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Brave new world: what every commercial practitioner needs to know about the new corporate insolvency law

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Introduction

On 26 June 2020 the UK Corporate Insolvency and Governance Act 2020 ("CIGA") entered into force. It represents a radical change in English insolvency law in that (among other things):

- It restricts the rights of a party to terminate a contract for the supply of goods and services in the event of counterparty insolvency;
- It provides for the directors of an insolvent company to place it into a new moratorium procedure thereby prohibiting proceedings against the company and its assets and prohibiting any steps to "crystallise" floating charges (including, arguably, sub-freight liens). Moreover, during the moratorium the directors remain in control of the company.
- It temporarily suspends the efficacy and potency of statutory demands, and restricts the circumstances in which an insolvent counterparty can be wound up.

It is not an exaggeration to say that the new provisions are probably the most significant change in English insolvency laws for commercial lawyers in a generation. In this brief article we seek to highlight only some of the key points that are immediately relevant to commercial lawyers. We anticipate more detailed articles on the provisions of the Act will appear in a Quadrant Chambers special edition of Cross-Border Insolvency and International Trade Law in September 2020.

Termination of contracts in the event of insolvency

Four major points stand out as having a potentially immediate impact on commercial parties.

Firstly, "ipso facto" clauses are deprived of their efficacy. Such clauses are commonplace in all sorts of English law commercial contracts. They typically provide for the automatic termination or right to terminate upon counterparty insolvency. The new Act inserts a fresh provision into the Insolvency Act 1986 (section 233B(3)(a)-(b)). It provides that any term contained in a "contract for the supply of goods and services" shall cease to have effect if it provides, upon a counterparty entering into "an insolvency procedure," for:

- the termination of the contract or
- an entitlement to terminate the contract or
- "any other thing to take place"

This is a game-changing provision. Unusually for an English insolvency law, it changes the substantive terms of the contract freely agreed between the parties. The final limb – viz. "any other thing to take place" - is potentially very wide in its ambit and we anticipate it will be subject to significant refinement as the Courts and arbitrators come to grapple with its scope.

Secondly, any right of termination "under the provision of the contract" arising before the commencement of any insolvency procedure may not be exercised, irrespective of whether that right arose from an insolvency-related matter or not (section 233B). It is unclear whether termination arising from the renunciation of the contract by the insolvent counterparty pre-insolvency would be prohibited under section 233B.

Thirdly, contracts may be terminated after the counter-party enters into insolvency but only if the grounds for termination arise post-commencement of insolvency. We anticipate that there will be complex questions as to when grounds giving rise to a right to terminate can be said to have arisen.

Fourthly, it prohibits a party from insisting as a condition for continued supply that it be paid all of its outstanding charges by the insolvent counterparty.

As a counter-balance to the scope and effect of the provisions summarised above, the new Act contains the following

provisions:

» Certain types of contract are excluded from their scope (e.g. loan agreements, commodities agreements, certain Master Agreements, and derivative and spot contracts, among others).

» Certain types of entity are excluded from their ambit (e.g. insurers, deposit taking banks).

» There is a specific exclusion for matters concerning the International Interests in Aircraft Equipment (Cape Town Convention) Regulation 2015.

» There is a temporary exemption running to 30 September 2020 for certain small company suppliers (namely suppliers who meet two of the three following criteria – annual turnover of not more than £10.2M, a balance sheet of not more than £5M; or a company having less than 50 employees).

» A supplier may enforce a termination provision with the consent of the insolvent company's office-holder, the consent of the company or by court order upon a showing of hardship (which concept is not defined in the new Act).

One possibly unintended consequence of the new provisions is that foreign representatives seeking to have a foreign insolvency proceeding recognised in England under the Cross-Border Insolvency Regulations 2006 will now be able to argue much more cogently that any prohibition under the foreign insolvency law of an "ipso facto" clause should be given effect upon recognition in England of the foreign insolvency proceeding. We surmise that the outcome of ***Re Pan Ocean Co Limited*** [2014] EWHC 2124 (Ch), where the English Judge refused to give effect to such a provision of Korean insolvency law in the context of a long-term contract of affreightment subject to English law might now be decided differently.

The new moratorium provisions

The new moratorium provisions inserted into the Insolvency Act 1986 ("IA") by CIGA prevent certain creditors from taking enforcement action while the company's directors, overseen by a licensed insolvency practitioner called the "monitor", seek to trade the company out of insolvency and save it as a going concern. The moratorium provisions also change the repayment priorities if the company subsequently falls into liquidation, with those who extend credit to the company during the moratorium taking priority over floating charge holders, preferential creditors, and other unsecured creditors.

Generally, a moratorium can be obtained by the directors simply filing the relevant documents at court if the company is an "eligible company" as defined, if it is not subject to a winding up petition (although this provision is disapplied until 30 September 2020), and if it is not an overseas company. Otherwise, as long as it is an "eligible company", the directors have to apply to court for a moratorium. Eligible companies do not include, among others, banks, insurers, payment institutions and certain overseas companies.

The relevant documents that must be filed or produced as part of the application include a statement from the directors that in their view, the company is or is likely to become unable to pay its debts, and a statement from the proposed monitor that in his or her view, a moratorium would probably result in the rescue of the company as a going concern. The moratorium begins from the date on which the relevant documents are filed at court, or if an order is needed, the date on which the order is made. The directors should then inform the monitor, who, in turn, should inform all creditors.

A moratorium initially lasts for 20 business days. It can be extended for another 20 days without creditor consent, to one year from the start of the moratorium with creditor consent, or it can be extended by court order.

The company does not have to repay certain "pre-moratorium debts" while a moratorium is in place. "Pre-moratorium debts" are defined as debts or other liabilities that have fallen due before the moratorium, or that fall due during the moratorium by reason of an obligation incurred before the moratorium came into force. There are six exceptions to the payment holiday for pre-moratorium debts:

» The monitor's remuneration or expenses

» Goods or services supplied during the moratorium

- Rent in respect of a period during the moratorium
- Wages or salary arising under a contract of employment
- Redundancy payments
- Debts or other liabilities arising under a contract or other instrument involving financial services.

CIGA defines "moratorium debts" as debts or other liabilities to which the company becomes subject during the moratorium other than by reason of an obligation incurred before the moratorium came into force, or any debt or liability to which the company becomes or may become subject after the end of the moratorium by reason of an obligation incurred during the moratorium. Generally, the company must continue to pay "moratorium debts" throughout the moratorium.

The monitor must bring the moratorium to an end if "moratorium debts" and the excepted "pre-moratorium debts" are not paid and the monitor thinks the company is unable to pay them, although enforcement action cannot be taken in respect of such debts while the moratorium is ongoing.

During the moratorium, among other matters:

- No petition may be presented for the winding up of the company other than by the directors.
- No administration may be applied for in respect of the company save by the directors.
- A landlord may not exercise a right of forfeiture by peaceable re-entry of premises let to the company, except with a court order.
- No steps may be taken to enforce security over the company's property (subject to certain exceptions).
- No steps may be taken to repossess goods in the company's possession further to any hire purchase agreement, save with court permission.
- No legal process, including proceedings or execution, may be carried out or continued without the court's permission, except employment tribunal proceedings or any legal process arising out of such proceedings, or such proceedings involving a claim between an employer and worker.

Those who continue to extend credit to a company in a moratorium are rewarded in that moratorium debtors and pre-moratorium debtors who are not subject to the payment holiday are given priority if the company enters into liquidation or administration within 12 weeks after the end of the moratorium. Such debtors rank below fixed charge holders, but above the expenses of the subsequent insolvency procedure, floating charge holders and preferential creditors.

One of the key provisions introduced by CIGA is that floating charges cannot be crystallised while a moratorium is ongoing, although there are certain financial market exceptions.

There are a number of potential ways out of a moratorium. It can be brought to an end if the company enters into a consensual debt restructuring or a relevant insolvency procedure, which includes a voluntary arrangement, administration or liquidation. It can also be brought to an end by the monitor or the court, or simply by reason of the time limit for the moratorium expiring.

Changes to use of statutory demands and presentation of winding up petitions

The restrictions on serving statutory demands and presenting winding up petitions are temporary and presently expire on 30 September 2020 with the power to extend beyond that date. They also have retrospective effect – this part of the Act is to be regarded as having come into force on 27 April 2020.

A winding up petition cannot be presented after 27 April 2020 in respect of a statutory demand served between 1 March 2020 and 30 September 2020 (the "relevant period"). The restriction applies equally to companies incorporated in and outside England and Wales (to the extent the English Court has jurisdiction over the foreign company). Unlike the changes to winding up petitions, the prohibition is absolute and there is no carve out for debtor companies unaffected by coronavirus.

Further, a creditor cannot petition for the winding up of a company on the ground it is insolvent (either on a cash flow or

balance sheet basis) unless the new "coronavirus test" is satisfied. This test places an onerous burden on the Petitioning Creditor to demonstrate that it has reasonable grounds for believing that:

(a) coronavirus has not had a financial effect on the company, or

(b) the company would have been insolvent (either on a cash-flow or balance sheet basis) even if coronavirus had not had a "financial effect" on the company.

Any winding up order on the basis that a company is unable to pay its debts made between 27 April 2020 and 25 June 2020 is void if it would not have been made because the coronavirus test would not have been satisfied.

There is a new insolvency practice direction relating to CIGA 2020 (published on 3 July 2020), which makes significant amendments to the relevant procedure. This makes significant changes to the hearing and determination of petitions. In particular, they will initially be treated as private and should not be advertised until the Court directs.

Conclusion

The new Act marks a radical change to English insolvency law that will impact on many aspects of commercial law both in England and further afield. In some respects it marks a significant step towards more debtor-friendly insolvency regimes where the concepts of substantively changing the terms of a contract by reason of an event of insolvency or allowing directors to manage companies in insolvency are not alien. How far these changes will lead to a significant re-drafting of commercial terms or, more generally, lead to a recalibration of creditor / debtor negotiations both pre- and post-insolvency remains to be seen. There is, however, no doubt English insolvency law is entering into a brave new world.

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"He is excellent - tactically astute, client-friendly and knowledgeable."

(Legal 500, 2020)

Jeremy specialises in commercial and modern chancery law. He is ranked as leading barrister for Commercial Litigation and Insolvency in The Legal 500 2020 and has been described in Chambers and Partners as a "superb advocate" whose "expertise in chancery, commercial and banking matters is a useful complement to his insolvency skills".

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"Very hands-on and user-friendly, she is a real team player and integrates very well." (Legal 500, 2020)

Nicola specialises in civil fraud, insolvency, company law (particularly shareholder disputes) and banking litigation. Nicola's practice has a strong international element; she was called to the Bar of the BVI in 2012, in the Cayman Islands in 2016 (limited admission) and many of her cases raise cross-border and jurisdictional issues. Nicola has a wealth of trial experience both as sole counsel and as part of a team.

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"Has a razor-sharp mind and a prodigious work ethic. Her ability to review, analyse and interrogate vast quantities of information is remarkable."

(Chambers UK, 2020)

Emily is a commercial litigator with a particular specialism in commercial fraud, and banking and finance. She has broad experience in obtaining urgent injunctive relief including freezing orders, search orders, asset preservation orders and delivery up orders. Emily's banking and finance practice has an emphasis on financial derivatives instruments, and standard form contracts including the ISDA Master Agreement.

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