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The implications of CIGA 2020 for secured lenders

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An article on the implications of the Corporate Insolvency and Governance Act 2020 for secured lenders.

The article looks at points to note in relation to the new Part A1 moratorium, the new Part 26A restructuring plan and termination of supply/ipso facto provisions. It also discusses practical issues such as the temporary extension of period for registering security at Companies House and changes a lender may wish to consider making to transaction documentation as a result of the points to note raised by CIGA 2020.

Scope of this article

The Corporate Insolvency and Governance Act 2020 (CIGA 2020) came into force on 26 June 2020. Under CIGA 2020, various new insolvency tools, and restrictions, have come into play.

This article focuses on some key points for a secured lender to be aware of in relation to CIGA 2020. It also looks at changes a lender may wish to consider making to facility and security documents as a consequence. It does not aim to provide a comprehensive analysis of all potential changes and issues connected with CIGA 2020.

For more information on CIGA 2020, see Practice note, Corporate Insolvency and Governance Act 2020: toolkit and tracker.

This article assumes that the security in question was granted by a company incorporated in England and Wales.

Part A1 moratorium

CIGA 2020 introduces a new concept of a freestanding moratorium, under the new Part A1 of the Insolvency Act 1986 (IA 1986) (as introduced by section 1 of CIGA 2020).

This Part A1 moratorium is separate from the notion of a moratorium on proceedings which already exists in an administration or liquidation scenario. It does, however, share some common features with a moratorium in an administration or liquidation, in particular the restriction of enforcement options during the relevant period.

The moratorium is a "debtor in possession" process in that the entity's management will remain in control of it during the process. However, the functioning of the moratorium is overseen by an insolvency practitioner appointed as a "monitor". For more information, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986: What is a Part A1 moratorium?.

For more information on the Part A1 moratorium, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986.

The key issues for a secured lender to note in relation to a Part A1 moratorium include the following:

Scheduled payments under loan agreements must be made during a Part A1 moratorium

CIGA 2020 introduces a payment holiday for certain pre-moratorium debts (that is, debts for which the liability to pay was incurred before the start of the moratorium) (section A18(3), IA 1986). However, a number of exceptions apply, including to the following:

- pre-moratorium debts for which the company does not have a payment holiday. These include debts or other liabilities arising under a contract or instrument involving financial services (loans, financial leases and securities contracts) (section A18, IA 1986); and
- moratorium debts. These are debts that fall due during or after the moratorium by reason of an obligation incurred during the moratorium (section A53(2), IA 1986).

As such, scheduled payments or repayments falling due during the period of a Part A1 moratorium under, for example, a facility agreement, remain payable.

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It is important to note that a Part A1 moratorium must be brought to an end if the company is unable to pay its moratorium debts and any pre-moratorium debts for which it does not have a payment holiday. Therefore, if a company subject to a Part A1 moratorium is going to be unable to make a scheduled payment under a facility agreement, the monitor and the directors should be taking steps to end the moratorium. This is likely in practice to lead to another insolvency process such as administration (unless the lender is willing to enter into a standstill arrangement for any required period).

Restrictions on enforcement during a Part A1 moratorium

Various forms of enforcement action are restricted during the period of a Part A1 moratorium (section A21, IA 1986). These include restrictions on winding-up and administration (except where instigated by the directors) and on the enforcement of security, with some exceptions.

The enforcement of a security interest under a security financial collateral arrangement is not captured by the restrictions on enforcement (which is similar to the position in an administration or liquidation scenario). Accordingly, lenders may wish to consider whether any existing or proposed security package includes assets constituting financial collateral and which are (or can be) secured pursuant to a security financial collateral arrangement under the Financial Collateral Arrangements (No.2) Regulations 2003 (SI 2003/3226). If so, this may put those lenders in a better position to recover in the event of their borrower entering into a Part A1 moratorium. For more information on financial collateral arrangements, see Practice note, Financial collateral arrangements.

However, contractual set-off rights appear to remain unaffected by a Part A1 moratorium. These rights may be a useful tool for any bank lender that holds bank accounts for the borrower, but may of course adversely affect the borrower's ability to trade and effect a rescue.

Impact of a Part A1 moratorium on floating charges

Under section A52(1) of the IA 1986, a provision in a security document is void if it provides for the obtaining of a Part A1 moratorium (or any steps with a view to obtaining a Part A1 moratorium) to cause any of the following:

- The floating charge in the relevant security document to crystallise.
- Restrictions on the disposition of property by the borrower.
- Give the lender grounds to appoint a receiver.

In addition, during the period of a Part A1 moratorium:

- The holder of a floating charge may not give notice to crystallise or impose any restriction on the disposal of any asset subject to a floating charge, and no other event during the Part A1 moratorium may give rise to such a crystallisation or restriction (section A22, IA 1986).
- No application may be made with a view to obtaining the crystallisation of a floating charge or the imposition of a restriction of the disposal of any asset subject to a floating charge (section A21, IA 1986).

These restrictions mean that automatic crystallisation provisions within a floating charge would not be effective during the period of a Part A1 moratorium. For more information, see Practice note, Taking security: Effect of Part A1 moratorium on floating charges.

Where the terms of the relevant security document require the chargee to give notice in order to crystallise a floating charge or restrict dispositions, and the prescribed notice period would otherwise expire during the period of a moratorium, the holder of the floating charge may give notice later than the terms of the security document permit, provided this is done as soon as is practicable after the end of the moratorium or the day on which they are notified of the end of the moratorium (section A22, IA 1986).

Can a borrower take on further debt or grant new security during a Part A1 moratorium?

It is possible for a company to incur debt and/or grant security during the period of a Part A1 moratorium. However, the company must disclose the fact that it has entered into a Part A1 moratorium to lenders and the monitor appointed to oversee the Part A1 moratorium must consent to the debt and/or security (sections A25 and A26, IA 1986).

Can a borrower dispose of its charged assets during a Part A1 moratorium?

A company is restricted from disposing of its charged assets during a Part A1 moratorium unless:

- the disposal is in accordance with the terms of the security; or
- the company obtains the permission of the court to do so.

(section A29, IA 1986.)

This is a potential issue for lenders as the court can effectively permit the disposal of a charged asset during the Part A1 moratorium despite the existence of a non-disposal covenant in the relevant security document

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and/or related facility agreement. The court would need to consider the position of the secured creditor and order compensation for its loss of rights. This is intended to operate so that the lender is paid what the security is worth. As such, this type of court-permitted disposal may not necessarily represent an adverse outcome for a secured creditor, subject of course to the market value of the secured asset at the relevant time.

Does a secured lender have any control over a Part A1 moratorium?

This is a complex area. Whether or not a secured lender can be said to have control over a Part A1 moratorium will depend on the particular aspect of a moratorium that is being considered. The following aspects of a moratorium illustrate how the control or otherwise that a secured lender may exert will vary:

Can a secured lender compel a company to enter into a Part A1 moratorium?

The directors of a company have the power to enter into a Part A1 moratorium, and while the pre-moratorium and moratorium finance debts are being paid, a lender has limited options available to it.

A lender cannot compel the entry of its borrower company into a Part A1 moratorium and a secured lender holding a qualifying floating charge does not have the opportunity to replace the monitor of the Part A1 moratorium (as they might in an administration scenario). However, a supportive lender might encourage a borrower to enter into a Part A1 moratorium in order to use the breathing space it offers to rescue the company.

Does a secured lender have any say as to whether a Part A1 moratorium is extended?

A Part A1 moratorium initially lasts for 20 business days and can be extended for a further 20 business days by the directors of the company. It can be further extended for up to 12 months with creditor consent (section A11 and section A12, IA 1986). A court may also extend the moratorium (section A13, IA 1986). For more information, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986: Start time and duration of moratorium.

However, the creditors from whom consent is required to extend do not include lenders who are owed moratorium debts and debts for which the company does not have a payment holiday. These lenders are not eligible to vote on the extension of a Part A1 moratorium and therefore have no say in any extension of the moratorium period.

Do secured lenders need to be consulted if the company applies to court for an extension of a Part A1 moratorium?

Where the directors apply to the court for an extension of a Part A1 moratorium, they are only required to state whether or not (and if not why not) they have consulted pre-moratorium creditors (that is, those owed pre-moratorium debts subject to a payment holiday which have not been paid or discharged) as part of the application (section A13, IA 1986). Lenders falling outside these categories would, therefore, be excluded from this court-ordered extension process.

So, the directors do not have to consult with secured lenders whose pre-moratorium debts are not subject to a payment holiday. This is because any extension should not affect them per se as their pre-moratorium debts and moratorium debts should still be paid during the extended moratorium, or the moratorium should be ended.

Can a secured lender accelerate during a Part A1 moratorium? What enforcement rights will it have?

If an amount is unpaid under a finance document during the period of a Part A1 moratorium, a lender could (subject to the terms of the facility agreement) accelerate the debt or make a demand for repayment under an on-demand facility. However, this has implications for priority (see Ranking of debt where an insolvency occurs following a Part A1 moratorium).

If such an amount is unpaid then, as mentioned above (see Scheduled payments under loan agreements must be made during a Part A1 moratorium), the monitor must terminate the Part A1 moratorium. This is required of the monitor where the company is unable to pay its moratorium debts and pre-moratorium debts for which the company does not have a payment holiday.

However, once a moratorium comes to an end, the enforcement options available to a secured creditor would revert to the pre-moratorium position. For example, the holder of a qualifying floating charge would have its usual rights in relation to the appointment of an administrator, and it would be possible for a creditor to instigate a liquidation process.

Ranking of debt where an insolvency occurs following a Part A1 moratorium

If a company enters into winding-up or administration proceedings within 12 weeks of the end of a Part A1 moratorium, any unpaid moratorium debts and pre-moratorium debts for which the company does not have

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a payment holiday (for example, loans) will benefit from "super-priority" for payment (section 174A, IA 1986, as amended by paragraph 4 of Schedule 3 to CIGA 2020). This means that such debts will rank as follows:

- Fixed charge creditors (including financial collateral arrangements).
- Unpaid moratorium debts and pre-moratorium debts for which the company does not have a payment holiday (note the caveat below regarding debts which were accelerated during the period of the moratorium).
- Adopted employee liabilities.
- Fees and expenses of the Official Receiver or administrator (as applicable).
- Preferential creditors.
- Floating charge creditors (subject to the prescribed part).
- Unsecured creditors.

For more information, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986: Nature of special treatment for moratorium and priority pre-moratorium debts in subsequent proceedings.

However, if a lender accelerates its loan during a Part A1 moratorium, that lender will not be entitled to super-priority for the accelerated amount in an insolvency commencing in the 12 weeks following the end of the moratorium (section 174A(3)(c), IA 1986). This is to prevent lenders benefiting from acceleration provisions during a Part A1 moratorium at the potential expense of other creditors. For more information, see Practice note, The moratorium under Part A1 of the Insolvency Act 1986: Notable exclusions from effect of moratorium.

Part 26A restructuring plan

What is the new Part 26A restructuring plan?

CIGA 2020 introduces a new restructuring plan (schedule 9, *CIGA 2020*) by bringing into force a new Part 26A of the Companies Act 2006 (CA 2006). This operates in a manner similar to a scheme of arrangement under Part 26 of the CA 2006, although with some key differences.

For more information on the main features of the Part 26A restructuring plan, see Legal update, Corporate Insolvency and Governance Bill: insolvency aspects: New Part 26A restructuring plan (arrangements and reconstructions for companies in financial difficulty.

How is a Part 26A restructuring plan implemented?

75% in value of a company's creditors (or members) must vote in favour of a Part 26A restructuring plan. This differs from the simple majority (of 50%) in number required to vote in favour of a company voluntary arrangement or a scheme of arrangement (for more information on CVAs and schemes of arrangement, see Practice notes, Company voluntary arrangements (CVAs): a quick guide and Schemes of arrangement: overview).

Note, however, that the court may sanction a Part 26A restructuring plan notwithstanding any dissenting creditors, provided the court is satisfied that:

- the dissenting creditors would not be any worse off than if the restructuring plan was not sanctioned; and
- where the restructuring plan has been approved by 75% by value of those creditors who would be eligible to receive a payment under it or who have a "genuine economic interest" in the company.

This means that, once approved by the court, all creditors are bound by the Part 26A restructuring plan, whether secured or unsecured. In this regard, secured creditors are in a very different position than they would be in a CVA scenario, which is designed to bind only the unsecured creditors unless any secured creditors agree to be bound. This is sometimes referred to as the ability to implement a "cross-class cram-down".

For more information, see Legal update, Corporate Insolvency and Governance Bill: insolvency aspects: Effect of voter dissent from a Part 26A plan.

What does this mean for secured creditors?

These voting levels, and the ability to cram down any dissenting creditors, may lead to junior or mezzanine lenders having more power as part of the voting classes in a Part 26A restructuring plan.

Secured lenders may be bound by the terms of intercreditor agreements, which may further dictate what they can and cannot do in the event of a borrower's insolvency. Lenders should consider the terms of any intercreditor agreements to which they are a party, and whether these restrict their ability to, for example, enforce security or benefit from any particular tranche of distributions following an insolvency. They should also consider whether they are, or may be, compelled to vote a particular way in relation to a Part 26A restructuring plan if, for example, they are directed to do so by the senior creditors or a security agent.

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Termination of supply/ipso facto provisions

What are the new provisions?

CIGA 2020 introduced a new section 233B of the IA 1986 which provides that suppliers are restricted from relying on provisions which enable them to terminate supply, demand repayment of existing debt as a condition of continued supply or "do any other thing" in relation to a contract for the supply of goods or services, as a result of the customer's insolvency. Such provisions are often called "ipso facto" clauses. This is a departure from the previous position under English law, but aligns with the stance taken in, for example, the US.

For more information, see Practice note, Restrictions on terminating supply contracts in insolvency proceedings : Section 233B: no termination of supplies of goods and services generally.

What does this mean for secured creditors?

Banks and investment firms, and loans, finance leases and securities contracts are excluded from these provisions. Therefore, lenders/secured creditors will not be restricted from terminating their facility agreements, cancelling their commitments or imposing new contractual terms as a result of their borrower's insolvency.

What is the impact on hedging arrangements?

While loan agreements do not fall within the category of agreements subject to these restrictions, there has been some debate (unresolved so far as we are aware) as to whether hedging arrangements might still be caught. If they are, then a hedging provider would be unable to close out a hedging arrangement early by reason of the insolvency of a counterparty alone. However, this would not prevent early termination of that hedging arrangement by reason of some other termination event such as non-payment, provided that such termination right was exercised before the commencement of the relevant insolvency proceedings.

It is possible to obtain the consent of an officeholder to the termination of a contract, or to apply to court for relief on the grounds of hardship to the supplier (section section 233B(5)(c), IA 1986). However, the threshold for hardship is not defined in CIGA 2020 and may be a high bar for many suppliers to meet.

Registration of security documents at Companies House

CIGA 2020 empowered the Secretary of State to introduce regulations which extend the period during which certain returns or filings must be lodged with Companies House. The Companies etc. (Filing Requirements) (Temporary Modifications) Regulations 2020 (SI 2020/645) (CFRTM Regulations 2020) were made under these powers and came into effect on 27 June 2020 (see Legal update, COVID-19: deadline for registering charges at Companies House extended to 31 days).

The CFRTM Regulations 2020 amended section 859A(4) of the CA 2006 such that any security granted by a company on and from 6 June 2020 benefits from a 31-day period for registration instead of the usual 21 days. Like the 21-day period, the 31 day-period will start the day after the date the security was created.

The extension of the period allowed for filing is to alleviate the burden on borrowers during the coronavirus outbreak and allow them to focus all their efforts on continuing to operate. The extension is a temporary measure and is expected to be in force until 5 April 2021.

For more information, see Practice note, Registration of charges created by companies and limited liability partnerships on or after 6 April 2013: Covid-19: temporary extension of period allowed for delivery of particulars of charges created on or after 6 April 2013.

Changes to consider making to your facility and security documents

- Under CIGA 2020, a floating charge may not crystallise (automatically or otherwise) during the period of a Part A1 moratorium (sections A22, A23 and A52, IA 1986). Secured creditors may wish to reflect this in their security documentation. For more information, see Impact of a Part A1 moratorium on floating charges and Standard document, Debenture: Drafting note: Part A1 moratorium.
- Any fixed charges should be carefully drafted and considered to ensure that they would in fact constitute fixed, rather than floating, charges in order to confer the benefits of priority for fixed charges in the event of a distribution. Of course, whether a charge is fixed or floating is a matter of fact and the terminology used will not be conclusive (see Practice note, Taking security: Control is crucial).

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- Facility agreements may include general provisions for waivers, payment holidays and/or deferral or relaxation of covenants. If a borrower then enters into a Part A1 moratorium and such provisions are available to the borrower (for example, a waiver existing in relation to certain breached covenants or a contractual grace period before a lender can enforce), these could potentially prevent a lender from accelerating the relevant loan during that moratorium. In order to avoid this issue, a lender may wish to amend its debt documentation to specify that such provisions will not apply in the event of the borrower entering into a Part A1 moratorium.
- However, lenders should bear in mind (see Ranking of debt where an insolvency occurs following a Part A1 moratorium) that they will not be afforded super-priority regarding the payment of accelerated debt in the event of the insolvency of the borrower within 12 weeks following the end of the Part A1 moratorium.
- Lenders may wish to update the insolvency and insolvency proceedings events of default and/or their definition of "Insolvency Event" as well as the security enforcement triggers in their finance documents so as to ensure they include the new Part A1 moratorium and Part 26A restructuring plan (and any step taken with a view to entering into either process).
- Lenders may wish to consider any restrictions on disposals of assets within their facility documents. For example, provisions allowing disposals in the "ordinary course of business" in relation to floating charge assets, could be tightened to, for example, restrict the sale of large proportions of stock. This is to ensure that a lender is able to exercise sufficient control over a company's assets during a Part A1 moratorium given that lenders will not be able to crystallise a floating charge or otherwise enforce their security at that stage.
- There is often an information undertaking in a facility agreement which requires the borrower to notify its lender of a default (for example, a potential event of default). Plans to implement a Part A1 moratorium or Part 26A restructuring plan would typically fall within insolvency and insolvency proceedings events of default, and would therefore trigger the information undertaking obligation to inform. That said, lenders may wish to make specific reference to a Part A1 moratorium or Part 26A restructuring plan in the information undertakings section.

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