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NEWS

Lawyers unpick the UK's draft Corporate Insolvency and Governance Bill

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"The biggest reform of the UK's restructuring and insolvency framework in more than 15 years," is how one lawyer has described the new draft Corporate Insolvency and Governance Bill now pending before the UK Parliament. Though widely welcomed in principle, practitioners have picked up on some unexpected omissions.

Placed before lawmakers on 20 May, the **draft bill** was rushed together to help businesses continue to operate through the covid-19 pandemic, though many of the measures contained within it have been touted since 2016 when the UK launched a consultation process on updating its restructuring and insolvency regime.

Among the bill's provisions: a new, permanent corporate restructuring plan and a "free-standing" moratorium process to give debtors a greater chance at survival. There are also temporary suspensions to wrongful trading provisions in UK insolvency law to avoid otherwise healthy companies filing for insolvency as a result of covid-related social distancing measures, and permanent restrictions on *ipso facto* clauses.

The bill also introduces temporary easements on filing requirements for accounts, registration of charges and other events subject to mandatory reporting, and permits greater flexibility on when and how annual general meetings are held.

Sitting in schedules within the 238 pages of its provisions, the draft bill includes an extensive list of exemptions, including types of debts to which the new moratorium does not apply and contracts carved out of the *ispo facto* curbs.

Having received its first reading before the lower house of the UK parliament, the House of Commons, the bill is scheduled for a second reading on 3 June. It will also

need to pass through the House of Lords and receive Royal Assent before it becomes law and the UK government has warned that many of the measures will require secondary legislation before they come into force.

This secondary legislation will be introduced "in due course", the government has said.

Magnifying glass on the moratorium

Among the new restructuring tools is a 20-day extendable moratorium for debtors that can be used in conjunction with any or no restructuring process, including a company voluntary arrangement (CVA), a scheme, a refinancing or one of the new restructuring plans envisaged in the bill.

The moratorium will be overseen by a licensed insolvency practitioner acting as a monitor and will be available to companies who haven't already had a moratorium in the last 12 months. This individual is required to make statements regarding the company's financial health and prospects for rescue before a moratorium is granted, and they must request the moratorium be brought to an end if it looks like a rescue is not going to happen.

The legislation proposes to lift some of the entry and exit requirements during the pandemic.

Introducing the restructuring plan

Located just behind the UK's existing scheme legislation, a new Part 26A of the UK Companies Act 2006 – "Arrangements and Reconstructions for Companies in Financial Difficulty" – will house the new restructuring plan, which envisages debtors, creditors and shareholders coming to a proposal between them. It permits cross-class cramdown for the first time in the UK, binding minority dissenting creditors to a restructuring plan, provided they would be no worse off under the plan than outside of it.

In its **explanatory notes** to the bill, the UK government has said that courts sanctioning a plan would broadly follow the process for approval of a scheme of arrangement, with the added responsibility of sanctioning a cross-class cramdown. While the cross-class cramdown sections are new, the notes state that Part 26A is similar enough to the existing scheme legislation that courts should be able to draw on the existing body of case law.

Most of the new restructuring tools, including the moratorium and cross-class cramdown, were initially suggested in the government's 2016 consultation and refined during a second consultation period between March and June 2018, before the government revealed its plans in a **proposed framework in August 2018**. But

legislating for the reforms has ultimately been delayed to now, with Brexit being widely blamed for taking up parliamentary time at everything else's expense.

Insolvency and covid-related measures

In addition to the new restructuring tools, the government is introducing some temporary changes to the 1986 Insolvency Act.

From 27 April to 30 June (or to one month after the bill comes into force – whichever is later) there will be a temporary ban on winding-up proceedings being opened on the basis of an unpaid statutory demand, and in cases where covid-19 has brought about the circumstances that caused the grounds for the proceedings. Creditors seeking to make a winding-up order will actively have to demonstrate to the court that covid-19 did not cause the company's inability to pay its debts.

New wrongful trading rules will also require courts to ignore any losses incurred during the period of the pandemic's impact when assessing whether to declare a director guilty of insolvent trading.

The wrongful trading covid exception will apply from 1 March to 30 June, or as above to one month after the provision comes into force, whichever is the latter – but it may be retrospectively extended for a six-month period if the pandemic is still having an impact on businesses in the future.

As with other provisions, the wrongful trading changes do not apply to the directors of certain companies particularly in the financial services and public-private partnership sectors.

Finally, the new insolvency legislation plans to widen the scope of restrictions on *ipso facto* clauses that permit counterparties to terminate a contract if one side enters insolvency or a rescue process. The new restrictions automatically invalidate *ipso facto* clauses in the contracts of a much wider range of suppliers, but again they do not apply to financial services contracts.

Even when an *ipso facto* clause is triggered by a non-insolvency-related event before a company enters insolvency, if the counterparty fails to terminate the contract immediately, they will be unable to exercise that termination for the duration of the insolvency proceedings.

All small businesses will be exempted from the *ipso facto* restrictions for a period as a covid measure.

Suppliers will also be prohibited from making payment of outstanding charges as a condition of continuing supply.

On the other hand, suppliers' safeguards include applying to the court to terminate their contracts on the grounds of hardship, and the possibility of terminating with agreement from the debtor or its insolvency practitioner.

New executive powers

Another temporary measure in the bill would allow the UK secretary of state to amend corporate insolvency and governance legislation by statutory instrument, so that further changes can be made quickly to deal with "significant and potentially unexpected future challenges" to businesses presented by the pandemic.

The government's explanatory notes say that while there are no plans to use this power at present, it could be used to extend deadlines, for example, if the pandemic is preventing parties from meeting the time limits set in insolvency and restructuring processes. "Any changes made by the use of the power in this provision must be kept under review by the Secretary of State and revoked if no longer needed or revised to take account of changing circumstances," the notes suggest.

Reactions

Jennifer Marshall, a partner at **Allen & Overy** in London and a very recent former president of the Insolvency Lawyers Association, discussed the bill with the UK's Insolvency Service in recent weeks in her capacity as chair of the City of London Law Society's Insolvency Sub-Committee.

Marshall says the bill represents the most significant changes to UK insolvency law since the Enterprise Act in 2003, and "possibly since the introduction of the Insolvency Act" in the mid-1980s.

While the drafters have done a "tremendous job" to put the legislation together quickly, she adds that the proof of whether it works will come when the law is actually put to practice.

Marshall says most practitioners will be surprised the government didn't switch off wrongful trading provisions entirely, but rather relaxed them so that courts won't consider losses during the covid period in making an assessment of personal liability. The temporary relaxation is "there to calm nerves and will have that effect," she says, "but the director is still on the hook".

She also points out that it isn't entirely clear how the courts should work out whether a company's difficulties were actually caused by covid-19 to allow it to take advantage of some of the temporary measures. "There may be companies that were struggling before covid – covid hasn't helped of course – but how do you work out whether the company's struggles were specific to covid or general?"

Other surprising elements in the new bill include the absence of any provisions on whether absolute priority or relative priority rules apply to the new restructuring plan. "We were expecting the absolute priority rule similar to Chapter 11 – that you can't pay junior creditors before senior creditors are paid in full," she explains, "but actually the legislation is completely silent."

Marshall says the outcome, at least in theory, is that a debtor could pursue a restructuring plan that gives all of the value to shareholders and junior creditors and noting to senior creditors. But in practice, the UK's "excellent judges" would act as gatekeepers and reject such a plan, she says.

Asked why it was necessary to introduce a new restructuring plan at all when adding cross-class cramdown to scheme provisions might have sufficed, Marshall points out that debtors have to show they are incurring financial difficulties that are affecting their ability to pay their debts to use a plan, meaning it is a bit closer to insolvency legislation than the scheme, which can also be used for solvent companies and takeovers.

As a result, though restructuring plans sit under the Companies Act like the scheme rather than the insolvency legislation, they could be easier to recognise under the UNCITRAL Model Law and the European Insolvency Regulation. "It might be easier, for example, to get Germany to recognise the restructuring plan than a scheme," she says.

Finally, Marshall notes that the new moratorium goes much further than international examples by providing debtors with a payment holiday on pre-moratorium debts as well as some types of post-moratorium debts. As a result, some pre-moratorium creditors could find they are waiting for up to a year for payment.

To balance the inclusion of pre-moratorium debts, the government has carved out debts owed to financial services providers from the moratorium, in a list of exclusions "longer than the provision itself". Marshall says the effect is that unless lenders give their support, the moratorium only really applies to landlords and the providers of good and services other than financial services.

Other lawyers echo Marshall's cautious enthusiasm. **Howard Morris**, head of the business restructuring and insolvency group at Morrison & Foerster in London, says he's "pleased" with the bill, having been an advocate of reform for a while.
"We are out of step with the World Bank's vision of what a restructuring and insolvency law should be and we, the UK, is out of step with the expectations and appetite of providers and users of capital," he notes.

But Morris says some key things are still absent from the UK's regime, including debtor-in-possession ending with super-priority – "a major reason why the trading administration is so rare".

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"Access to working capital is of fundamental importance to a company in distress and without it pre-packs are about the only game in town, but, now, the pre-packs at anything like a decent value have actually left town," he says. "I'm pleased to see something like the *ipso facto* rule so that companies in the moratorium can continue to get supplies necessary for business to continue."

Kate Stephenson, a partner at Kirkland & Ellis, similarly picked up on the lack of a DIP funding provision – but she says it was not a surprise, and that it appears the government is keeping the measure under consideration for the future.

The provisions on the new restructuring plan are "elegant in their simplicity and familiarity, closely mirroring those of scheme of arrangement", Stephenson adds. She points out that the draft legislation opens up the possibility of the plan being used by non-English companies provided they have a "sufficient connection" to the UK, so it "can potentially play a role on the global restructuring stage".

But the moratorium provisions are "disappointing", she says. Stephenson highlights the fact that companies party to capital market arrangements – a concept that is widely defined in the draft – are ineligible for the moratorium altogether. "This is likely to render use of the moratorium limited in practice, at least at the top end of the market," she says.

Along the same theme, she says it is surprising that companies party to capital market arrangements have been carved out of the wrongful trading provisions. "This is especially unhelpful given the government announced that measure would be back-dated to 1 March, so companies and directors that have been operating on the assumption they were relieved from the pressure of wrongful trading provisions now unhelpfully find themselves back on the hook," she says.

Another omission is the reform of pre-pack administration sales to connected parties. Stephenson notes that a "sunset clause" introduced in 2015, which reserved power for the government to reform pre-packs involving connected parties' sales, expires on 26 May, so it was widely expected the government would act at least to extend the clause. "Still, it remains possible we may see secondary legislation before then," she says.

Elsewhere, **Colin Haig**, president of the insolvency and restructuring trade body R3 – many of whose members are likely to be taking up monitor positions under the new moratorium – said the group welcomed the bill.

"The measures contained in the bill will support the profession's efforts to help businesses navigate the enormous economic damage caused by the pandemic – this legislation comes not a minute too soon," he noted in a statement.

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Haig said R3 is pleased its feedback on draft proposals was taken on board by the government. "Previously, for example, the moratorium would only have been open to solvent businesses, but now the legislation will enable insolvent businesses to obtain a breathing space to review their options, free from the risk that a creditor may push the company into an insolvency procedure prematurely," he adds.

But like others, Haig said the profession would be examining the detail of the legislation closely. "We appreciate that in producing this bill, the government has condensed a process that usually takes more than a year into just a few weeks," he noted.

Jo Windsor, a partner at Linklaters, said the draft bill signals a change of focus for the UK, away from financial creditors and towards protecting businesses from hostile operational creditors such as landlords, suppliers and trade creditors. "Historically, most restructurings over the last decade have focussed primarily on resizing a company's financial indebtedness, the assumption being that operational creditors, with the possible exception of landlords, would be largely untouched by the process and would, therefore, be repaid in full," he noted.

"This legislation strongly suggests an expectation that things will be different this time, and that landlords, suppliers and trade creditors will increasingly be pulled into restructuring processes during the forthcoming recession."

In late April, the UK's Coronavirus Act 2020 already put a **moratorium on commercial landlords** enforcing the forfeiture of leases for unpaid rents until 30 June.

Olga Galazoula, a partner at Ashurst in London who provided the opening line about the bill being the biggest reform of the UK's regime in over 15 years, said additional tools "will always be welcome" by the restructuring community. But the jury is still out – and will be for some time.

Galazoula says it is unclear how widely the new tools will be used in the current "extraordinary" circumstances, or how effectively they will be able to compete with other, more tried and tested tools like rescue administrations.

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