KEY POINTS

- The Corporate Insolvency and Governance Act 2020 (CIGA) introduced a standalone moratorium procedure into UK insolvency law.
- The procedure allows eligible companies facing financial difficulty to obtain a stay on creditor action and a payment holiday in respect of certain pre-moratorium debts.
- As this article explains, obligors that are party to capital market transactions are likely to be ineligible for the moratorium. Obligors that are eligible, but that have financial creditors, may find the procedure of limited use unless they can ensure that their financial creditors are paid during the moratorium or they have otherwise agreed contractual standstill arrangements with them.

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Capital market transactions and the standalone moratorium procedure

This article considers the capital market exemption under the Corporate Insolvency and Governance Act 2020 (CIGA). The question of whether the exemption applies may be complex to answer.

THE CIGA AND THE NEW MORATORIUM PROCEDURE

Many commentators have described the Corporate Insolvency and Governance Act 2020 (CIGA) as the most profound change to UK insolvency law in a generation. The CIGA, which came into force earlier this year, introduced a number of new restructuring measures into UK law with the objective of providing companies with flexibility and breathing space to continue trading when in financial difficulty. Some of the measures are temporary and aimed at providing companies with immediate relief in response to the ongoing COVID-19 crisis. However, the idea of a standalone moratorium outside existing UK insolvency proceedings (such as administration or winding-up) had been under government review and consultation for a number of years. The moratorium procedure is one of the permanent measures under the CIGA.

The CIGA introduces a new Pt A1 into the Insolvency Act 1986 (IA 1986), which provides an eligible company with the ability to obtain a moratorium on creditor action and a payment holiday for many of its pre-moratorium debts. The moratorium is available to eligible UK companies (being companies registered under the Companies Act 2006) and overseas companies. While eligible overseas companies will need to apply to court to enter a moratorium, in many cases eligible UK companies will be able to enter a moratorium by merely filing documents at court. In each case, the directors must be of the view that the company is, or is likely to become, unable to pay its debts.

The key objective of the standalone moratorium, which is deduced from the role of the "monitor", is to rescue the company. Appointed at the outset of the procedure, the monitor's role is to monitor the company's affairs on an ongoing basis so that he may form a view as to whether it remains likely that the moratorium will result in the rescue of the company as a going concern. If the monitor considers that this is no longer likely, he must immediately terminate the moratorium. To help the monitor form that view, the directors (who remain in place during the moratorium) must provide the monitor with any information that the monitor requires in order to carry out his functions.

The moratorium runs for an initial period of 20 business days, but that period may be extended by the directors for up to an aggregate period of 40 business days, or, with creditor consent, for up to an aggregate period of one year, or by application to court. The monitor does not need to consent to any extension, but he must continue to be satisfied that it is likely the moratorium will result in the rescue of the company as a going concern.

IMPLICATIONS FOR CAPITAL MARKET PARTICIPANTS

If the moratorium is available to a company, capital market participants will find their rights and recourse against that company curtailed by virtue of the moratorium. For example, the moratorium prevents creditor action to wind-up the company, appoint an administrator or enforce most security rights.

However, in practice, it is likely that many companies will be ineligible for the procedure. The CIGA sets out a number of exemptions that limit the application of the procedure to certain companies. This article does not cover each of these exemptions, which are extensively defined in Sch ZA1 of the IA 1986. However, of particular relevance to capital market participants will be to consider whether paras 13 and 14 of Sch ZA1 apply to their particular factual scenario. These paragraphs provide for an exemption to a company's eligibility for the new moratorium (referred to as the capital market exemption).

Specifically, a company is ineligible for the moratorium if, at the time the company files for a moratorium:

- it is a party to an agreement which is or forms part of a capital market arrangement;
- a party has incurred, or when the agreement was entered into was expected to incur, a debt of at least £10m under the arrangement; and
- the arrangement involves the issue of a capital market investment.

The drafting of the capital market exemption above largely follows the provisions introduced by the Enterprise Act 2002 in relation to administrative receiverships and will therefore be familiar to practitioners. However, the question of whether the capital market exemption applies may be complex to answer. Participants to capital market transactions will need to consider carefully the capital market exemption in order to determine whether or not an obligor will be able to avail itself of the moratorium.

What is a "capital market arrangement"?

An arrangement will be a "capital market arrangement" if any of the following apply:

- it involves a grant of security to a person holding it as trustee for a person who holds a capital market investment issued by a party to the arrangement;
- at least one party guarantees the performance of the obligations of another party;
- at least one party provides security in respect of the performance of obligations of another party; or
- the arrangement involves an investment of a kind described in Arts 83 to 85 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (more specifically, options, futures and contracts for differences).

Consequently, a capital market instrument that benefits from guarantees or security will likely constitute a "capital market arrangement", though the capital market exemption will not extend to all secured or guaranteed instruments.

When is a company a "party" to an agreement which is or forms part of a capital market arrangement?

What constitutes a "party" for these purposes is widely cast by the legislation. Typically, companies that are party to the contracts that constitute the capital market arrangement should be a party for these purposes. However, the definition of "party" goes further than contractual counterparties. The term also includes a party to an agreement which provides for the raising of finance as part of the capital market arrangement, or that is necessary for the purposes of implementing the arrangement. Consequently, it might be possible to argue that companies within the same corporate group that have benefitted from the on-loan of proceeds of a capital market arrangement might also be caught by the definition of "party", even if they are not party to the agreements that constitute the capital market instrument.

What is a "capital market investment"?

The CIGA defines an instrument as a "capital market investment" if it meets one of two conditions (referred to as Condition A and Condition B).

Broadly, Condition A requires that the investment in question is a debt instrument that is (or is designed to be) either:

- listed on the official list maintained by The Financial Conduct Authority;
- rated by an internationally recognised rating agency; or
- traded on a market established under a recognised investment exchange or specified foreign market.

By contrast, Condition B does not require that the investment is listed, rated or traded. Rather, Condition B applies to investments that are a "bond" or "commercial paper", and that have been issued to investment professionals, high net worth individuals, high net worth companies or certified sophisticated investors for the purposes of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. Condition B also applies to bonds or commercial paper issued to persons in a State other than the UK, who under the law of that State are not prohibited from investing in bonds or commercial paper.

The CIGA defines "commercial paper" and "bond" by reference to terms used in existing financial regulatory legislation. The definition of "commercial paper" is clear, being short-dated paper with a maturity of less than one year from the date of issue. However, "bond" is not defined in the existing legislation and therefore its precise meaning is somewhat unclear. The question of what will and what will not constitute a "bond" for these purposes may need to be clarified by the courts or by Parliament in time, although it seems likely that the term "bond" can be read broadly and used interchangeably with debt instruments that are described as "notes".

WHAT IF AN ISSUER OR GUARANTOR IS ELIGIBLE FOR THE NEW MORATORIUM PROCEDURE?

As a consequence of the capital market exemption, it is likely that many companies that are party to sophisticated bond or note finance transactions will be ineligible for the moratorium. However, even if a company that has issued or guaranteed a capital market instrument is eligible, there are a number of other creditor protections that may limit the practical use of the moratorium for debtors.

For example, while the moratorium provides a company with a payment holiday on certain pre-moratorium debts, that protection does not extend to scheduled debts and liabilities arising under a "contract or other instrument involving financial services" and that fall due before or during the moratorium. If the company fails to meet scheduled debt payments under such contracts, or the monitor thinks that the company is unable to pay these amounts as they fall due, then the monitor must immediately bring the moratorium to an end.

What constitutes a "contract or other instrument involving financial services" is extensively defined and includes contracts for the provision of financial services consisting of lending, and contracts for the purchase, sale or loan of a security (or group or index of securities). Accordingly, it appears that scheduled debt payments under loan agreements, and bond or note purchase agreements, would need to be met by the company during the moratorium.

This provides some protection for financial creditors, as the company will need to keep current any scheduled payments under its finance contracts through the moratorium. A likely consequence of these provisions is that the moratorium may be

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less appealing to eligible companies that have impending debt service obligations to their financial creditors. Without the relevant financial creditors consenting to a waiver or postponement of the company's payment obligations, the moratorium may provide little to no assistance for companies. The practical effect of this is that the moratorium is likely to be most useful where a company is facing immediate or short-term issues with trade creditors, but is otherwise confident of being able to service its obligations to, or obtain contractual waivers or relief from, its financial creditors.

CONCLUSION

At the date of writing, the authors are not aware of any reported instances of debtors having made use of the procedure in the months since the CIGA came into force. As with any new procedure, it remains to be seen if debtors will find the moratorium useful in practice. The procedure is a welcome addition to UK insolvency law, albeit that its scope is relatively modest compared with the stay available under Chapter 11 of the US Bankruptcy Code. By providing eligible companies with a payment holiday and protection from creditor action, the procedure could provide companies with some short-term breathing space from trade creditors during a period of financial difficulty to give it time to propose a restructuring to creditors.

From a financial creditor's perspective, participants in capital market transactions should be aware of the new procedure and consider whether an issuer or guarantor of a capital market instrument might be able to avail itself of moratorium protection. However, by virtue of the widely-cast capital market exemption, the moratorium is unlikely to cause concern for these types of creditor. Even if an obligor is eligible for a moratorium, financial creditors may take comfort from the protections afforded to scheduled debt obligations under contracts for financial services. In large-scale financial restructuring scenarios, the moratorium may only have limited use as a tool to ensure the company is protected from action by trade creditors, while the company negotiates a broader restructuring with its financial and other creditors. ■

Further Reading:

- Corporate Insolvency and Governance Act 2020: a balancing act (2020) 9 JIBFL 629.
- Moratoria laws globally and the COVID-19 pandemic (2020) 8 JIBFL 536.
- LexisPSL: Banking & Finance: The new Standalone Moratorium procedure under CIGA 2020.