Corporate Insolvency and Governance Bill 2020

PART ONE

Stefan Ramel, Simon Passfield & Govinder Chambay

Guildhall CHAMBERS

The journey so far…

Guildhall
CHAMBERS

Genesis…

- A Review of the Corporate Insolvency Framework (May 2016).
- Insolvency and corporate governance (March 2018).
- EU directive on preventive restructuring frameworks, on discharge of debt, etc… (EU 2019/1023).
- Corporate Insolvency and Governance Bill 2019-21 (20 May 2020).

Guildhall CHAMBERS

28 March 2020

“Our overriding objective is to help UK companies which need to undergo a financial rescue or restructuring process to keep trading. These measures will give those firms extra time and space to weather the storm and be ready when the crisis ends, whilst ensuring that creditors get the best return possible in circumstances.”

Alok Sharma, Business Secretary

Guildhall CHAMBERS

Corporate Insolvency and Governance Bill 2020 (parliamentary timeline)

- Publication and 1st reading in House of Commons (20 May 2020).
- 2nd and 3rd readings in the House of Commons (3 June 2020).
- 1st reading in the House of Lords (3 June 2020), and 2nd reading in the House of Lords (9 June 2020).
- 3rd (and final) reading in the House of Lords (pencilled in for 23 June 2020).

Guildhall CHAMBERS

Overview of the Bill

- **Permanent Insolvency Measures**
  - Moratoriums (ss.1-6 and Sch.1-8)
  - Arrangements and reconstructions (s.7 and Sch.9)
  - Termination clauses in supply contracts (ss.12-17 and Sch.12-13)
- **Temporary Insolvency Measures**
  - Winding Up Petitions (ss.8-9 and Sch.10-11)
  - Suspension of liability for wrongful trading (ss.10-11)
- **Corporate Governance Measures** (ss.35-38 and Sch.14)
- **Delegated and Henry VIII powers** (ss.18-34, 39-44)

Guildhall CHAMBERS

Moratoriums

Guildhall
CHAMBERS

An overview

- Available to all companies (except financial services companies).
- Out-of-court / in court entry routes (depending on whether a winding-up petition has been presented).
- Initial 20-day period extendable by 20 days (no consent) or to a year (creditor consent, or court order).
- Entry into and extensions of the moratorium are overseen by a ‘monitor’, but debtor remains in possession.
- Special coronavirus exemptions.

Guildhall CHAMBERS

Arrangements and reconstructions

Guildhall
CHAMBERS

An overview

- The plan is available to any company able to be wound up under IA 1986.
- The gateway requires establishing “financial difficulty” and a proposed compromise with creditors to “eliminate, reduce, prevent or mitigate” effect of the difficulties.
- The process involves an application to court, followed by a meeting of creditors (75%), followed by the court sanctioning the plan.
- New Part 26A CA 2006 includes a cross-class cram down, and binds all creditors.

Guildhall CHAMBERS

Termination clauses in supply contracts

Guildhall
CHAMBERS

An overview

- New s. 233B engaged where company is subject to a ‘relevant insolvency procedure’, whereupon:

- Any contractual provision which envisages the contract terminating “or any other thing would take place”, or the supplier being able to terminate the contract / supply “or do any other thing” ceases to have effect.

- A contract can be terminated if the officeholder or the company consents or the court is “satisfied that the continuation of the contract would cause the supplier hardship”.

- Supplier cannot require outstanding charges to be paid as a continuation of supply in the insolvency procedure.

Guildhall CHAMBERS

Winding Up Petitions and Orders

Guildhall
CHAMBERS

Foreshadowing (1)

Government Statement – 23 April 2020

"The majority of landlords and tenants are working well together to reach agreements on debt obligations, but some landlords have been putting tenants under undue pressure by using aggressive debt recovery tactics. To stop these unfair practices, the government will temporarily ban the use of statutory demands and winding up petitions, where a company cannot pay its bills due to coronavirus. This will help ensure these companies do not fall into deeper financial strain. The measures will be included in the Corporate Insolvency and Governance Bill, which the Business Secretary Alok Sharma set out earlier this month."

Guildhall
CHAMBERS

Foreshadowing (2)

Updated Government Statement – 25 April 2020

"…the government will temporarily ban the use of statutory demands (made between 1 March 2020 and 30 June 2020) and winding up petitions presented from Monday 27 April, through to 30 June, where a company cannot pay its bills due to coronavirus…"

"Under these measures, any winding-up petition that claims that the company is unable to pay its debts must first be reviewed by the court to determine why. The law will not permit petitions to be presented, or winding-up orders made, where the company's inability to pay is the result of COVID-19."

Guildhall CHAMBERS

Shorts Gardens LLP v Camden LBC [2020] EWHC 1001 (Ch) 27 April 2020

"[I]t seems overwhelmingly likely that the proposed legislation will be limited to companies in certain identified sectors of economic activity, and to relate to statutory demands and petitions based upon claims by landlords for arrears of rent. Although the press statement does contain phrases that might, if taken out of context, suggest a wider prohibition, when those phrases are read in the broader context of the announcement as a whole, I anticipate that the prohibitions are not intended to extend to entities [which are not tenants in the retail or hospitality industry], or to petitions which are not based upon arrears of rent."

Snowden J at [83]

Guildhall CHAMBERS

Key amendments (1)

From 27 April 2020

- No WUP may be presented on basis of non-compliance with SD served between 1 March 2020 and one month after coming into force of Sch.10
- Petitioner must have reasonable grounds for believing that coronavirus test met
- Court must not make WUO unless coronavirus test met

Guildhall CHAMBERS

Coronavirus Test

- Coronavirus has not had a “financial effect” on the company (i.e. company’s financial position has not worsened in consequence of/for reasons relating to coronavirus) **OR**
- Relevant ground/facts by reference to which ground applies would apply/have arisen anyway

Guildhall CHAMBERS

Pre-commencement WUPs and WUOs

- If WUP presented between 27 April 2020 and coming into force of Sch.10 and petitioner did not have reasonable grounds for believing coronavirus test met, court may make order restoring pre-WUP position.

- If WUO made between 27 April 2020 and coming into force of Sch.10 and coronavirus test not met:
  - court to be regarded as having had no power to make WUO (and, accordingly, WUO is to be regarded as void)
  - Court may give directions to OR/liquidator to restore pre-WUP position

Guildhall CHAMBERS

Key amendments(2)

From coming into force of Sch.10

- WUP must contain statement that petitioner considers that coronavirus test satisfied
- Until court has determined whether likely that coronavirus test satisfied:
  - Petitioner may not advertise
  - Court file may not be inspected without permission of the court

Guildhall CHAMBERS

WUP Timeline

- Application to restrain presentation?
  - Travelodge Ltd v Prime Aesthetics Ltd [2020] EWHC 1217 (Ch)
  - Re A Company (Injunction To Restrain Presentation of Petition) [2020] EWHC 1406 (Ch)
- Presentation of WUP
- Application to restrain further proceedings?
- Determination of whether likely that coronavirus test met
  - Paper dismissal
  - Contested hearing
- Advertisement of petition
- Substantive hearing (inc. determination of whether coronavirus test met)

Guildhall CHAMBERS

Key amendments(3)

Re: WUO made on WUP presented between 27 April 2020 and one month after coming into force of Sch.10

- Winding up deemed to commence on making of WUO
  - 127 IA does not apply
- Consequential amendments to relation back-period in IA:
  - Beginning of relevant period calculated by reference to presentation of WUP (if WUO made less than 6 months thereafter) OR WUO (if made more than 6 months after WUP)
  - End of relevant period calculated by reference to WUO

Guildhall CHAMBERS

Amended relation-back periods in IA

- s.74(2)(a) – liability of former member to make contribution
- ss.206-208 – malpractice before and during liquidation
- s.214A – adjustment of withdrawals by former member of LLP
- s.240 – relevant time for TUV and preference claims
- ss.242 & 243 – gratuitous alienations and unfair preferences (Scotland)
- s.245 – avoidance of certain floating charges

Guildhall CHAMBERS

Suspension of liability for wrongful trading

Guildhall
CHAMBERS

Rationale?

- The Explanatory Notes to the CIGB:
  - ‘The objective of this measure is to remove the deterrent of a possible future wrongful trading application so that directors of companies which are impacted by the pandemic may make decisions about the future of the company without the threat of becoming liable to personally contribute to the company’s assets if it later goes into liquidation or administration.’

Guildhall CHAMBERS

Insolvency Act 1986 s.214

- Unless s.214(3) applies:
  - The court may declare a director liable to contribute towards the assets of a company where it has gone into insolvent liquidation/administration and at some time before the company was wound up, the director knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation or insolvent administration.

Guildhall CHAMBERS

S.214 – General Observations

- S.214 is concerned with losses caused to the Company, not creditors. See: (Zwieten. K, '*Disciplining the directors of insolvent companies: essay in honour of Gabriel Moss QC*' Insolvency Intelligence (2020) 33(1) 2-10.)

- S.214 is an officeholder action which enures for the benefit of unsecured creditors.

- Must be a critical date by which the director knows or ought to have concluded that there was no reasonable prospect of avoiding an insolvent liquidation.

Guildhall CHAMBERS

The New Measures – Clause 10

‘(1) In determining for the purposes of section 214 or 246ZB of the Insolvency Act 1986 (liability of director for wrongful trading) the contribution (if any) to a company’s assets that it is proper for a person to 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**.

(2) In this section the “relevant period” is the period which—

(a) begins with **1 March 2020**, and

(b) ends with **30 June 2020** or one month after the coming into force of this Act, whichever is the later.’

Guildhall CHAMBERS

Immediate Observations

- Limits the **extent** of any contribution which a director may be ordered to make:
  - losses incurred during relevant period will **not** be taken into account.

  BUT..
  - May still be required to contribute for any loss caused to the Company for wrongful trading which **occurred outside the Relevant period eg: February; (if applicable).**
- Liability is extinguished completely where ‘wrongful trading’ occurs **throughout the Relevant Period only.**
- Reference to creditors?

Guildhall CHAMBERS

Impact on Directors

- Fear factor removed
  - directors more likely to assume new liabilities to keep the company afloat? see: (https://www.rpc.co.uk/perspectives/restructuring-and-insolvency/covid19-the-suspension-of-wrongful-trading-provisions/)
  - A positive for companies which were viable before the pandemic – those companies should continue…
  - Conventional lenders may be more risk averse – recourse to high interest alternative providers?
  - Increase in number of personal guarantees?

BUT…

- Suspension is applicable to all eligible companies, so unviable businesses will continue to trudge on whilst supported by high levels of debt. A negative for the economy when the pandemic subsides.

Guildhall CHAMBERS

Impact on Directors II

- Not a get out of jail free card - the following measures remain applicable:
  - Directors duties s.171-177 of the Companies Act 2006
  - The Company Directors Disqualification Act 1986 ("**CDDA**")
  - The avoidance provisions contained within the IA – (s.238, 239 of the IA)
  - S.213 of the IA – Fraudulent Trading.

Guildhall CHAMBERS

Impact on Officeholders & Creditors

- Assumption, not a presumption
  - An assumption is not capable of rebuttal–no opportunity for the officeholder to say the suspension should not apply.
- Problematic because:
  - **There is no requirement to show that the company's worsening financial position was due to the COVID-19 pandemic.**
- Potential for abuse?
  - Does this reflect Parliament's intention? - "**impacted by the pandemic**".

Guildhall CHAMBERS

Possible Solution?

- Change the wording from assumption to presumption:
  - Capable of being rebutted in an appropriate case.
  - Strikes the right balance between ensuring the right companies continue trading and preventing the measures from being abused.
- Lessons to be learned from other parts of the CIGB? – See Schedule 10 and changes to Winding up Petitions.

Guildhall CHAMBERS

Impact on Officeholders & Creditors II

- Will Directors Duties be an effective safeguard?
  - In the current climate, directors may have a better chance of arguing that continuing to trade was in the interests of creditors.

- If alleging a breach of directors duties is the route to recovery:
  - Debenture holders may benefit as a result of the suspension, see: Zwieten.K, 'The Wrong Target? Covid-19 and the Wrongful Trading Rule.

Guildhall CHAMBERS

Impact on Officeholders & Creditors III

- What about the CDDA?
  - Can the Secretary of State sidestep the suspension and seek compensation for losses **incurred during the Relevant Period?**
- Compensation Orders ss15A-C (SBEEA 2015 S.10):
  - SOS can apply for an order that the director concerned pay compensation for any loss which he has caused to one or more of the insolvent company's creditors or to undertake to pay the same to the SOS.

Guildhall CHAMBERS

Compensation Orders Cont..

- Ss15 A-C of CDDA is a free-standing regime:
  - Unlike S.214 IA, liability is based on losses caused to **creditors**.
- Two requirements that must be met before an order granting compensation is made:
  - A person has to have been made subject to a disqualification order or have given a disqualification undertaking.
  - Conduct for which the person is subject to the order or undertaking has caused loss to one or more creditors of an insolvent company.

Guildhall CHAMBERS

Compensation Orders Cont..

- If “WT” occurs during the Relevant Period only:
  - No DQ and therefore the question of compensation does not arise.
- If part of the WT occurs outside the Relevant Period and if loss has been caused to creditors:
  - DQ is possible and the compensation regime is brought into play.
- But will the compensation include losses incurred during the Relevant Period…?

Guildhall CHAMBERS

Arguments For and Against

- **Main argument for compensation following DQ**
  - The CIGB could only have suspended the liability to contribute towards the company's assets, but not liability to make good any losses suffered by creditors. Since s.214 IA is not concerned with the latter. Therefore, there should be no prejudice to the SOS to seek redress for creditors directly **for losses caused during the Relevant Period.**
- **Main argument against**
  - The only 'misconduct' is in respect of matters outside the Relevant Period, and it is therefore **only losses occurring outside the Relevant Period which are compensable**.
- The outcome is likely to be policy based.

Guildhall CHAMBERS

Remaining Options?

- If the “WT” occurs during relevant period only – No DQ order can be obtained, and the compensation provisions are not triggered.

BUT..

- Trading whilst insolvent with no reasonable prospect of paying creditors:
  - Not the same as s.214 IA.
  - Constitutes a ground of unfitness by which a director may be DQ, which brings the compensation regime into play..
- However, a court may be unlikely to disqualify the director in the current climate and in light of Parliament’s overarching intention.

Guildhall CHAMBERS

Conclusion

- The suspension is fair and correct in principle.

BUT

- It needs to strike a fairer balance between ensuring the right companies continue and the potential for abuse.
- Interesting questions remains as to the CDDA…
- Efficacy of the safeguards should not be taken for granted in the current climate.

Guildhall CHAMBERS

Delegated and Henry VIII powers

Guildhall
CHAMBERS

Henry VIII clauses

"'Henry VIII clauses' are clauses in a bill that enable ministers to amend or repeal provisions in an Act of Parliament using secondary legislation, which is subject to varying degrees of parliamentary scrutiny."

(www.parliament.uk)

Guildhall CHAMBERS

Secretary of State's powers

- Secretary of State has a wide-ranging power to amend by SI "corporate insolvency" or "governance legislation".

- Amendments can (i) relate to conditions of entry into a process, (ii) alter the manner in which the process applies to an entity, and (iii) change or disapply duties / liabilities of a person with corporate responsibility.

Guildhall CHAMBERS

Secretary of State's powers

- Regulations can only be made if the Secretary of State is satisfied that they are expedient in the light of coronavirus.
- Amendments made must be 'proportionate' to the purpose sought to be achieved and that the same requires legislation.
- Any such regulations will be time-limited (6 months)
- Watch this space…!

Guildhall CHAMBERS