

## Corporate Insolvency and Governance Act

June 30, 2020

The Corporate Insolvency and Governance Act (the “Act”) received Royal Assent on 25 June 2020 and is now in force. As anticipated in our client alert of 26 May 2020, the Act represents the most extensive changes in the insolvency landscape since the Enterprise Act came into force in 2003.

The provisions of the Act contain both:

1. Permanent, long-term reforms to corporate insolvency law, including the introduction of a free-standing moratorium, a new restructuring plan which includes a “cross-class cram down” mechanism and further protections for certain supply contracts.
2. Temporary, emergency provisions initiated by the COVID-19 crisis, including the suspension of the wrongful trading legislation, restrictions on the use of statutory demands and winding-up petitions, and the extension of certain corporate governance deadlines.

Further detail on the provisions of the Act follows below. The legislation is light on detail in some respects because of the speed at which it has been implemented by Parliament. It is likely that the courts will have much to do in developing the measures introduced by the Act.

### Permanent Reforms

#### Moratorium

The Act introduces a moratorium to allow companies in financial distress breathing space in which to explore their rescue and restructuring options free from legal action, which can only be taken against the company during this period with leave of the court. The moratorium extends to the enforcement of security (other than financial collateral or collateral security charges) and the crystallisation of floating charges (other than financial collateral, collateral security, market or system charges).

In order to qualify for the moratorium, the relevant company must be unable to pay its debts or be likely to become so, but it must still be capable of being rescued. The company does not have to be solvent to qualify for the moratorium. The moratorium is

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also free-standing, and so does not need to be used in conjunction with another restructuring or insolvency process.

The moratorium is obtained by filing papers at court (and, in certain circumstances, requires the grant of a court order) and lasts for an initial period of 20 business days. The moratorium period may be extended by the company for a further 20 business days, or for a longer period with the agreement of the company's creditors or the court. During the period of the moratorium, the directors will remain in charge of the company (it is a "debtor-in-possession" process). However, the moratorium will be overseen by a qualified insolvency practitioner who will act as a monitor and, among other things, assess throughout the moratorium period whether there continues to be a prospect of the company being rescued. Whilst the moratorium lasts, the company cannot dispose of property (other than in the ordinary course of business) or grant security over its assets without consent of the monitor or the court.

## **Restructuring Plan**

The Act introduces a new restructuring plan that is available to companies which have encountered, or are likely to encounter, financial difficulties that are affecting, or will or may affect, their ability to carry on as a going concern. The new restructuring plan is similar in many respects to a scheme of arrangement and it is clear the courts are to apply the wealth of scheme case law to many aspects of the new restructuring plan. There are, however, a number of critical differences:

- A scheme of arrangement requires the approval of each class voting on it. In contrast, the new restructuring plan includes a "cross-class cram down" mechanism that will allow dissenting classes of shareholders or creditors to be bound to the plan, provided that:
  - none of the members of a dissenting class would be any worse off under the restructuring plan than they would be in the event of the "relevant alternative"; and
  - at least one class who would receive a payment or would have a genuine economic interest in the company in the event of the "relevant alternative" must have voted in favour of the plan.

The "relevant alternative" is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned; so, while liquidation will often be the "relevant alternative", it will not always be so.

- As a result of the cross-class cram down mechanism, shareholders of a company could be crammed down into a restructuring plan which would deliver equity and other equity-based instruments to creditors (subject to the requirements set out above).<sup>1</sup> The absence before now of such a shareholder cram-down mechanism has often led to consideration having to be offered to shareholders in return for their consent.
- The approval threshold for a class of creditors or shareholders is 75 percent by value. There is no numerosity requirement for a restructuring plan, whereas a scheme of arrangement also requires approval by a majority in number (of each class).

It had been expected that the cross-class cram down mechanism would include an "absolute priority rule", whereby the claims of a dissenting class of shareholders or

creditors must be satisfied in full before the claims of a more junior class are satisfied, as is the case in US Chapter 11 proceedings. However, this requirement has not been included in the Act, and it is yet to be seen how the courts will react to the absence of the absolute priority rule in the legislation.

It is clear that the Act provides only the foundation for the use of the new restructuring plan and that the court will have an instrumental role in shaping and developing how plans are used in practice, particularly as regards the critical question of valuations that will have to be prepared (and may then be contested by creditors and shareholders) in connection with plans. While the case law relating to schemes is likely to be relevant in many respects to the court's consideration of issues relating to plans, this will not be the case in relation to valuation issues and disputes which will necessarily arise as a result of the introduction of the cross-class cram down mechanism.

## **Termination Clauses**

The Act introduces provisions that widen the restrictions on suppliers using insolvency termination clauses (so-called "*ipso facto*" clauses) in supply contracts to terminate or vary the terms of those contracts. This will mean that, subject to certain exceptions, contracted suppliers will have to continue to supply companies in restructuring or insolvency processes, with the hope being that this will allow companies to trade through those processes.

The Act provides some safeguards for suppliers. The company is required to pay for any supplies made to it when it is in the relevant restructuring or insolvency process and suppliers can apply to the court for permission to terminate the supply contract on grounds of hardship. Further, the measure does not apply to small suppliers until 30 September 2020 (though this period may be curtailed, or extended in connection with the COVID-19 crisis). Terminations due to nonpayment (and other contractual termination events) are also still permitted.

## **Temporary Provisions**

### **Suspension of Wrongful Trading**

The Act introduces provisions that temporarily suspend the existing wrongful trading legislation. The objective of this temporary suspension is to allow directors of companies that are impacted by the COVID-19 crisis to take decisions in relation to those companies without the threat of becoming personally liable to contribute to the relevant company's assets under the wrongful trading legislation if the company later goes into liquidation or administration.

The suspension period runs from 1 March 2020 to 30 September 2020 (though this period may be curtailed, or extended in connection with the COVID-19 crisis). During that time, the court is to assume in any wrongful trading proceedings that the directors are not responsible for the worsening of the financial position of the company or its creditors (the worsening of the company or its creditors' financial position during the suspension period was due to the COVID-19 crisis in order for this assumption to apply). Although this change is important for directors, the balance for directors in taking decisions in relation to the company will still be delicate. The general duties of directors remain unchanged, and so the directors of a company in the zone of

insolvency still have a duty to act in the best interests of creditors. The existing fraudulent trading and director disqualification laws also remain unchanged.

### **Restrictions on the Use of Statutory Demands and Winding-up Petitions**

The UK government moved quickly in response to the pandemic to introduce under the Coronavirus Act 2020 a moratorium on commercial landlords enforcing forfeiture of leases for unpaid rents, so as to protect tenants who are experiencing financial difficulties. Since then, it has come to the government's attention that some landlords had instead been using statutory demands followed by winding-up petitions to put pressure on tenants to pay their rent. The Act introduces provisions that temporarily prevent winding-up petitions being made on the basis of statutory demands made between 1 March 2020 and 30 September 2020 (though this period may be curtailed, or extended in connection with the COVID-19 crisis). This temporary suspension applies to all statutory demands (irrespective of whether the financial difficulties being experienced by the debtor are linked to the pandemic) and to all creditors, not just landlords.

The Act also introduces a temporary suspension on winding-up petitions based on cash flow insolvency in circumstances where COVID-19 has had a financial effect on the relevant debtor that has caused the grounds for the proceedings. As a result of this temporary suspension, a creditor requesting a winding-up order on grounds that a company is unable to pay its debts must demonstrate to the court that the company's inability to do so was not caused by the COVID-19 crisis. In current global circumstances, it will be hard in many cases to show that this requirement is met. Any winding-up orders made by the courts from 27 April 2020 but prior to the Act coming into force which do not meet this requirement will be void, and the petitioner can also be made liable for the costs of undoing the negative effects of such petitions. The Act also includes provisions allowing the court to make orders to restore a company's position where a petition was brought under the existing law but this requirement was not met (potentially at the cost of the petitioner).

### **Corporate Governance Measures**

The Act introduces provisions to provide respite to companies in relation to certain corporate governance matters:

- The Act temporarily allows those companies that are under a legal duty to hold an annual general meeting (AGM) to hold their AGMs electronically so as to adhere to social distancing, even if their constitution would not normally allow it. It also includes provisions which extend the deadline for holding AGMs currently scheduled to take place after 26 March 2020 to 30 September 2020 (or later, if the Secretary of State so decides).
- The demand for case-by-case extensions of filing deadlines from the Companies House registrar has increased substantially. The Act therefore also introduces provisions temporarily extending the deadline for public companies to file annual accounts and reports to the earlier of 30 September 2020, and the date falling 12 months after the end of the relevant accounting reference period.
- The provisions of the Act also enable the Secretary of State to make regulations to extend deadlines for the filing of accounts, confirmation statements and registrations of charges of all companies.

We are continuing to monitor closely developments in relation to the Act for our clients.

<sup>1</sup> It is not yet clear how this mechanism will work in the case of companies incorporated outside the UK

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