Feature

KEY POINTS
- These are still relatively early days for the Corporate Insolvency and Governance Act 2020 (CIGA), with many companies availing themselves of government coronavirus support meaning they have not had to resort to the new restructuring tools thus far.
- But references to CIGA are starting to creep into loan documentation.
- Further developments in this area can be expected, especially following recent jurisprudence around the use of the cross-class cram down mechanic as part of the new restructuring plan.

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The impact of the Corporate Insolvency and Governance Act 2020 on drafting loan documentation and practice

Almost a year has now passed since the Corporate Insolvency and Governance Act 2020 (CIGA) first entered force on 26 June 2020. According to the Explanatory Notes that accompanied CIGA, "the overarching objective of [the Act] is to provide businesses with the flexibility and breathing space they need to continue trading during this difficult time". To this end, CIGA introduces a number of permanent and temporary amendments to the UK's insolvency landscape which are aimed at ensuring businesses can maximise their chances of survival against the backdrop of the COVID-19 pandemic.

This article takes stock of CIGA's impact on the drafting of loan documentation and related practice points for finance lawyers.

A QUICK RECAP

CIGA introduced the following permanent amendments to the English restructuring toolkit: a "free-standing" moratorium under Pt A1 of the Insolvency Act 1986; a new restructuring plan under Pt 26A of the Companies Act 2006; and restrictions on the ability of suppliers to exercise termination clauses triggered by counterparty insolvency. Other English restructuring tools remain unchanged by CIGA, namely schemes of arrangement, company voluntary arrangements, administration, receivership and liquidation. And significant though CIGA was, it merely scratched the surface of re-visiting connected party sales on administrations – for that we have had to wait some several months later.[1]

So, to what extent do loan, intercreditor, security and ancillary finance documents need updating to take account of the new restructuring tools? We take each in turn below.

CIGA'S IMPACT ON DRAFTING FACILITY AGREEMENTS

The Loan Market Association (LMA) recently updated its template loan documents to reflect changes required following the end of the Brexit transition period. But it has made no changes to those documents to reflect CIGA.

The obvious place where amendments might be expected to those LMA documents would be in respect of the insolvency-related representations, undertakings and events of default. The prevailing view seems to be that the existing provisions are wide enough to capture both the new freestanding moratorium under Pt A1 of the Insolvency Act 1986 as well as the new restructuring plan under Pt 26A of the Companies Act 2006.

Advocates against referencing the new moratorium and restructuring plan in the insolvency-related provisions noted above might argue that these tools are not to be regarded as formal insolvency procedures. The moratorium must be targeted at achieving the rescue of the company as a going concern. The purpose of any compromise or arrangement that forms the basis of any restructuring plan (which finds its way into Pt 26 of the Companies Act 2006) must be to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern (s 901A(3)(b) Companies Act 2006). In other words, neither the new moratorium nor restructuring plan have any place in an event of default dealing with insolvency procedures.

Some may however take a different view. The LMA insolvency default mentioned immediately below already includes a reference to the commencement of proceedings in relation to a suspension of payments or reorganisation achieved by way of a scheme of arrangement. If a scheme is good enough for such a default, one might argue that a Pt 26A restructuring plan should be good enough too (especially bearing in mind that a scheme is not an insolvency process as such).

There is also the fact that a restructuring plan can be combined with the new moratorium or, in parallel, with a company voluntary arrangement (as the PizzaExpress group illustrated). So, if you are looking for your insolvency provisions to bite on actions which may be a prelude to more formal insolvency procedures, then arguably references to the new restructuring tools should be included. And to add to this argument, we also now have the benefit of Mr Justice Zacaroli's decision following the convening hearing for Gategroup's proposed restructuring plan.[2] In his judgment handed down on 17 February 2021, Mr Justice Zacaroli found that a Pt 26A restructuring plan was an "insolvency proceeding" and therefore fell outside the scope of the Lugano Convention 2007, in contrast to a scheme of arrangement.

Whichever position one adopts in respect of the debate discussed above, if one takes the default in cl 29.7 (Insolvency proceedings) of the LMA's Leveraged Facilities Agreement as an example, the following observations can be made:

- The LMA clause applies where any action or step is taken in relation to, among other things, "a moratorium of any indebtedness". This is arguably too narrow, as the effect of the new moratorium on creditors goes much further than this (restricting, for example, actions in respect of insolvency proceedings as well as other enforcement and legal proceedings during a moratorium). In other words, the reference to "a moratorium *of any indebtedness*" is arguably too limiting.
- The LMA default refers to "a composition, compromise, assignment or arrangement with any creditor of any member of the Group". This does not expressly refer to a restructuring plan under Pt 26A of the Companies Act 2006. Perhaps more problematic is that the LMA clause refers to compositions with any *creditor*, whereas a Pt 26A restructuring plan could involve a compromise or arrangement between the company *and its members*.
- The LMA default also applies where any "liquidator, receiver, administrative receiver, administrator, compulsory manager or similar officer" is appointed in respect of any borrower group member or its assets. Query whether a "similar officer" includes a "monitor" in respect of a Pt A1 moratorium. Arguably it does not. On the other hand, including the monitor within this list may be going too far, given its limited role. In particular, whilst the monitor's consent is required for certain transactions, the directors remain in day-to-day control of the business during the moratorium (unlike in the case of a liquidator's appointment, for example, where director powers are suspended).

EXERCISING ENFORCEMENT OPTIONS UNDER FACILITY AGREEMENTS

What effect has CIGA had on the exercise of enforcement options under loan agreements? The main area of focus here has been the impact that the new Pt A1 moratorium has on creditors, including lenders under loan agreements, given that there is no automatic moratorium with the new restructuring plan under Pt 26A of the Companies Act 2006.

Sections A20-A23 of the Insolvency Act 1986 outline the effect of the new Pt A1 moratorium on creditors. For example, during a moratorium, there are restrictions on the commencement of legal proceedings against a company or its property, whilst no winding-up petition shall be presented for the company's winding-up unless initiated by its directors.

The following observations can be made:

- Clause 29.20 (Acceleration) of the LMA's Leveraged Facilities Agreement lists a menu of enforcement options which the agent may, and shall if so directed by the majority lenders, take after an event of default occurs. These include the right to exercise or direct the security agent to exercise any of its rights under the finance documents. Strictly speaking the security agent may not be able to exercise all its rights under the security documents (as we discuss below), but in our view this does not mean the wording of cl 29.20 should be re-visited.
- When CIGA was introduced some queried whether a Pt A1 moratorium might prevent lenders from accelerating a loan altogether. Practitioners have since got comfortable that in most instances this will not be the case. In particular, a company enjoys a payment holiday during a Pt A1 moratorium in respect of pre-moratorium debts that fall due either before or during the moratorium. Such pre-moratorium debts exclude those listed under s A18(3) of the Insolvency Act 1986, including those arising under a financial services contract (s A18(3)(f) Insolvency Act 1986). The result is that most bank facilities are excluded from the payment holiday, meaning that ordinarily a lender will still be able to accelerate a loan where it is entitled to do so even if the borrower is subject to a Pt A1 moratorium. (As an aside, the eligibility criteria for the Pt A1 moratorium prevents many companies from using the new moratorium altogether, including those subject to a current or recent insolvency proceeding (within the past 12 months), certain securitisation companies and companies which use a capital market arrangement).
- Perhaps most importantly, during a moratorium no steps may be taken to enforce any security over a company's property (s A21(1)(c) Insolvency Act 1986). Whilst this is obviously a limiting factor, those with the benefit of share security over a company that is subject to a Pt A1 moratorium may be able to navigate around this. Also, there are some limited exceptions to this restriction, most notably in relation to security created under a financial collateral arrangement (see s A21(1)(c)(ii) Insolvency Act 1986). Time will yet tell whether this will result in an increased willingness to take security by way of a financial collateral arrangement.
- CIGA also elevates moratorium and priority pre-moratorium debts to super-priority status in any subsequent liquidation or administration that commences within 12 weeks of the end of a Pt A1 moratorium (as well as protection from compromise as part of any restructuring plan, CVA or scheme). Importantly, a priority pre-moratorium debt excludes any relevant accelerated debt. This is broadly-speaking defined as a pre-moratorium debt that falls due during the relevant period by reason of the acceleration in the relevant contract (see, for example, the new s 174A Insolvency Act 1986 as inserted by Sch 3, para 13 of CIGA). This raises the curious possibility that lenders under a term loan that is accelerated during a moratorium may not benefit from subsequent super-priority status or protection from compromise. By contrast, an unpaid amount under a revolving credit facility that falls due during a moratorium and remains unpaid without being rolled over would benefit from super-priority status and protection.

A BRIEF CONSIDERATION OF THE IPSO FACTO REGIME

We should also consider the extent to which the ipso facto rules introduced by CIGA affect lenders when exercising their enforcement options. To rehearse the point, s 233B of the Insolvency Act 1986 (as introduced by s 14 of CIGA) provides (among other things) that if a contract for the supply of goods or services entitles the supplier to terminate that contract by reason of the counterparty entering a relevant insolvency procedure, then that provision ceases to have effect.

A key point for determination is whether the counterparty is in fact subject to a relevant insolvency procedure. The rules do not apply, for example, if a notice of intention to appoint an administrator is filed (in contrast to the actual appointment of administrators), if a meeting of creditors is convened to consider a company voluntary arrangement (as opposed to when the voluntary arrangement takes effect), if a company is subject to a scheme of arrangement, or if a fixed charge receiver (rather than an administrative receiver) is appointed over a company's assets. But assuming this threshold question is ticked, are loan and other related finance contracts caught by the new ipso facto regime?

A few points are worth noting here:

- Schedule 4ZZA Insolvency Act 1986 (as referred to at s 14(10) of CIGA) lists various exclusions from the ipso facto rules. Part 2 of this schedule lists various persons involved in financial services to whom the new rules do not apply, whilst Pt 3 lists various financial service contracts which are also exempt from the ipso facto regime. These include contracts for the provision of financial services consisting of lending (including factoring), financial leases and swap agreements (including those relating to interest rates or foreign exchange agreements).
- The ipso facto regime is therefore irrelevant for most finance contracts. Take a syndicated loan agreement based on the LMA template, for example. If the borrower enters liquidation, the lender(s) would still be entitled to call an event of default and accelerate the loan (assuming the agreement contains the typical insolvency defaults found in LMA documentation). Equally, a swap provider should still be entitled to close out any swap entered into with that company which has termination rights based on insolvency events too (as is typically the case in most ISDA documentation).
- Thinking slightly further afield, what about a direct agreement used on project finance transactions? Typically, these entitle the lenders (either directly through a security trustee or via an appointee) upon the occurrence of certain events to step into the shoes of the project company and exercise its rights under key commercial agreements (for example, a gas supply contract). CIGA may operate to prevent a supplier from terminating a supply contract by reason of the project company commencing a relevant insolvency procedure. That is obviously a good thing from the lenders' perspective. But they may still wish to step in where the project company is, for example, insolvent even if the supplier is prevented from terminating themselves. Lenders should still be capable of doing that since direct agreements should not be caught by the ipso facto regime. From a drafting perspective, however, it is important that the step in right arises where the project company goes insolvent or some other event of default occurs under the finance documents and not just if the supplier terminates or purports to terminate.

CIGA'S IMPACT ON SECURITY DOCUMENTS

We have noticed the following drafting amendments to security documents as a result of CIGA:

- First, practitioners have re-visited the wording of floating charges to reflect s A22 of the Insolvency Act 1986. This prevents the holder of an uncrystallised floating charge during any Pt A1 moratorium from giving notice to crystallise a floating charge or impose any restriction on the disposal of property of the company. The amendment often seen is to specify that conversion of a floating charge by notice can only be done *where permitted by applicable law*.
- Second, s A52 of the Insolvency Act 1986 provides that a provision in an instrument creating a floating charge is void if it provides for the obtaining of a moratorium, or anything done with a view to obtaining a moratorium, to be an event that causes a floating charge to crystallise. Many debentures contain floating charges which crystallise automatically upon certain events. Practitioners have started to include carve-outs from such automatic crystallisation provisions. Typically these provide that (unless s A52(4) Insolvency Act 1986 allows) the floating charge shall not be converted into a fixed charge solely by reason of the obtaining of a moratorium or anything done with a view to obtaining a moratorium under Pt A1 of the insolvency Act 1986.
- Third, s A52(1)(c) of the Insolvency Act 1986 provides that a provision in a floating charge which entitles a person to appoint a receiver where a moratorium is obtained is void. As such, many floating charges now provide that unless s A52(4) Insolvency Act 1986 allows, the chargee is not entitled to appoint a receiver solely by reason of:
  - the obtaining of a moratorium; or
  - anything done with a view to obtaining a moratorium under Pt A1 Insolvency Act 1986.

None of the amendments discussed above should prove controversial. Even if not included, a well-drafted security document which fails to respect the provisions discussed above should still work perfectly fine so long as it includes the usual severability language.

CIGA'S IMPACT ON INTERCREDITOR AGREEMENTS

We are yet to see ourselves any specific drafting changes to intercreditor agreements based on the introduction of CIGA. But one

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point on which activity may follow relates to the optional cl 12.4 (Exercise of voting rights) in the LMA's leveraged intercreditor agreement. As drafted, this requires each creditor (other than the senior agent or senior arranger) to cast its vote in respect of any insolvency or similar proceedings relating to any member of the borrowing group as instructed by the security agent. This is intended to empower the instructing group to control how other creditors vote on any court sanctioned restructuring.

Mezzanine lenders and their advisors often have an allergic reaction to these kinds of provisions. Arguably, even without such provision, the new restructuring plan under Pt 26A of the Companies Act (as introduced by s 7 of CIGA) with its cross-class "cram down" feature obviates the need for this kind of provision in the first place (at least insofar as the insolvency proceedings concerned involve the new restructuring plan). But will this mean that junior creditors reject such provisions altogether, knowing that the senior creditors can use the restructuring plan procedure if necessary?

In determining whether a class of creditors can be subject to a cross class "cram down", two specific conditions need to be satisfied as set out in the new s 901G Companies Act 2006. The first of these (Condition A) is that the court must be satisfied that, if the compromise were sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of "the relevant alternative".

The relevant alternative Condition A was not tested on either the Virgin Atlantic[3] or PizzaExpress[4] restructuring plans but was considered in the *DeepOcean* case.[5] In this case, the relevant alternative was accepted to be the withdrawal of additional funding for those companies for whom the restructuring plan was proposed from the wider DeepOcean group, which would result in the formal insolvency of those plan companies. Trower J confirmed that when considering Condition A the exercise was similar to identifying the appropriate comparator for class purposes in relation to a Pt 26 scheme of arrangement, or identifying the "vertical" comparison for the purposes of an unfair prejudice challenge to a company voluntary arrangement. In *DeepOcean*, the decision was fairly straightforward – evidence presented to the court showed that the relevant unsecured creditors would be likely to receive nothing in the insolvency of the plan companies. Under the proposed plan they would receive a dividend of around 4% (funded by other group companies). The dissenting creditors were not represented at the hearing, and the valuation showing them to be "out of the money" in the relevant alternative was not challenged. Condition A therefore was satisfied.

These are early days so far as the new restructuring plan is concerned. But as its use becomes more widespread, will we see junior and mezzanine creditors attempting to pre-bake provisions such as cl 12.4 (Exercise of voting rights) in the LMA's leveraged intercreditor agreement with, for example, conditions which set out how they expect any valuation exercise to be undertaken whenever determining what the most likely relevant alternative is? Watch this space.

LEGAL OPINIONS

And finally, a brief mention of legal opinions given on finance transactions. To the extent these include any insolvency qualifications, revisions may be necessary to reflect the new restructuring procedures introduced by CIGA. Similarly, where opinions comment upon the completeness of searches undertaken, additional qualifications may be needed to note the limitations of these searches. For example, the appointment of a monitor in respect of a Pt A1 moratorium would not necessarily be revealed by a search with the Central Register of Winding Up Petitions. Where legal opinions comment upon the efficacy of particular provisions, qualifications might also be needed to discuss the limitations on the crystallisation of floating charges or the enforcement of security interests generally whenever a company becomes subject to a Pt A1 Insolvency Act 1986 moratorium. These are all however broad statements and each law firm will no doubt approach these matters in its own preferred way.

FINAL THOUGHTS

The Insolvency Service's quarterly company insolvency statistics for Q4 2020[6] included the following telling statistic: between 26 June and 31 December 2020, just four companies obtained the new moratorium and two companies had a restructuring plan sanctioned by the court. The low number was attributed to the range of UK government support measures designed to see companies through the COVID-19 pandemic. In short, CIGA's new restructuring tools have been scarcely used so far. The cross-class cram down mechanism under the new restructuring plan was used successfully for the first time in the *Deep Ocean* case. This may therefore provide the encouragement others were waiting for to use this new restructuring tool. But at least for the time being, the observations made in this article represent at best early lessons learnt only. As others gain more practical experience of the new tools in action, we can expect further lessons to follow. ■

1 See The Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 which are due to come into force on 30 April 2021.
2 *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch).
3 *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch).
4 *Re Pizza Express Financing 2 plc* [2020] EWHC 2873 (Ch).
5 *Re Deep Ocean I UK Ltd and others* [2021] EWHC 138 (Ch).
6 https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2020

Further Reading

- Rank inequality: the consequences of the creation of "super priority" debts under the Corporate Insolvency and Governance Act 2020 moratorium (2021) 2 JIBFL 97.
- Corporate Insolvency and Governance Act 2020: a balancing act (2020) 9 JIBFL 629.
- LexisPSL: Banking & Finance: Corporate Insolvency and Governance Act 2020 – overview.