Milbank

Financial Restructuring Group

Client Alert

UK government proposes new legislation introducing significant changes to UK restructuring and insolvency regime

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On 20 May 2020, the Corporate Insolvency and Governance Bill had its first reading in the House of Commons. This is the bill that enacts many of the measures referenced in the government's announcements earlier this year. Alongside some temporary Covid-19 response measures, the Bill introduces several permanent changes that will have a significant impact on the range of options available to creditors and debtors in distressed situations.

As the Bill is in draft stage, there could still be changes to the legislation before it comes into force. However, in this summary we provide an overview of the core elements which we expect to be part of the legislation when it takes effect.

Permanent reforms

Moratorium

The Bill introduces a new moratorium for a company that is, or is likely to become, unable to pay its debts. The moratorium is intended to create breathing room for the company – with a payment holiday in respect of certain pre-moratorium debts, and a stay on legal proceedings and security enforcement during the moratorium period.

The moratorium is a "debtor-in-possession" procedure, leaving the company's management and directors to run the business, subject to the oversight of a "monitor". The monitor is an insolvency practitioner but, in this role, performs a light-touch supervisory function, essentially tasked with monitoring that it is and remains likely that the moratorium would result in the rescue of the company as a going concern.

The moratorium lasts for an initial period of 20 business days but is extendable by another 20 business days by the company. Further extensions beyond this period require creditor consent, or court intervention.

The moratorium was hinted at in the March announcements, and the Government views it as a means to give struggling companies time and space to address their financial difficulties so as to ensure their survival.

New scheme / Restructuring plan

A further novelty, which has the potential to dramatically impact the way financial restructurings are implemented in the UK, is the new scheme of arrangement. In prior government consultations, this was referred to as a "restructuring plan", but the Bill slots the new provisions to English corporate law alongside and supplemental to the existing scheme of arrangement framework.

The new scheme is targeted at companies in financial distress – the company must have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern. The new scheme is intended to eliminate, reduce or prevent, or mitigate the effect of, any of those financial difficulties.

The fact that the "new scheme" is modelled on the existing scheme of arrangement provisions will bring a significant degree of comfort, as existing case law will, to a large extent, remain relevant. The key difference between the "old" and "new" schemes is that the new regime introduces a cross-class cram-down, allowing a scheme to be sanctioned even where one voting class has not approved the proposal at its scheme meeting.

A number of the features of the new scheme will be welcomed by the restructuring community as addressing failings of the old regime, which were often dealt with by sandwiching together different processes with consequent increased cost and complexity. However, the lack of protections for dissenting or "out of the money" classes – in particular the omission of any protection akin to the absolute priority rule under Chapter 11 – is a cause for concern.

Insolvency termination clauses

The Bill also introduces provisions restricting a supplier of goods or services to a company who is subject to an insolvency procedure from terminating that contract, or conditioning future performance on the payment of existing debts. Although similar provisions had been introduced in respect of "essential" suppliers in the context of administration, the provisions set out in the Bill would go further in terms of the range of suppliers and circumstances in which they would apply. There are some protections for suppliers, including an ability to apply to court to allow termination on grounds of hardship. There is also a temporary suspension with respect to small suppliers, which will last until the later of 30 June 2020 or 1 month after the Bill comes into force.

Temporary Covid-19 response measures

Wrongful trading

One of the key features of the Government's announcement in March was the proposal, which was publicly announced a few months ago but is only introduced in this Bill, that a directors' potential personal liability for wrongful trading be temporarily suspended. The suspension will apply to trading between the period starting 1 March 2020 and ending 30 June 2020 (or one month after the legislation takes effect, if later).

The wrongful trading provisions mean that directors of limited liability companies may become personally liable for certain business debts if they continue to trade when there is no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration. The aim of the suspension appears to be to encourage directors of businesses which have been hit by the economic turmoil caused by Covid-19 and resulting public health measures to try and work through the current circumstances without feeling obliged to file for insolvency. It is, however, important to note that this is a temporary and relatively limited suspension with a number of carve outs. Furthermore, directors' other duties, such as fiduciary duties, will still continue to apply.

Winding-up petitions etc.

The second temporary measure suspends the ability of creditors to present winding up petitions and statutory demands. It is not a wholesale suspension, as petitions etc. are allowed where it is able to be shown that coronavirus has not had a financial effect on the company, or that the grounds for the petition would have arisen even if coronavirus has not had a financial effect on the company. The provision will have retrospective effect, with it being regarded as having come into force on 27 April 2020, and will last until the later of 30 June 2020 or one month after the Bill comes into force.

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