One moment a Bill, next an Act

Corporate Insolvency and Governance Act 2020 becomes law

In May, we reported (please refer to our previous alert available here) that the UK Government's much anticipated reforms to UK insolvency law were introduced in Parliament when the *Corporate Insolvency and Governance Bill 2020* (the "**Bill**") started its passage in the House of Commons on 20 May 2020.

As expected, the Bill has been fast-tracked through Parliament. The Bill received Royal Assent and the *Corporate Insolvency and Governance Act 2020* (the "**Act**") became an Act of Parliament on 25 June 2020, just five weeks after the legislative process began. The majority of its provisions commence today, on 26 June 2020, albeit most of the temporary business protection measures it enacts have retrospective effect from 1 March 2020.

The Act needs to be seen in the context of being processed, in large part, as emergency legislation. To this end, any amendments made to the Bill are limited to those seen as critical and in respect of which there had been significant objections. These include, most notably, the Pensions Regulator and the Pensions Protection Fund (as appropriate) being given rights to receive information and/or challenge actions in respect of a moratorium and restructuring plan, financial debt accelerated during the moratorium not being granted super priority status after the moratorium comes to an end, and extending the time period for which the COVID-19 specific special measures are in place until 30 September 2020.

In this alert, we recap the changes and the divergences between the legislation as it was introduced in the Bill last month and the form of the final Act.

Summary of Reforms

Temporary measures

The Act introduces the following temporary reforms to the existing framework governing wrongful trading and the issuing of statutory demands and winding-up petitions, as well as re-instating certain requirements about sales to connected parties in pre-pack administrations:

1. **Wrongful Trading**: allows administrators or liquidators to bring actions against directors to personally contribute to the assets of a company where directors have allowed a company to continue to trade when the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation or administration. While the Act does not "suspend" or "switch off" the existing wrongful trading provisions, it requires courts to assume that during the "relevant period" a director is not responsible for any worsening of the financial position of the company or its creditors. The "relevant period" introduced under the Bill was from 1 March 2020 – 30 June 2020, but this has now been extended to 30 September 2020 (with continued scope for extension). Directors of certain types of entities are excluded from relying on these provisions, primarily where companies are party to any "qualifying capital market arrangement" or the company is an "Excluded Entity" (a term used throughout the Act, which includes insurance companies, banks and investment banks).
2. **Statutory demands and winding-up petitions**: statutory demands served between 1 March to 30 September 2020 cannot be used as a basis for issuing a winding-up petition. From 27 April to 30 September, winding-up for cashflow or balance sheet insolvency will also not be available during this period if the cause of non-payment is because the company cannot pay its debts because of the "financial effect" of COVID-19 on the company's financial position. Whether COVID-19 has had a "financial effect" on a company will be a question of fact.
3. **Pre-pack administrations to connected parties**: a measure which was not included in the Bill, but was introduced by the House of Lords and features in the Act, is the reinstatement of powers given to the Secretary of State to make regulations in relation to the administration procedure and sales to connected persons. This temporary reform is aimed at promoting fairness and transparency in the administration process. The Secretary of State will be able to make regulations to prohibit, impose requirements, or conditions on, the disposal, sale or hiring out of property by an administrator to a connected person. The powers must be used by the Secretary of State before the end of June 2021. The Act did not go so far to make it compulsory to refer potential pre-pack sales to the pre-pack pool.

Permanent measures

The Act also introduces the following permanent reforms:

1. **New moratorium**: a free-standing statutory moratorium which will be available to most companies (although "Excluded Entities", see above, will not be able to access it), while the directors continue to remain in control of the company with the oversight of a Monitor, being a licensed insolvency practitioner. The moratorium is similar to the one currently available in administration, but with some important differences. In particular, while the company gets a "payment holiday" from most pre-moratorium debts there are some key exceptions, including the need to meet liabilities in respect of contracts involving financial services. Any moratorium debts and pre-moratorium debts not subject to a payment holiday will benefit from a super priority over all other debts (except fixed charges) if the company enters into an administration or liquidation within 12 weeks following the end of the moratorium. The drafting of the Bill had the unintended consequence of elevating all financial debt, as lenders could potentially have accelerated their debt during

the moratorium and in turn obtain the benefit of this super priority, but this has been addressed in the Act (see below).

2. **New restructuring plan**: the Act introduces a new restructuring plan that is largely based on the existing English law scheme of arrangement available under Part 26 of the Companies Act 2006, albeit with the added ability to allow for cross-class cram-down (a first in English law). There is also no requirement for a majority in number of creditors to approve the restructuring plan providing 75% in value of creditors in each class approve the restructuring plan (or the cram-down provisions are invoked).

3. **Protection of supplies of goods and services**: if a company enteres into a qualifying restructuring or insolvency process, the Act restricts the rights of a supplier under "any contract for goods or services" from terminating or doing "any other thing" in relation to such a contract by reason alone of the company entering into such process. Termination rights relating to events arising after the insolvency process begins (e.g. in relation to non-payment for post-insolvency supplies provided) may still be exercised. Suppliers are also restricted from exercising a termination right that arose before the relevant insolvency procedure commenced but was not exercised. A qualifying process includes the new moratorium procedure, administration, a company voluntary arrangement, administrative receivership, liquidation or the new restructuring plan (but not a scheme). Certain sectors (including banking and financial services and insurance companies) are exempt from the restriction. The Act does not include a definition of a "contract for the supply of goods or services" but the meaning is potentially broad. While each agreement would need to be assessed on a case-by-case basis, the phrase is likely to be construed as a matter of ordinary language. The intended policy of the legislation, which is to ensure that companies are not deprived of supplies they need in order to promote the rescue of a company as a going concern, should also be borne in mind when considering whether the provisions are applicable to a particular contract.

Material amendments to the Bill

As noted, minimal amendments have been made to the Bill. The amendments that have been made are restricted to certain pitfalls and unintended consequences of the Bill that came to light immediately after its publication.

The main changes between the Bill and Act are as follows:

- lenders to a company in a moratorium procedure are not entilted to a super-priority position for their debt in a subsequent insolvency process by accelerating that debt during the moratorium;
- extension of the scope of the "financial contract" exclusions to include certain financial derivative products;
- the Pensions Regulator and the Board of the Pension Protection Fund have been provided with rights to receive notifications and information in the moratorium and restructuring plan processes;
- as addressed above, the Government's power to regulate pre-pack sales to connected persons (which had expired in May of this year) has been revived;
- the temporary provisions relating to wrongful trading and the issuing of winding up petitions and statutory demands have been extended to 30 September 2020 (with scope for further extensions in six-month increments); and
- the wide power for the Secretary of State to temporarily amend corporate insolvency or governance legislation to mitigate the effect of coronavirus has been slightly qualified (and a new absolute time limit of two years following Royal Assent for extensions to those powers has been imposed).

Commentary

We welcome these reforms to UK insolvency law. As noted in our previous alert, the new provisions give companies and their various stakeholders increased options when dealing with distressed situations. The profession will be watching keenly to see how the permanent measures will be used in practice. For example:

- Will the new free-standing moratorium develop its own niche to deal with trade creditors in the lead up to a company proposing a company voluntary arrangement or restructuring plan?
- Will debtors continue to use the tried and tested existing scheme of arrangment, or will the flexibility of the restructuring plan and its potential ability to compromise operating and financial liablities as part of one process be its drawcard and make it a "one stop" solution? We look forward to seeing how the English courts interpret the new cross-class cram-down tests and how debtors seek to describe the "relevant alternative" concept.
- The new continued supplies provisions mark a signficant departure from current law and it will be interesting to see how they drive behaviour in the market and drafting of commercial contracts.

Your contacts

Geoff O'Dea
Partner
geoff.odea
@bakermckenzie.com
Work +44 20 7919 1968
Mob +44 7894 493056

Bevis Metcalfe
Partner
bevis.metcalfe
@bakermckenzie.com
Work +44 20 7919 1102
Mob +44 7912 259198

Marc Florent
Partner
marc.florent
@bakermckenzie.com
Work + 44 20 7919 1880

Hugh Lyons
Partner
hugh.lyons
@bakermckenzie.com
Work +44 20 7919 1491
Mob +44 7515 606936

Anne Sharp
Consultant
anne.sharp
@bakermckenzie.com
Work +44 20 7919 1564
Mob +44 7701 332550

Priyanka Usmani
Senior Associate
priyanka.usmani
@bakermckenzie.com
Work +44 20 7919 1791
Mob +44 7872 844985

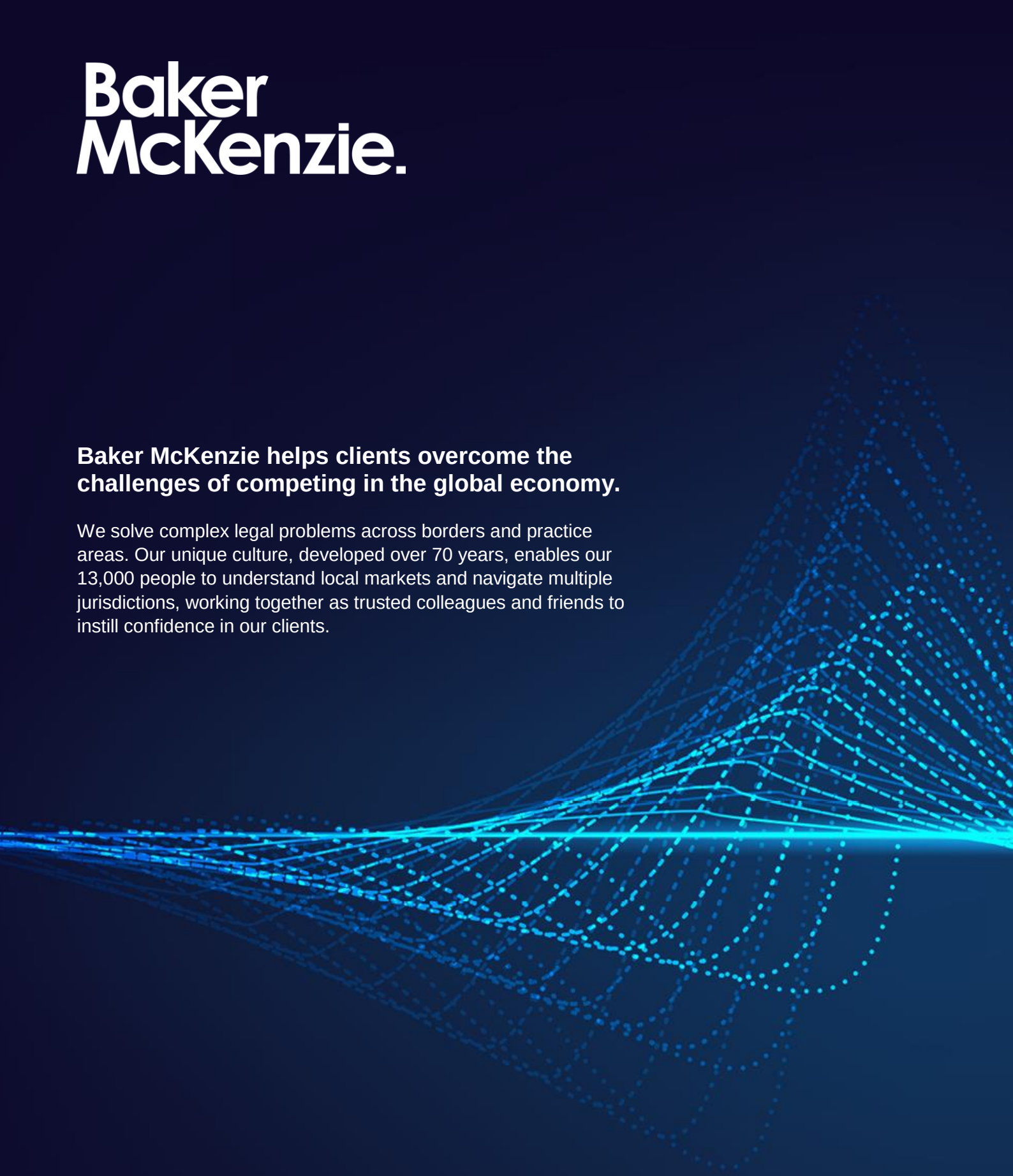
William Sugden
Associate
william.sugden
@bakermckenzie.com
Work +44 207 919 1638
Mob +44 7923 233515

Jerome Small
Associate
jerome.small
@bakermckenzie.com
Work +44 207 919 1974
Mob +44 7701 360051

Baker McKenzie.

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 70 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instill confidence in our clients.



bakermckenzie.com