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A FREESTANDING MORATORIUM AND CROSS-CLASS CRAM-DOWN: FEATURES OF THE NEW UK INSOLVENCY LAW

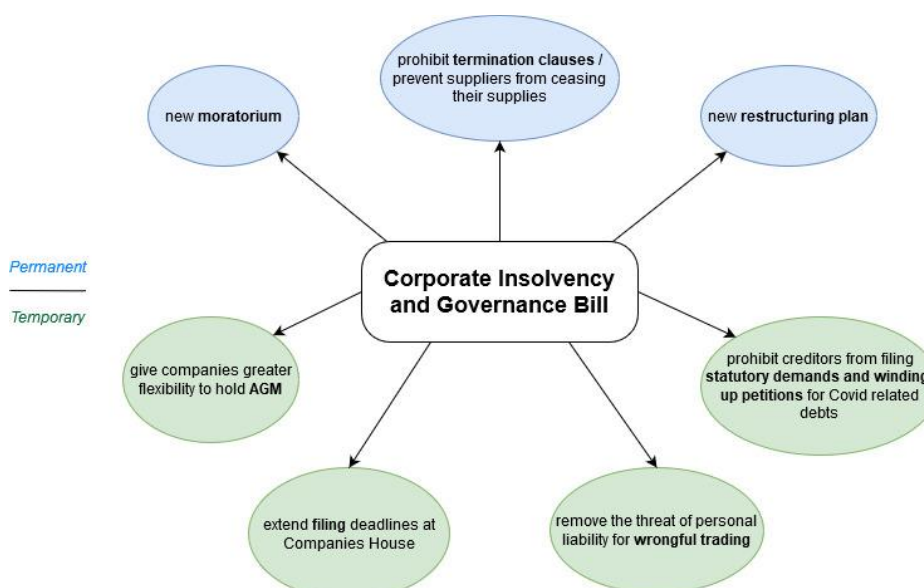
Introduction

The Corporate Insolvency and Governance Bill (the "Bill") was introduced in the House of Commons on 20 May 2020. The Government had already announced plans to introduce new insolvency restructuring measures in August 2018. On 28 March 2020, in light of the COVID-19 outbreak, the Business Secretary announced that the Government would introduce these measures at the earliest opportunity, together with temporary COVID-19-related measures to protect companies from the aggressive use of statutory demands and winding-up petitions. As such, the Bill consists of permanent and temporary changes to insolvency law and corporate governance. For more information on temporary measures and applicable extensions and deadlines, please see: The Corporate Insolvency and Governance Bill Temporary Measures.

The Department for Business, Energy & Industrial Strategy describes the three main objectives of the Bill as follows:

- introduce new corporate restructuring tools to the insolvency and restructuring regime to give companies the breathing space and tools required to maximise their chance of survival;
- temporarily suspend parts of UK insolvency law to allow directors to continue trading through the emergency without the threat of personal liability for wrongful trading and to protect companies from creditor action; and
- amend company law and other legislation to provide companies and other bodies with temporary easements on company filings and AGMs.

Permanent and temporary changes to insolvency law and corporate governance



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Moratorium ("A breathing space")

Most notably the Bill introduces the concept of a freestanding moratorium for UK companies. The aim is to provide UK-incorporated companies in financial distress a breathing space during which enforcement action cannot be taken. The Government has provided a case study to illustrate how the newly introduced moratorium will work in practice.

Who is eligible?

The moratorium will apply to most UK-incorporated firms, except financial services companies. To protect creditors' interests and avoid abuse, a moratorium will not be available to a company which has entered into a moratorium, administration, or a CVA within the preceding twelve months, or is subject to a winding-up order.

How long does a moratorium last?

A moratorium lasts for an initial period of 20 business days. During that period the directors remain in control of the company but under the supervision of a licensed practitioner who will act as a monitor. Throughout the moratorium period the monitor will assess whether there continues to be a prospect of the company being rescued.

The company's directors can extend this initial period for a further 20 business days, or a longer period with the agreement of the company's creditors or the court. In order to request an extension the directors will need to file with the court certain documents, including a statement from the monitor that it is likely that the moratorium will result in the rescue of the company.

How do companies obtain a moratorium?

Companies can apply for a moratorium even if they are subject to an outstanding winding-up petition (i.e. if a petition for winding up has been presented and not withdrawn or determined). In order to obtain a moratorium, a company will have to file the following documents with the court:

- a notice that the directors wish to obtain a moratorium;
- a statement from a qualified person[1] (the "proposed monitor") that the person:
  - is a qualified person; and
  - consents to act as the monitor in relation to the proposed moratorium;
- a statement from the proposed monitor that the company is an eligible company;
- 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 their view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern.

[1] an insolvency practitioner

Directors of a company that is subject to an outstanding winding-up petition will have to apply to court for a moratorium. When deciding whether to grant an application, the court will consider the impact of the moratorium on the company's creditors. It will only make an order if it is satisfied that a moratorium for the company would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being subject to a moratorium). Entering into moratorium gives rise to notification obligations; the company's directors must notify the monitor of the moratorium, and they in turn must notify the Registrar of Companies and every creditor of the company.

What is the Impact on Creditors?

The aim of the moratorium is to facilitate the eventual rescue of the company, which might take the form of a company voluntary arrangement (CVA), a restructuring plan, or simply an injection of new funds.

The moratorium will impose some restrictions on creditors and may run against their interests. During the moratorium period, no insolvency proceedings can be commenced against the company.

Further, except with the leave of the court, no steps may be taken to enforce any security over the company's property or repossess any goods in the company's possession under any hire-purchase agreement.[2] It is possible for the company to dispose of property subject to a security interest with the permission of the court. However, it is a condition of the permission that the net disposal proceeds (which the court may determine as the net amount that would be realised on the sale of the property at open market value) are applied towards discharging the sums secured.

No other proceedings or legal processes can be commenced or continued during a moratorium, except those before an employment tribunal, those relating to claims between an employer and a worker, or those to which the court expressly consents (which will not include proceedings for the enforcement of pre-moratorium debts for which the company has a payment holiday).[3]

The moratorium also prevents a landlord from exercising its right of forfeiture in relation to premises let to the company, except with the leave of the court. Further, while a moratorium is in force, a floating charge cannot crystalise and restrictions cannot be imposed on the disposal of any of the company's property.

During the moratorium, a company can only grant security with the consent of the monitor. In reaching its decision the monitor will consider whether the security supports the rescue of the company as a going concern.

The moratorium also imposes restrictions on the company. The directors have limited powers to enter into transactions, to make payments and dispose of properties.

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[2] Some exceptions apply i.e. a security can be enforced if it is a security created under a financial collateral arrangement or a step to enforce a collateral security charge.
[3] Pre-moratorium debts are debts that have fallen due before the moratorium or fall due during the moratorium, other than amounts payable in respect of: (a) the monitor's remuneration or expenses, (b) goods and services supplied during the moratorium, (c) rent in respect of a period during the moratorium, (d) wages or salary arising under a contract of employment, (e) redundancy payments, or (f) debts or other liabilities arising under a contract or other instrument involving financial services.

The insolvency reforms proposed by the Government in 2018 included provisions that would prevent creditors, comprising secured creditors, from taking action against a company while it considered its options for rescue.

The 2018 consultation considered the strengths and weaknesses of the moratorium from a creditor's perspective.

Strengths	Drawbacks
▪ Encourages directors to act earlier to tackle financial difficulties. ▪ Facilitates the rehabilitation and rescue of companies in the longer term, thereby preserving value and safeguarding jobs. ▪ CVA moratoria have been criticised for being available only to small companies. Lifting size restrictions to allow medium and large-sized companies to use CVA moratoria should be welcomed. ▪ The non-availability of moratorium results in companies resorting to making repeated notices of intention to appoint an administrator in an attempt to achieve a breathing space by benefiting from the interim moratorium provisions. ▪ Enhances the possibility of company rescue by providing time and space to consider available options when most needed.	▪ Moratorium could be abused, especially by businesses with no realistic prospect of rescue. (In response to this issue, the Bill provides that moratoria should exclude companies that are already insolvent. Companies which have, in the previous 12 months, entered in a moratorium, an administration, a CVA, or have been the subject of a petition for winding up are all excluded.) ▪ Concerns that the suspension of creditors' rights of enforcement would not offer adequate protection and safeguards for creditors. These concerns included: o the proposed length of the moratorium (28 days was proposed as an initial period in 2018); o supervision of the company during the moratorium; and o the position of the creditors, suppliers and employees as the moratorium runs its course. ▪ Knock-on insolvencies for creditors impacted by the moratorium.

The New Restructuring Plan

The Bill unveils a new restructuring plan modelled on the existing schemes of arrangement procedure and adding a "cross-class cram-down" feature, drawing inspiration from U.S. Chapter 11 proceedings.

This new flexible procedure is a welcome addition to the already existing CVAs and schemes of arrangement restructuring procedures - addressing shortcomings in the existing UK insolvency framework, such as the inability to impose a restructuring plan upon dissenting creditors and members.

The new restructuring plan was first suggested in a consultation paper published in May 2016, as part of "A Review of the Corporate Insolvency Framework".

Who is eligible?

No financial conditions need to be met to qualify for this restructuring plan - the company does not need to be insolvent to propose a plan - enabling directors to anticipate difficulties before they arise and encouraging earlier action.

Additionally, as with schemes of arrangement, eligible companies do not need to have their centre of main interests in the UK - enabling non-UK companies to use this procedure, provided that they have a "sufficient connection" to this jurisdiction.

The company, any creditor or any shareholder may propose a restructuring plan. It is designed to be extremely flexible, allowing companies to contemplate a wide range of potential restructuring outcomes and to determine the time period of the restructuring plan.

The process will closely mirror that of schemes of arrangement, benefitting from an already long-established and tested body of case law that courts will be able to draw upon when dealing with new restructuring plans.

Who has a say on the restructuring plan?

Every creditor or member of the company whose rights are affected by the plan must be permitted to vote on it.

However, an application can be made to the court to exclude a class of creditors or members if the court is satisfied that none of the stakeholders in this class has a "genuine economic interest in the company".

Creditors and members will vote on the company's proposed restructuring plan in separate classes, based on commonality of rights. The similarity of the restructuring plan concept to the existing schemes of arrangement will enable the courts to draw on extensive case law on class rights when they have to consider these issues.

For each separate class of creditors or members to agree on a restructuring plan, at least 75% in value of those present and voting must vote in favour, which is notably higher than the 2/3 majority required under US Chapter 11 proceedings.

What is a cross-class cram-down?

The Bill introduces a new "cross-class cram-down" feature that allows a company to bind all creditors to a restructuring plan, including dissenting senior or junior classes of creditors even if they vote against the plan.

Crucially, even if one or more classes has not reached 75% in favour, the court can still confirm the plan, provided that:

- the court is satisfied that none of the members of the dissenting class would be any worse off under the plan than they would be in the event of the "relevant alternative"; and

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- at least one class who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative, has voted in favour.

Conversely, the court has absolute discretion over whether to refuse to confirm a plan, even though all requirements have been fulfilled.

Therefore, the court may have to consider different "relevant alternatives" and consider valuation evidence in the most likely scenario. The "relevant alternative" is the outcome the court considers to be the most likely to occur if the plan was not to be sanctioned.

Earlier suggestions to inject flexibility into the 'absolute priority rule' ("APR") contained in Chapter 11 of the US Bankruptcy Code do not explicitly appear in the draft Bill. The APR provides that the claims of a class of creditors must be satisfied in full before any claims of a class of more junior creditors to that class may be paid. However, there is no express requirement for a plan to follow the established APR. Indeed, the Government stated its intention to permit the court to confirm a restructuring plan even if it does not comply with the APR if non-compliance is necessary to achieve the aims of the restructuring and it is just and equitable in the circumstances.[4]

[4] Insolvency and Corporate Governance, Government response, 26 August 2018, pages 72-73.

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