced. The director is only protected against responsibility *for any worsening of the financial position of the company during the relevant period*; they will still have responsibility for deciding whether the company should continue to trade or whether any steps should be taken to minimise loss to creditors, on the basis of the company's position prior to or after the end of, the relevant period. If the company should not have been trading before the start of the relevant period or should have ceased trading when that period ended (including as a result of the deterioration of the company's financial position during the relevant period), the director could still be exposed to wrongful trading contribution liability in respect of their actions or omissions either side of the relevant period.

The Act says that the court is required to *assume* that the director had no responsibility for any worsening of the company's financial position; it does not provide that the director is deemed or treated as having no responsibility. While this might raise the question of whether evidence could be provided to rebut that assumption, that seems very unlikely. Indeed, the Government pointed out in the House of Lords debate on the Bill that the relevant clause deliberately omitted qualifying wording such as "unless the contrary is shown." The intent of these provisions is clearly to provide protection for directors forced to take difficult decisions during the COVID-19 crisis and that would be seriously undermined if the directors' judgement and action during the crisis could be called into question by the possibility of rebutting the statutory assumption.

Finally, despite the relaxation in wrongful trading liability, directors will still need to be aware of their potential liability under other IA or CA provisions, such as for fraudulent trading, and in relation to their fiduciary duties as directors, including the requirement to take particular account of creditors' interests when their company's solvency is in doubt. In addition, no modifications have been made to the potential application of the Company Directors Disqualification Act 1986 to directors of insolvent companies. Under that Act, such directors can, in certain circumstances, be ordered to pay compensation where their conduct has caused one or more creditors loss. Since none of these sources of liability is relaxed or suspended by the Act, it remains to be seen how much breathing space this relaxation in wrongful trading liability will provide directors in practice and to what extent it will help them in their critical decision-making during the COVID-19 crisis.

### Statutory Demands

Under U.K. insolvency law a creditor can put pressure on a debtor company to pay an outstanding debt exceeding £750 by serving on it a formal "statutory demand" for payment. If the debtor fails to discharge the debt within 21 days after having been served with the demand, the debtor will be deemed unable to pay its debts, providing one of the grounds on which a court may order the company to be wound up.

Early on in the pandemic landlords were temporarily prohibited from enforcing a right of re-entry or forfeiture in respect of unpaid rent. The new temporary restrictions on serving statutory demands have been introduced partly to stop circumvention of the forfeiture restrictions by the serving of a statutory demand that might be followed by a petition for winding up.

Under the Act, as from 27 April 2020 the presentation of a winding up petition will not be permitted on the basis of a statutory demand served during a "relevant period" of 1 March 2020 to 30 September 2020. Regulations may extend that period by up to six months. In contrast with temporary bans on winding up petitions (see below), this is a blanket ban that will apply whether or not COVID-19 has had an impact on the company's failure to discharge the demand.

Petitions presented before the Act came into force on the basis of a statutory demand served during the relevant period will cease to be petitions in respect of which the court can make an order for winding up.

## Winding Up Petitions

In addition, no other winding up petitions will be permitted during the period of 27 April 2020 to 30 September 2020 on the basis of a company's inability to pay its debts *unless* the creditor has reasonable grounds for believing that COVID-19 has not had a financial effect on the company or that the company's inability to pay its debts would have existed even if COVID-19 had not had a financial effect on the company (essentially, where the company's financial problems or insolvency would have existed irrespective of any impact of COVID-19). What exactly will need to be shown to the court with respect to COVID-19 either having or not having a "financial effect" on the company is far from clear beyond the Act providing that for these purposes "financial effect" means if (and only if) the relevant company's position worsens in consequence of, or for reasons relating to, COVID-19. No doubt the courts will avoid adopting too restrictive or demanding a view as to what must be demonstrated. The requirement to advertise the presentation of the petition under the Insolvency Rules is also disapplied until the court has determined whether it is likely that it will be able to make a winding up order in respect of it.

With regards to petitions that have been presented during this period but before the Act came into force, the court can make such order as it thinks appropriate to restore the position to what it would have been if the petition had not been presented. This could lead to the voiding of winding up orders made in respect of such petitions.

Winding up is normally deemed to start on the presentation of the petition, with the consequence that under the IA any dealings in the company's property, etc. are voided and the company's bank accounts will be frozen. However, the Act delays the start of winding up for petitions presented during this period until the making of the winding up order.

## Winding Up Orders

No winding up orders may be made during the period of 27 April 2020 to 30 September 2020 on the basis of an inability to pay debts if: (i) it appears to the court that COVID-19 had a financial effect on the company before the presentation of the petition, and (ii) the court is not satisfied that the inability to pay debts would have existed even if COVID-19 had not had a financial effect on the company.

Any winding up orders made during this period but before the Act came into force will be void and the court can give directions to the insolvency office holder to restore the company to its "pre-petition" position.

The look back periods under the IA in respect of which transactions at an undervalue or preferences may be reviewed and reversed, are also effectively extended (but by no more than six months) so that they will run back from the date of the winding up order rather than the date of the presentation of the winding up petition.

The "relevant periods" for the purposes of these winding up petitions and orders provisions may be extended or shortened by regulations made under the Act.

## Further Changes

The Act confers on the Government extensive powers—so-called "Henry VIII powers"—to make a very wide range of further amendments to existing corporate insolvency and governance legislation by delegated regulations. The breadth of these powers has attracted criticism particularly since there is no absolute sunset clause to their use. While no regulations can be issued after 30 April 2021, this date can be extended by, effectively, up to two years from the Act

coming into force and any existing regulations in force when this power expires can continue to be renewed (at up to six monthly intervals).

There are a number of restrictions on how, and the purposes for which, this power may be exercised. The legislation that may be amended in this way includes the Act, the IA, Part 26A of the CA, the Companies Directors Disqualification Act 1986 and the Cross-Border Insolvency Regulations 2006.

## Governance Changes

Two requirements under U.K. company law that have proved to be problematic for companies during COVID-19 have been with respect to the holding of shareholder meetings and the filing of prescribed information with the registrar of companies.

## Company Meetings

A public company must hold an annual general meeting (including its “accounts meeting” at which its annual accounts are laid before shareholders) within six months after the end of its financial year. During the pandemic with “stay-at-home” restrictions on public gatherings in place, this has presented significant problems for companies, both in satisfying this legal requirement as well as in maintaining appropriate and effective dialogue with their investors.

Guidance has been published to assist companies in holding their AGMs in accordance with these restrictions as well as to encourage companies to maintain an effective dialogue with their shareholders when holding “closed” or non-physical meetings<sup>vi</sup> and a number of listed companies have already held their AGMs while subject to these restrictions. The Act now allows companies much greater freedom with respect to shareholder meetings that must be held during the period of 26 March 2020 to 30 September 2020. This “relevant period” can be extended by regulations in up to three-monthly periods with an end date of 5 April 2021.

The Act makes some general changes to the legal requirements for holding meetings during this period by allowing for virtual meetings, electronic and other means of voting and by removing from a participant the legal right to attend the meeting in person, etc. These changes overrule any contrary provisions in legislation and the constitution of the relevant company.

AGMs that have to be held in a period ending during the relevant period must instead be held by 30 September 2020. In addition, regulations may also be made to extend the deadline for holding any general meetings that must be held during a period that overlaps to any extent with the above relevant period by up to a further eight months.

## Company Filings

The Act also extends the deadline for a public company to file its annual accounts (this can be up to 12 months after the end of its accounting reference period instead of six months). In addition, regulations have been made under the Act<sup>vii</sup> to

<sup>vi</sup> See, for example, ICSA/FRC AGMs and impact of Covid-19: supplementary guidance 27 March 2020 and BEIS/FRC – updated guidance for AGMs – 08 June 2020

<sup>vii</sup> See: [the Companies etc. \(Filing Requirements\) \(Temporary Modifications\) Regulations 2020](#)



extend various other filing deadlines for companies and other filing entities, such as for confirmation statements, company charges and certain other company notifications. Companies House has issued guidance with respect to the extension of these filing deadlines<sup>viii</sup>.

## Final Thoughts

The Act has been fast-tracked through Parliament with limited opportunity for detailed scrutiny. Since a number of the key principles underlying the insolvency reforms appear in rather general terms in the Act, it is likely that their scope and applicability will be tested in the courts as companies and creditors start to use the new provisions.

The significance of the three major new insolvency reforms cannot be overstated. For the first time, U.K. insolvency and restructuring law provides debtor-friendly means for companies facing financial difficulties to buy themselves some critical time in which to try to reach agreement with their creditors on a restructuring of their liabilities. By making use of the new moratorium to impose a stay on “non-financial” creditor action and by relying on the protection of supplies to their businesses provided by the ban on *ipso facto* termination clauses, companies—including overseas companies that satisfy the jurisdictional tests currently applicable to schemes—will be able to put forward a comprehensive restructuring plan to their creditors and shareholders which will no longer be at the mercy of an unrestricted rejection by a particular class of “hold out” creditors. Indeed, going forward, the new Plan is very likely to become the restructuring tool of choice for companies, replacing creditor schemes in terms of popularity and usage.

Despite this, given the wide exclusions from the eligibility for, or the application of, the moratorium and *ipso facto* termination clauses, these options will not be fully available to a significant portion of U.K. businesses. This will be the case where companies have tapped the bond markets or have incurred other financial debt.

With regards to the temporary insolvency changes, important as they are, it remains to be seen whether they will succeed in providing sufficient breathing space to enable businesses to get back on their feet on a sustainable basis, or if they will simply delay the inevitable for some severely challenged businesses.

<sup>viii</sup> See: [Temporary Changes to Companies House filing requirements – 1 July 2020](#)

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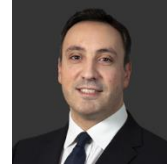
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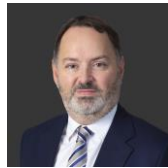
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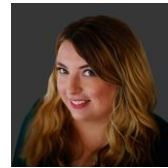
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