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Corporate Insolvency (2021)

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Corporate Insolvency (2021)

The law as stated during this webinar is up to date as of **20 July 2021**

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Corporate Insolvency and Governance Act ("CIGA") 2020

Has it worked? Where next?

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CIGA 2020 - what did it do?

- CIGA 2020 introduced both temporary measures and permanent reforms:
  - Temporary measures (eg. restrictions on winding-up petitions until 30 November 2021; relaxation of wrongful trading rules – see Phil's section; changes to filing / meetings requirements).
  - Permanent reforms (eg. the 'moratorium'; the 'restructuring plan').

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Temporary measures – winding-up petitions

- Have the restrictions on presentation of winding-up petitions ("WUPs") been a success?
  - Measures intended to prevent a wave of insolvencies precipitated by creditor action.
  - **NB** the modifications do not apply to all WUPs.
  - Anecdotally, creditors appear reluctant to present WUPs.
  - Modifications to procedure in the B&PC: some WUPs listed for a preliminary hearing.
  - At a final hearing, the court will treat "financial effect" as a low evidential burden, such that a debtor will be able to avoid a winding-up order if it adduces limited evidence of the impact of coronavirus: ICC Judge Barber in *In Re A Company* [2020] EWHC 1551 (Ch).

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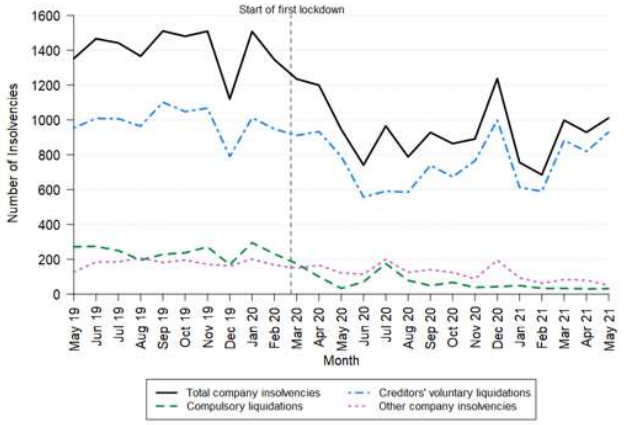
Temporary measures – have they worked?

- Since March 2020 there has been a decline in company insolvencies, with CVLs and compulsory liquidations falling most dramatically (figures taken from the Insolvency Service).



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Temporary measures – have they worked?

- Of the 1,011 registered company insolvencies in May 2021:
  - There were 31 compulsory liquidations, which is 6% lower than May 2020 and 89% lower than May 2019;
  - 930 were CVLs, which is 18% higher than May 2020 but 3% lower than May 2019;
  - Six were CVAs, which is 50% lower than May 2020 and 81% lower than May 2019;
  - There were 43 Administrations, which is 61% lower than May 2020 and 55% lower than May 2019; and
  - There was one receivership appointment.
- It is clear that CIGA 2020 has had a **dramatic** effect on compulsory liquidations.

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Temporary measures – what next?

- Concern amongst policymakers and advisory groups as to the 'cliff edge' that may arise when the temporary restrictions on WUPs are lifted: a wave of insolvencies caused by creditor action.
- Likewise, the prevalence of 'zombie' companies – being businesses that are insolvent but cannot or have not been liquidated as a consequence of creditor action – is dangerous for creditors (who may not get paid) and directors (who may breach their duties, eg. under s.172(3) of the Companies Act 2006).
- How can the 'cliff edge' be avoided?
  - Gradual relaxation of measures – but what form might this take?
  - Change to the debt threshold for the presentation of petitions or require the debt to have been unpaid for eg. 12 months?
  - Financial support for companies.
  - A review of Hansard (a debate on extending the temporary measures on 19 January 2021) suggests the UK Government does not yet have the answers.
  - The UK Government has recently (May 2021) held a consultation on commercial rents and COVID-19 – possibly with a view to forcing commercial landlords and tenants to mediate or arbitrate.

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Permanent measures – how do they work?

- Moratorium:
  - A reform intended to provide companies the breathing space to pursue rescue as a going concern, via a streamlined and free-standing process. Unlike in administration or liquidation, a moratorium will leave the company's directors in charge of the company. But a monitor who is a qualified insolvency practitioner is appointed at the same time to oversee the process.
  - No insolvency proceedings can be instigated against the company during the moratorium period except in limited circumstances. It also prevents legal action being taken against a company without permission from the court.
- Restructuring plan:
  - A device which enables a company in financial difficulties to enter into a Court-sanctioned "compromise" or "arrangement" with its creditors or members, with a view to surviving the financial difficulties.
  - Permits the court to sanction a plan that binds creditors if it is fair and equitable. Creditors vote on the plan, but the court can impose it on dissenting creditors ("cram down") provided that the necessary conditions are met.

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Permanent measures – have they been used?

- Between 26 June 2020 and 31 May 2021:
  - Four companies obtained a moratorium; and
  - Nine companies had a restructuring plan registered at Companies House.
- On 12 May 2021 the High Court approved a restructuring plan for the Virgin Active Group (see *Re Virgin Active Holdings Ltd & Ors* [2021] EWHC 1246 (Ch)). The Court:
  - Considered administration was 'almost certain' (§116) if the plans were not approved;
  - Concluded that the dissenting creditors would be no worse off than in administration;
  - Noted that sufficient creditors supported the plans; and
  - Imposed restructuring plans on dissenting creditors across different classes.
- The Court recently (on 28 June 2021) declined to approve a restructuring plan in *Re Hurricane Energy plc* [2021] EWHC 1759 (Ch).

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Permanent measures – what next?

- It appears that the permanent reforms introduced by CIGA 2020 will take some time to 'bed in', as insolvency practitioners and the legal profession grow accustomed to the new rules and procedures.
- A greater understanding of how the Courts / creditors are likely to approach the new processes is also likely to lead to their more widespread adoption.
- The moratorium / restructuring plan for now appear to be preserved for larger and more complex businesses.

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Wrongful trading

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What is wrongful trading?

- Section 214(2), Insolvency Act 1986

(2) This subsection applies in relation to a person if—

(a) the company has gone into insolvent liquidation,

(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and

(c) that person was a director of the company at that time

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Ingredients of Wrongful Trading

- Goode on Principles of Corporate Insolvency Law (14-32) – elements of Wrongful Trading:

1. The company has entered insolvent liquidation or insolvent administration (ss 214(2)(a), 246ZB(2)(a)) – note not MVL

2. At some time before the commencement of the winding-up or administration, a person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or administration

3. That person was a director at the time

4. The director fails to establish the statutory defence of taking every step he ought to have taken to minimise the potential loss to creditors

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Why prohibit wrongful trading?

- Keay & Murray (2015):

The aim of the [wrongful] trading provisions in the UK … is to stop directors from continuing to trade while their companies are on the slide into insolvency, thereby, hopefully, reducing the potential loss suffered by creditors.

- Encourages directors to take greater responsibility for companies in financial strife

- Penalises reckless or cavalier conduct

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Business closures – COVID-19

- Restrictions and 'lockdown' March 2020
- City of London Law Society – 26 March 2020:

> *If the short-term impact of Covid-19 is not satisfactorily countered, and viable businesses are not preserved, there will be lasting damage to the wider economy.*
>
> *The "wrongful trading" provisions in section 214 Insolvency Act 1986 could be amended, so as to make it clear that, when assessing whether a company still had a reasonable prospect of avoiding insolvent liquidation or administration, a director should not be made liable if, acting reasonably, they misjudged the potential negative impact of Covid-19 on their business in particular they should not be exposed to personal liability for incurring any indebtedness under the emergency borrowing arrangements provided by or supported by the government to assist in this crisis. An easier alternative would be to suspend these provisions altogether for a limited period, relying instead on the fraudulent trading and common law duties to keep directors honest.*

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Government response

- Business Secretary Alok Sharma press statement – 28 March 2020:

> *There will be a temporary suspension of wrongful trading provisions for company directors, to remove the threat of personal liability during the pandemic. This provision will have retrospective effect from 1 March. However, to be clear, all of the other checks and balances that help to ensure directors fulfil their duties properly, will remain in force.*

- Consistent with the simpler of the proposals put forward by CLLS

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The legislative solution

- Corporate Insolvency and Governance Act 2020, section 12(1):

In determining for the purposes of section 214 or 246ZB of the Insolvency Act 1986 (liability of director for wrongful trading) the contribution (if any) to a company's assets that it is proper for a person to make, the court is to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period.

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Suspension of wrongful trading

- Enacted on 25 June 2020
- Relevant period retrospective – 1 March 2020 – 30 September 2020
- Corporate Insolvency and Governance Act (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020/1349
- Further 'relevant period' beginning 26 November 2020
- Second period originally due to run until 30 April 2021
- Extended to 30 June 2021
- No further extension after 30 June 2021 (yet)

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Issues for Courts and office-holders

- Not an actual 'suspension' of wrongful trading – claims can still be brought
- Relevant only to quantum
- No change to misfeasance or fraudulent trading provisions
- But can directors really be held liable for failing to liquidate companies during the pandemic?
- To what extent can and should discretion be exercised?
- This will likely become clear over the following months and years

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Reform of pre-packs

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What is a pre-pack?

- Not an original or unique form of insolvency process
- It is a descriptive term for a subcategory of administration
- No statutory definition in the Act or Rules
- Generally accepted definition

  an arrangement for the sale of all or a substantial part of a company's business prior to the company entering administration, after which the appointed administrator completes the sale, usually on day one of the administration, thereby rescuing the business in whole or part

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What is the issue with pre-packs?

- Pre-packs currently account for approx. 29% of administrations in England and Wales
- In many pre-packs, the pre-arranged sale of the business is often to a director, a family member or someone connected to the Company
- Creditors are generally unaware until after the sale has taken place
- Can generate a sense of frustration and exclusion

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The Graham Review of 2014

- Teresa Graham was asked to look into pre-packs and ultimately produced what is known as the Graham Review or Graham Report in 2014
- The report quite fairly concluded that pre-pack sales were a valuable tool for business rescue and can often help to preserve jobs
- This came as no surprise to most who work in the industry
- It also concluded that the process was cheaper than the only real equivalent option (in the sense of the procedure being worked through prior to formal insolvency proceedings) – namely a scheme of arrangement
- The Report concluded that where deferred consideration is agreed in a pre-pack it is generally paid
- Finally (albeit tentatively) she concluded that pre-packs formed part of a functioning and effective insolvency regime which encouraged companies to have their COMI in the UK
- The Graham Review did not give pre-packs an entirely clean bill of health either
- She identified a number of matters which she said needed improving
  - The process lacks transparency
  - Marketing of businesses needs to improve
  - Better explanation of the valuation methodology
  - Lack of investigation into the viability of the NewCo

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Pre-pack pool

- **Key recommendation 1 (Graham Review):**

  The establishment of the Pre-pack Pool. On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on.

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Small Business, Enterprise and Employment Act 2015 (SBEEA)

- The Government at the time, however, were plainly concerned that this might not be enough
- So SBEEA – Small Business, Enterprise and Employment Act 2015 introduced paragraph 60A into Sch B1 of the Act
- Section 60A provides a power to the Secretary of State to make regulations prohibiting or imposing conditions on the disposal of company property to a connected person
- This was put in place to enable rules to be imposed in the event the voluntary scheme – plan A – did not work
- Paragraph 60A was time limited and actually expired on 26 May 2020
- Corporate Insolvency and Governance Act 2020 (CIGA) revived para 60A until June 2021

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The 2021 Regulations

- Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 – made under the SBEEA power in March 2021
- Applies to administrations commencing on or after 30 April 2021
- Applies where the administrator seeks to dispose of a substantial part of the company's business or assets to a connected person within 8 weeks of the start of the administration
- In such circumstances, the administrator must obtain either creditor approval for the disposal or a report from the purchaser
- The report should be prepared by an evaluator and should consider whether the grounds and consideration for the disposal are reasonable
- The evaluator report will either declare the 'case made' or the 'case not made'
- Even if the evaluator declares 'case not made' the administrator may still proceed provided they provide an explanation to creditors

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Recent Developments and Expected Trends

- Crown preference
- Insolvency Act Applications and procedure

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Crown Preference

- What is it?
  - Preferential status to HMRC in respect of VAT, PAYE, income tax, employee national insurance, student loan deductions and Construction Industry Scheme Deductions
  - Brought into effect by the Finance Act 2020 (s.98) and amendment to the Insolvency Act 1986 (s.386)
- Previous History:
  - Pre-2003 – HMRC retained preferential status in relation to all unpaid taxes, capped at 12 months of arrears depending on the tax
  - Crown preference abolished by the Enterprise Act 2002

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Crown Preference – Effect on Waterfall

- Fixed charge holder(s)
  - Liquidation/administration expenses
    - Preferential creditors:
      - Ordinary preferential creditors (e.g. employees)
      - Secondary preferential creditors (HMRC source taxes)
        - Prescribed part
          - Floating charge holder(s)
            - Unsecured creditors (including HMRC in respect of non-source taxes)
              - Shareholders

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Crown Preference – Application in Practice

- Effect on Lending
  - Floating charge holders exposed
  - Decrease in lending, especially in distressed situations
  - Where lending available, increase in rates and due diligence
  - Likely increase in insolvency processes
- Reduced distribution to general unsecured creditors
  - Reduced appetite to bring winding up petitions
- Control on CVAs
- Characterisation of fixed and floating charges
  - ***Re Spectrum Plus Ltd; National Westminster Bank plc v Spectrum Plus Ltd and others [2005] UKHL 41***

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Insolvency Act Applications and Procedure

- Hybrid claims involving Insolvency Act claims and Part 7 actions
- ***Manolete Partners Plc v Hayward And Barrett Holdings Ltd & Ors [2021] EWHC 1481 (Ch)***
- ***Taunton Logs Ltd (In Liquidation) and others v Cruickshanks and other [2020] EWHC 3480 (Ch)***

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Taunton Logs Ltd (In Liquidation) - Facts

- Administration on 14 June 2018 and thereafter entered creditors voluntary liquidation on 11 June 2020
- It was common ground that 15 shareholders personally paid only 30% of the nominal value of the shares allotted to them
- By an Insolvency Act Application Notice, the Administrators and the Company sought various declarations to seek payment:
  - Pursuant to s. 33 of the Companies Act 2006 and the company's Articles of Association
  - Pursuant to paragraph 19 of Schedule 1 and paragraph 60(1) of Schedule B1 to the Insolvency Act 1986
  - A claim in debt

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Taunton Logs Ltd (In Liquidation) – Respondents' Application

- Strike out application by 15 Respondents:
  - The true nature of the claim against the Respondents was a simple debt claim
  - The court was not concerned with uncalled capital, and the making of a call for monies unpaid in respect of shares. Consequently, paragraph 19 of Schedule 1 of the Insolvency Act 1986 was not engaged
  - "Insolvency proceedings", which may be brought by way of Insolvency Act Application Notices as provided for by rule 1.35 of the Insolvency Rules 2016 are confined to applications made specifically under the Insolvency Rules 2016 or the Insolvency Act 1986, and in particular Parts 1 to 11
- The Liquidator relied on ***Phillips v McGregor-Paterson [2010] 1 BCLC 72*** - it was open to the court to rectify the defect either under Insolvency Rule 12.64 , or under CPR 3.10

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Manolete v Barrett – Facts

- Blackwater Plant Ltd entered in to creditors voluntary liquidation on 17 August 2018
- Claims assigned to Manolete Partners Plc by the Liquidators of Blackwater Plant Limited. The assigned claims included:

  "all and any claims that [Blackwater] may have…such claims to include…breach of duty at common law, breach of fiduciary duty or statutory duty or other legal or equitable duty, any claim in fraud, whether common law or equitable fraud, conspiracy by unlawful means and/or any claim under the…Companies Act 2006."

- Insolvency Act Application for various relief including antecedent transactions and breach of duty

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Manolete v Barrett – Respondents' Application

- Application for an unless order requiring Manolete to pay the issue fee that would have been payable under a Part 7 claim
- Manolete had no authority or power to make a claim pursuant to section 212 of the Insolvency Act as it did not fall within any of the categories of person able to make such an application under section 212(3): Re Ayala Holdings Ltd (No 2) [1996] 1 BCLC 467 applied
- Manolete's response:
  - Distinguished Taunton Logs on the facts – approach taken by HHJ Cawson QC was contrary to established practice: ***TSB Bank Plc v Katz*** **[1997] BPIR 147**, *Re Shilena Hosiery Co Ltd* [1980] Ch 219 and *Re Clasper Group Services Ltd* (1988) 4 BCC 673
  - It is "illogical" to have two sets of proceedings. Such an outcome would lead to a "waste of time and court resource" which is contrary to the principles in CPR 1.1

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Manolete v Barrett – Judgment

- Insolvency application notices may only be used to issue proceedings brought under Parts 1–11 of the Insolvency Act 1986
- *"I reach these conclusions with regret. The criticisms of the procedure are well made by Mr Curl. They do not promote a convenient or sensible or economical use of court resource. In modern parlance the result fails to ensure that claims of this nature are dealt with expeditiously, allotting an appropriate share of the court's resources. An office-holder and assignee of claims will be forced to issue claims arising from an insolvency using different procedures, in different lists within the Business and Property Courts, with a risk that without a transfer they will be case managed, at least, by different judges although the claims arise out of the same facts"*
  - S

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Manolete v Barrett – Applications Going Forwards

- Effect on Hybrid claims and nil-asset estates
- Correct procedure
- Insolvency Service Consultation

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Questions?

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Corporate Law webinars in 2021

- VC0121 Brexit and corporate law (2021) - Q1 2021
- VC0221 The UK Corporate Governance Code (2021) - Q1 2021
- VC0321 Money laundering in 2021 - Q2 2021
- VC0421 The latest in corporate governance (2021) - Q2 2021
- VC0521 Corporate insolvency (2021) - Q2 2021
- VC0621 The Takeover Code in 2021 - Q3 2021
- VC0721 Financial reporting in 2021 - Q3 2021
- VC0821 Corporate dispute resolution (2021) - Q4 2021
- VC0921 Climate change reporting (2021) - Q4 2021
- VC1021 Corporate Law - end of year round-up 2021 - Q4 2021

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