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In Practice

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CIGA Report March 2022: assessing the impact of the new insolvency provisions

KEY POINTS

- The Part 26A restructuring plan has been broadly welcomed, with the 'cross-class cram down' seen as an essential addition to the restructuring toolkit, if the UK is to maintain its international status as a restructuring jurisdiction. Cost is the main limiting factor, with the cost of challenge also an issue for creditors.
- The Part A1 freestanding moratorium may offer a useful breathing space for essentially solvent companies to pursue a going concern rescue. However, the conditions for entry significantly limit the extent to which it may be used, and the introduction of a new category of 'super-priority' liabilities in any subsequent insolvency procedure is of real concern.
- It is too early to assess the impact of the restrictions on contractual '*ipso facto*' termination clauses due to government support during the pandemic. They may reduce IP time spent in negotiating with key suppliers, but suppliers may be willing to risk non-compliance.

On 21 June 2022, the government published an interim report (the 'Report') on its review of the three permanent measures introduced by the Corporate Insolvency and Governance Act 2020 ('CIGA'). Arguably, the full impact of the amendments to the Insolvency Act 1986 ('IA 86') and Companies Act 2006 ('CA 2006') is yet to be felt, with corporate insolvencies having been artificially suppressed by government support during much of the period since CIGA came into force on 26 June 2020. However, the Report, based on research by the University of Wolverhampton, finds these measures have been positively received overall, whilst also identifying some areas of potential difficulty that could impact their practical use and take up.

THE RESTRUCTURING PLAN

In high value restructurings, the restructuring plan created under Part 26A of CA 2006 ('RP') has been readily adopted as an alternative to the scheme of arrangement under Part 26 of CA 2006 ('Scheme'). The introduction of the 'cross-class cram down' under s 901G CA 2006 ('CCCD') gives scope for an RP to succeed where a Scheme would have failed. In brief, the CCCD allows for a dissenting class of creditors to be overruled or 'crammed down' where two conditions are met:

(1) None of the members of the dissenting class of creditors would be worse off in the relevant alternative (which is likely to involve another insolvency procedure); and

(2) The RP has been agreed by 75% in value of a class of creditors who would receive a payment, or have a genuine economic interest in the company, in the relevant alternative.

The explanatory note to CIGA confirmed that Part 26A was 'largely modelled' on a Part 26 Scheme, and the intent was for the overall commonality between the two procedures to enable courts to draw on existing Part 26 case law where appropriate. The Report notes that this familiarity, together with the extensive experience of the High Court judiciary in relation to Schemes, has contributed to the success of the RP at the top end of the market.

However, comparisons with similar procedures in other jurisdictions led some respondents to suggest that the RP could be made more competitive by lowering the consent threshold (currently 75% by value) and reducing the number of court hearings required. The Dutch *Wet homologatie onderhands akkoord* ('WHOA') was praised for having a consent threshold of two-thirds with a single court hearing required, whilst the German *Insolvenzplan* requires a simple majority.

COST AND FAIRNESS

The cost of an RP is a significant barrier to usage and is thought to have largely prevented the SME sector from engaging with the measure. According to the Report, the turnover of companies applying for a RP has varied from £27m to £3bn, with the majority having a turnover of over £100m. However, the sanction of the first 'mid-market' RP (*Re Amicus Finance plc* [2021] EWCH 3036 (Ch)) indicated there could be potential for wider application and, as this article was going to press, the first RP for an SME was sanctioned (*Re Houst Ltd* [2022] EWHC 1941 (Ch)).

Some respondents said that dispensing with the convening hearing in favour of a single sanction hearing, or having a 'two-track' process with only a single hearing required in straightforward cases, would reduce cost and be more appropriate for smaller companies. However, it seems more likely that any reduction in costs will instead be driven by increasing efficiencies in drafting and simplified documentation. The introduction of a 'standard form' RP may make the procedure more accessible to SMEs – similar to the R3 template for CVAs, which is thought to have made a significant difference to the practical use of that procedure.

The difficulty and expense of challenging a RP is also seen as an issue, potentially disenfranchising all but the largest of creditors and meaning that in many cases an RP is effectively 'unchallengeable'. The Report notes a perceived problem with asymmetry of information, making it hard for creditors to put forward an alternative. Creditors may not have access to commercially sensitive information about the company, or receive information at too late a stage to refute the company's evidence. The Report suggests that improvements to transparency and disclosure options could be considered. Valuation evidence is seen as a particular source of expense, and the suggestion of a joint independent expert on valuation, appointed by the court, is an interesting one which could assist all parties.

THE MORATORIUM

In contrast to the RP, the freestanding moratorium under Part A1 IA 86

In Practice

Biog box

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is viewed as almost exclusively a small company procedure; in part due to the eligibility criteria, which excludes companies that are party to a capital market arrangement in which they have incurred a debt of at least £10m. The Report notes that this rules out not only large companies, but also many companies in the mid-market and even larger SMEs.

One issue raised regarding the Part A1 moratorium is the limited circumstances in which it might be used in practice. Proposed monitors must be willing to make the necessary statement that, in their view, it is likely that the moratorium would result in the rescue of the company as a going concern. The company must also be able to continue paying certain obligations during the moratorium period, including moratorium debts (as defined in s A53), and certain pre-moratorium debts for which there is no payment holiday as defined in s A18(3) including goods and services supplied during the moratorium; rent for the moratorium period; employee wages; and debts arising under a financial services contract.

However, the policy objective of the moratorium was to give essentially viable (solvent) companies the opportunity to explore rescue options, and these requirements should be viewed in this context. This overarching policy objective is also the reason why debts under contracts involving 'financial services' are excluded from the payment holiday under the moratorium – to avoid lenders being discouraged from lending to a company in a moratorium, therefore reducing the likelihood of rescue.

This 'financial services' exception was considered in *Re Corbin & King Holding Ltd* [2022] EWHC 340 (Ch): notwithstanding that the companies were subject to the moratoria in force, they remained bound to pay sums for which they were liable under guarantees (being contracts involving financial services) as and when they fell due for payment. However, it is noted in the Report that there is a lack of clarity around the definition of 'financial services' for the purpose of this exception – eg, it is not clear whether it would include payments under hire purchase contracts.

ALTERATION OF PRIORITIES

The aspect of the moratorium which continues to cause the greatest concern (and, it is surmised, hinders uptake) is the alteration of the relative priority of creditors in a subsequent insolvency proceeding. By way of reminder, CIGA introduced s 174A and para 64A of Sch B1 to the IA 86, which provide respectively that where a company enters into winding up proceedings or administration within 12 weeks of a moratorium coming to an end, 'moratorium debts' and 'priority pre-moratorium debts' will be payable ahead of all other liabilities. In other words, they will gain super-priority, ahead of office-holders' fees and expenses, and the claims of any floating chargeholder.

Broadly, 'moratorium debts' refers to any debts arising in relation to obligations incurred during the moratorium period, whilst 'priority pre-moratorium debts' refers to certain obligations incurred before the moratorium period (and is slightly narrower than the category of 'pre-moratorium debts for which there is no payment holiday', referred to above). 'Priority pre-moratorium debts', as defined in s 174A(3), include the monitor's remuneration or expenses; rent for the moratorium period; wages and salary relating to employment before or during the moratorium; redundancy payments; and debts arising under a contract involving financial services which fell due before or during the moratorium (save where it fell due as a result of acceleration or early termination).

The consequences of these provisions are described as 'potentially absurd' by the authors of the Report. The disruption to the usual order of priority could, for instance, result in a situation where, an unsecured lender (potentially one connected with the insolvent company) leapfrogs the floating chargeholder. The Report gives the hypothetical example of company directors, who have not drawn salary for a year prior to a moratorium, gaining super-priority in a subsequent liquidation – ahead of the liquidator's own fees and expenses – for the full amount of their unpaid salary up to the end of the moratorium.

Unsurprisingly, this alteration of priorities has led to a reluctance among IPs to recommend a moratorium where there is any risk of a subsequent administration or liquidation. To encourage the use of the moratorium (and remove the risk of manipulation by creditors to gain super-priority), the Report concludes that there is a strong argument for revisiting these provisions and reinstating the usual order of priority of liabilities in any post-moratorium liquidation or administration.

SUSPENSION OF '*IPSO FACTO*' CLAUSES

The final measure considered by the Report was the introduction of s 233B to the IA 86. This provides that '*ipso facto*' clauses (ie clauses which allow the contract to be terminated, or any other step taken, as a result of the other party's insolvency) in supply contracts cease to have effect, where a company enters into a relevant insolvency procedure. Although the Report finds that it is too early to assess the effect of the measure, the provision is considered likely to bring increased certainty to supplier relations and reduce the time and fees incurred by IPs in negotiating with suppliers.

However, the Report also acknowledges that enforcement of the measure may be difficult, as there are no clear consequences of non-compliance. In practice, a supplier may be willing to take the risk and call the IP's bluff, in the knowledge that in most cases they are unlikely to take legal action. There is also a risk that suppliers will be advised to terminate their supply earlier than they otherwise might have (if their contractual terms allow), to avoid the effects of s 233B.

FINAL THOUGHTS

It is clear from the Report that the RP has been the runaway success of the CIGA provisions to date. Whilst the procedure could be made more cost-effective, the bottom line is that this is a premium restructuring tool that enables the UK to remain competitive as a restructuring jurisdiction.

The measures aimed at supporting the SME end of the market have had a more mixed reception. The moratorium is in principle a useful tool, but concerns around the alteration of priorities are likely to limit its use. Meanwhile s 233B may prove difficult to enforce, or may even have the unintended effect of causing suppliers to terminate at an earlier stage if a company shows signs of distress.

The government's review of the measures continues, and it will be interesting to see if the feedback results in any permanent changes – particularly in relation to the moratorium, which seems unlikely to realise its potential unless and until the priority concerns are addressed. ■