ARTICLE

Winding-Up in the Post CIGA World

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Synopsis

The Corporate Insolvency and Governance Act ('CIGA') which came into force on 26 June 2020 represents one of the biggest changes to the insolvency law of England and Wales in two decades.

This Article focuses on the significant changes contained in schedule 10 of CIGA relating to statutory demands and winding-up petitions and the recent decision in *In Re A Company* [2020] EWHC 1551 (Ch). It also touches upon the new procedure as laid down in the Insolvency Practice Direction relating to the Corporate Insolvency and Governance Act 2020 which was published on 3 July 2020.

Important timing points

Before turning to the specific provisions of schedule 10 of CIGA, two general points are noteworthy. First, the changes brought about by schedule 10 are temporary and presently expire on 30 September 2020. However, the Secretary of State has power to extend beyond that date for up to a further six months if necessary. Secondly, practitioners should not assume that because the changes came into force on 26 June 2020 that they apply from that date as the restrictions imposed by schedule 10 have retrospective effect.

The end of the statutory demand?

The effect of paragraph 1(1) of schedule 10 of CIGA is that a winding-up petition cannot be presented on or after 27 April 2020 based upon a statutory demand served between 1 March 2020 and 30 September 2020. This provision is to be regarded as having come into force on 27 April 2020. This prohibition is absolute – there is no carve out for debtor companies unaffected by coronavirus.

It is doubtful that this provision in isolation will have a far-reaching effect. This is because, unlike its equivalent in bankruptcy, the statutory demand has never been a central feature of corporate insolvency law. An unsatisfied statutory demand provides one circumstance in which a company is deemed, under section 123(1) of the Insolvency Act 1986 ('the IA 1986') as unable to pay its debts.

A company will also be deemed unable to pay its debts, if it is proved to the satisfaction of the court that it is insolvent on a cash flow or balance sheet basis: that is, if it is proved to the satisfaction of the court 'that the company is unable to pay its debts as they fall due' (section 123(1)(e) of the IA 1986) or 'that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities' (section 123(2) of the IA 1986).

It remains open to a creditor to send a letter demanding payment of a debt and to present a petition otherwise than in reliance upon a statutory demand. However, the circumstances in which such petition may be presented and a winding-up order made have been significantly curtailed by schedule 10 of CIGA.

Restrictions on winding-up petitions

A creditor may not, between 27 April 2020 and 30 September 2020, petition for the winding up of a company on a ground specified in section 123(1)(a) to (d) of the IA 1986 unless the 'coronavirus test' is satisfied (CIGA schedule 10 para. 2(1)). Similarly, a creditor may not, between 27 April 2020 and 30 September 2020, 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 'coronavirus test' is satisfied (CIGA schedule 10, para. 2(2)). Parallel restrictions in respect of the winding up of unregistered companies are contained in paragraph 3 of schedule 10.

So, what is the coronavirus test? The wording is slightly different depending on which ground of the IA 1986 is relied upon, but the substance is the same. The creditor must have reasonable grounds for believing that:

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

(b) the facts by reference to which the relevant ground applies would have arisen [or the relevant ground would apply] even if coronavirus had not had a financial effect on the company.

Paragraph 21(3) of schedule 10 provides that, 'coronavirus has a "financial effect" on a company if (and only if) the company's financial position worsens in consequence of, or for reasons relating to, coronavirus.'

It will be a rare case in which a creditor is able to demonstrate reasonable grounds for believing that coronavirus has not had a financial effect on the company given the breadth of the definition in paragraph 21. It will be easier for a creditor to bring itself within sub-paragraph (b). In this regard, timing is likely to be critical. If the debt arose long before coronavirus took hold, the creditor will have a better prospect of demonstrating that the company was and is insolvent absent coronavirus. The recent decision of ICC Judge Barber in *In Re a company* [2020] EWHC 1551 (Ch), discussed below, sheds some light on how the Court is likely to approach the coronavirus test.

Winding-up petitions: transitional provision

Paragraph 4 of schedule 10 applies where a creditor presents a petition under section 124 of the IA 1986 between 27 April 2020 and 25 June 2020.

If the court to which the petition is presented is satisfied that the creditor presented it in the absence of the coronavirus test being met, the court may make such order as it thinks appropriate to restore the position to what it would have been if the petition had not been presented. The form this order will take is unclear. Presumably at the very least the petition will be dismissed, or perhaps deemed withdrawn if the creditor so indicates. If the company has incurred any costs in defending the petition, it seems likely that the petitioner will be ordered to pay these.

Restrictions on winding-up orders

Paragraph 5 of schedule 10 applies where:

(a) a creditor presents a winding-up petition under section 124 of the IA 1986 between 27 April 2020 and 30 September 2020;

(b) the company is deemed unable to pay its debts on a ground specified in section 123(1) or (2) of the IA 1986; and

(c) it appears to the court that coronavirus had a financial effect on the company before the presentation of the petition (CIGA schedule 1, paragraph 5(1)).

Where those three conditions are met, the court's power to wind up a company is restricted. It may wind the company up under section 122(1)(f) of the IA 1986 on a ground specified in section 123(1)(a) to (d) of that Act only if satisfied that the facts by reference to which that ground applies would have arisen even if coronavirus had not had a financial effect on the company (CIGA schedule 1, paragraph 5(2)). It may make a winding-up order on a ground specified in section 123(1)(e) or (2) of the IA 1986 only if satisfied that the ground would apply even if coronavirus had not had a financial effect on the company (CIGA schedule 1, paragraph 5(3)).

The operation of this provision in practice is analysed below in the context of the decision in *In Re a company*.

Winding-up order: transitional provision

Any winding-up order made between 27 April 2020 and 25 June 2020 on the basis that a company is unable to pay its debts is to be regarded as void if it would not have been made because the coronavirus test would not have been satisfied (CIGA schedule 10, paragraph 7).

The wording of this provision suggests that it is intended to have automatic effect. However, one can readily see the benefit, in terms of certainty, of applying to the Court for a declaration that a winding-up order is void. It seems likely such an application will be necessary in any event, to deal with issues such as the status of any transactions entered into by the Liquidator and the Liquidator's costs. Paragraph 7(4) of schedule 10 provides that, 'The court may give such directions to the official receiver, liquidator or provisional liquidator as it thinks fit for restoring the company to which the order relates to the position it was in immediately before the petition was presented.'

In Re A Company – an application of the coronavirus test

On 16 June 2020, ICC Judge Barber handed down judgment in *In Re A Company* [2020] EWHC 1551 (Ch), which concerned an application by the company to restrain the advertisement of an extant petition (presented on 13 May 2020 based on a stat demand served on 27 March 2020) and the presentation of a further petition. Although the case was decided before CIGA came into force, it was common ground that the Court should have regard to the provisions of the then Corporate Insolvency and Governance Bill in deciding whether to exercise its discretion to restrain advertisement and presentation. Paragraph 1 of schedule 10 was fatal to the petition as it was founded on a statutory demand served during the relevant period. However, the Court accepted that the petitioner would be able, instead, to rely on a pre-action letter and if necessary, amend the petition to make it clear that it was based on s.123(1)(e) of the IA 1986.

The Court, therefore, considered whether the coronavirus test was met in relation to the presentation of the petition: namely, whether the petitioner

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could show that, as at the date of presentation, it had reasonable grounds for believing (a) coronavirus had not had a financial effect on the company, or (b) that s.123(1)(e) would apply even if coronavirus had not had a financial effect on the company.

The petitioner accepted that it could not come within paragraph (a). However, the Court accepted that the petitioner satisfied paragraph (b). Key in the Court's decision was that the loan which gave rise to the petition debt was due for repayment on 22 January 2019 which, as the Court said, was 'long before Covid-19 hit.' Further, rather than repay the loan on the repayment date, the company reached an agreement with the petitioner pursuant to which the company was to make interest payments. The company did not make the interest payments, which suggested ongoing significant cashflow problems. By letters starting in December 2019 and culminating in a formal demand letter dated 24 January 2020, the petitioner enquired and latterly demanded repayment of the debt, which letters were met with silence or holding responses. It was not until 16 April 2020, almost three months following the formal demand for repayment that the company wrote to its creditors, including the petitioner, effectively blaming coronavirus for its financial problems. The Court accepted that the petitioner was entitled to view the April communication as 'something of an opportunistic attempt to jump on the Covid bandwagon.'

That was not the end of the matter, as the Court had to consider whether the petition would be likely to result in a winding-up order, having regard to paragraph 5 of schedule 10. The first two conditions in paragraphs 5(1)(a) and (b) were clearly met: the petition had been presented in the relevant period and the company was deemed unable to pay its debts on a ground specified in section 123(1) of the IA 1986.

In relation to the third condition, the Judge noted that the burden was on the company to demonstrate that coronavirus had had a financial effect on the company. That was clearly intended to be a low threshold; the requirement is simply that 'a' financial effect must be shown: it is not a requirement that the pandemic be shown to be the, or even a, cause of the company's insolvency. Moreover, the language of that provision, which requires only that it should 'appear' to the court that coronavirus had 'a' financial effect on the company before presentation of the petition, is in marked contrast to that employed in paragraph 5(3), where the court is required to be 'satisfied' of given matters. The term 'appears' must be intended to denote a lower threshold than 'satisfied'. Taking all that into account, the Judge held that the evidential burden on the company for these purposes must be to establish a prima facie case, rather than to prove the 'financial effect' relied upon on a balance of probabilities.

The evidence before the Court was that the company was not solvent for its day to day operations but relied on rolling over corporate debt and fund-raising by the issue of equity for its long-term financing. The company said that COVID-19 had prevented both routes to acquiring new financing as international capital markets had frozen. According to the company, it had agreements in principle for significant capital financing, all of which fell away in March 2020 when the coronavirus crisis ensued. Although the Court expressed some reservations regarding the quality of the company's evidence, it was satisfied that the company met the relatively low threshold in paragraph 5(1)(c).

This meant that the test in paragraph 5(3) fell to be applied and that the Court was only able to wind up the company if satisfied that the relevant ground, in that case s.123(1)(e) would apply even if coronavirus had not had a financial effect on the company. The burden was on the petitioner to show that even if the financial effect of coronavirus was ignored, the company would still be insolvent. The petitioner was unable to discharge that burden because the company's re-financing efforts had been hampered by coronavirus.

The facts of *In Re a Company* demonstrate the difficulty of fulfilling the coronavirus test in relation to the making of a winding-up order. Notwithstanding that the evidence was consistent with the company being insolvent pre-COVID, the company's ability to return to solvency had been thwarted by COVID-19.

A new insolvency commencement date

In respect of winding-up petitions under s.124 of the IA 1986 presented between 27 April 2020 and 30 September 2020 which result in a winding-up order, the winding up is deemed to commence on the making of the winding-up order rather than at the time of the presentation of the petition (CIGA, schedule 10, paragraph 9). This amendment is significant because the presentation of a petition would normally lead to the freezing of the company's bank account by reason of section 127 of the IA 1986 and the need to apply for a validation order in the event that the company wished to continue to trade or to dispose of any property. This amendment strips s.127 of any potency and removes the need to apply for a validation order. It also changes the commencement date to the date of the winding-up order for the purpose of antecedent transactions such as preferences and transactions at an undervalue.

The new practice direction

A new insolvency practice direction relating to CIGA 2020 was published on 3 July 2020. This makes significant amendments to the relevant procedure for the hearing and determination of petitions. It is suggested that practitioners read the new PD in full. The following are its key features:

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- There will be an initial review of the petition when it is sent to the Court and it will not be accepted for filing unless it contains a statement that the creditor has reasonable grounds for believing that the coronavirus test is satisfied along with a summary of the grounds relied upon by the petitioner.
- The petition will initially be treated as private and should not be advertised until the Court directs.
- Upon being issued, the petition will be listed for a non-attendance pre-trial review with a time estimate of 15 minutes for the first available date after 28 days from its presentation.
- The purpose of the non-attendance pre-trial review is to enable the Court to give directions for a preliminary hearing or, in the event the company does not oppose the petition and the Court is likely to may make a winding-up order having regard to the coronavirus test, to list the petition for further hearing in the winding-up list.
- The parties may file evidence in accordance with the time limits specified in the PD to be relied upon at the preliminary hearing.
- At the preliminary hearing, if the Court is not satisfied it is likely it will be able to make a winding-up order having regard to the coronavirus test, it shall dismiss the petition. If the Court is satisfied that it is likely it will be able to make a winding-up order having regard to the coronavirus test, it shall list the petition for hearing in the winding-up list.

Concluding comment

The reforms introduced by CIGA certainly seem to mark the start of a more debtor friendly regime. It remains to be seen just how friendly. One thing is clear at this stage: given the new restrictions introduced by schedule 10 and the steps detailed in the Practice Direction, practitioners can expect that it will take considerably longer for petitions presented during the relevant period to be determined.

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