Feature

KEY POINTS

- A cessation of business clause may be triggered by a disposal of part of a business outside an insolvency scenario.
- Whether the clause will be engaged will be a question of fact and degree depending upon all the circumstances.
- However, some guidance can be drawn from consideration of the drafting of "material adverse change" clauses which address the meaning of "material".
- Other caselaw assists in the construction of the term "substantial" and companies should consider carefully a disposal of more than 10% of its business.

Author Charlotte Eborall

Atishoo, atishoo: we all fall down? Implications of business disposals upon cessation of business clauses

In this article Charlotte Eborall examines how a company considering a change in the entity's structure or business by divestment of part or all of its business can avoid potential issues relating to the triggering of a "cessation of business" event of default clause. It also considers how the courts might approach the question of interpretation of such clauses should one proceed to trial.

In December 2024, a group of investment companies sued Essity alleging that the manufacturer of hygiene and health products had defaulted on bond notes when it sold a 51.6% stake in Vinda (a Chinese tissue company, part of the Essity group) to Isola Castle Limited. The eight investors, who are the ultimate beneficial owners (UBOs) of certain loan notes issued by Essity, have invited the High Court to declare that the sale constituted a "cessation of business" triggering an event of default that would result in Essity being obliged to repay medium term, flexible debt securities early pursuant to such demand.[1]

Other hedge funds and private equity firms are attempting to exploit the cessation of business clause to the same end,[2] arguing that such provisions are triggered by disposals, restructurings, or carve-outs, sometimes despite the business continuing in its new guise.

This article examines the potential issues arising in a company restructuring or divestment as regards event of default clauses. It also considers how the courts might approach the question of interpretation of such provisions.

STANDARD FORM AGREEMENTS

Default provisions relating to "cessation of business" are not new. Indeed, they are common in many standard form contracts. The Loan Market Association (LMA) in London has developed model agreements to facilitate the smooth running of the loans market and the events of default section in their documentation includes a cessation of business clause. International Capital Market Association (ICMA) bond and note documentation also commonly includes a clause allowing for acceleration of debt if the issuer ceases or threatens to cease substantial business operations. Although the International Swaps and Derivatives Association (ISDA) Master Agreement does not automatically contain such a clause, it may be added in a credit support annex or bespoke schedule.

Such clauses are usually found under the insolvency-related events of default. However, that does not mean that the relevant event need be an insolvency event itself, or a cessation of business instigated due to insolvency concerns.

Of course, the devil is in the detail and the precise drafting of the provision will be crucial in determining whether it could be alleged that an event of default has occurred. The usual formulation of such a clause is that the following constitutes an event of default:

> "An Obligor suspends or ceases to carry on (or threatens to suspend or cease to carry on) all or a material [or substantial] part of its business except as a result of any disposal allowed under this Agreement."

Even where the standard form wording is used and there is no deviation or amendment by the parties, the wording of the event of default, gives rise to several areas of uncertainty.

WHAT IS A "SUSPENSION" OR "CESSATION" OF BUSINESS?

Each of these terms, according to their ordinary meaning, connote an ending of the business in question. However, that end need not be permanent. This is apparent from the inclusion of the word "suspension" in the alternative to a "cessation" of business (although, in a different context, even a "cessation" was construed as being capable of being either temporary or permanent: see *Spowage v Revenue an Customs Commissioners* [2009] UKFTT 142 (TC), considering the meaning of "ceased" in the Offshore Installations and Pipeline Works (Management and Administration) Regulations 1995, reg 3(2)(d)). However, how long must a "suspension" or "cessation" of business be to trigger an event of default?

There is a dearth of case law directly on this point. However, the meaning of "suspension of business" has been considered by the English courts in the insolvency context.[3] There, the court will enquire whether the business has been abandoned in its entirety, either wilfully or simply due to the inability to carry on trading for other reason: *Re Madrid and Valencia Railway Co* (1850) 19 LJ Ch 260.[4] It must be something more than the suspension of trading on a seasonal basis[5] or the suspension of business as a temporary measure to allow a trade recession to pass.[6] The fact that a company has simply ceased activity in a certain area and become a holding company is not sufficient to satisfy

the meaning of suspension, at least under the statute: *Re Eastern Telegraph Co Ltd* [1947] 2 All ER 104. Further, if the company can show that there was no intention to abandon the business, "either wilfully or simply due to inability to carry on trading for other reasons", then it is less likely that a cessation or suspension of business has occurred.[7]

If the clause specifies the period of suspension (for example a suspension of business for more than 21 days), then the event of default will be triggered if that time has passed. However, otherwise, the above authorities can offer some guidance, but ultimately each case will depend upon its own facts.

THE "BUSINESS" THAT IS CEASED

A second question that arises is the nature or the size of business that is ceased. For example, if a retail business sells or does not renew the leases in respect of its physical stores, it may be said that such divestment of assets constitutes a cessation of business. But if the purpose of releasing those stores is to plough resources into a flourishing online business, then arguably the "business" has been retained and not ceased. Does one then take account of the nature of the business or its size? Does one consider a business to have been suspended or ceased only when its shares are sold or when assets are sold? Can a "cessation" in revenue or profit ever trigger the clause?

In such cases, the first task is to identify the business of the relevant company. A holding company, for example, is in the "business" of buying, holding, and selling its subsidiaries therefore this would, it is submitted, be unlikely to trigger a cessation of business clause (unless it were to cease being a holding company altogether). However, the business of a trading company without significant subsidiaries will be relatively simple to identify and therefore whether there has been a cessation of business will also be relatively easy to determine.

As to the question whether one looks to shareholding or assets or some other attribute of the business, a sale of shares would be likely to be considered further, as would a significant selling-off of assets that were assets used in the carrying on of the company's business. It is submitted that the terms "cessation" and "suspension" do not sit easily with the income generating ability of a company: a company would be unlikely to intend to stop earning revenue or profit, and a failure to do so in a particular period, should not trigger a cessation of business clause.

Companies undertaking internal reorganisations or considering disposals of all or part of their subsidiaries should also be wary of cessation of business clauses. Some clauses are drafted to prevent a cessation of business not only of the holding company but also of any material subsidiaries, or sometimes even all subsidiaries. Even an internal transfer from a company to its wholly owned subsidiary could, depending upon its interpretation, trigger the clause.

TO "THREATEN" TO SUSPEND OR CEASE BUSINESS

In the context of considering whether a right to appoint receivers had arisen, the court considered that a "threat" to cease to carry on business did not require a statement of threat with menaces but covered the case where the company by objective facts presented a threat that it would cease to carry on business: see *Demite Ltd v Protec Health Ltd* [1998] BCLC 638 (Park J) (in that case, a warning that the company might cease to trade gave rise to a triable issue on this point).

A "MATERIAL" OR "SUBSTANTIAL" PART OF THE BUSINESS

Another question of interpretation, and one which has received more coverage in the authorities, is whether a "substantial" or "material" part of the business has ceased or suspended.

In relation to the term "material": in *Attrill & Ors v Dresdner Kleinwort Ltd* [2012] EWHC 1189 (QB) at 242, Mr Justice Owen, considering the meaning of "additional material deviations" held that the word "material" must mean "a deviation of substance, i.e. more than de minimis …". Certainly, in the context of an event of default, which holds serious consequences for the alleged defaulter, any alleged cessation of business must be more than de minimis. But how significant must it be?

Although tempting to do so, in the majority of cases, the courts have declined to apply fixed percentages or thresholds to the term, instead preferring to elaborate on the meaning of such language by further explanation.

The authorities were summarised by Lionel Persey KC, sitting as a Judge of the High Court, in *Finsbury Food Group PLC v Axis Corporate Capital UK Ltd* [2023] EWHC 1559 (Comm) at [119]:

> "What, therefore, is a material adverse change for the purposes of the TCW? The parties are agreed that there is no set meaning that has been ascribed to these words in the authorities. Similar words have been considered in the following recent cases: *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 (Comm); *Decura IM Investments LLP v UBS AG London Branch* [2015] EWHC 171 (Comm); and *Travelport Ltd v WEX Inc* [2020] EWHC 2670 (Comm). In the *Decura IM* case Burnton J held, at [7] and [31] that a 'material adverse effect' meant something that was substantial or significant, as opposed to something of a de minimis level. In the *Grupo Hotelero* case Blair J held at [364] that an adverse change would be material if it significantly affects the borrower's ability to repay the loan in question. In other cases, however, such as *Kitcatt & Ors v MMS UK Holdings Ltd and Ors* [2017] EWHC 675 (Comm), a material adverse impact was specifically defined, in *Kitcatt* as being at least 20% in the case of operating income and 10% in the case of revenue [196]."

In *Finsbury Foods*, the judge was not prepared to read across from a different clause into the relevant provision a threshold of 20%, determining that they were two separate warranties with different criteria applied to them. However, the judge was satisfied that a material adverse change since the account date must exceed 10% of the total group sales of the company to result in a breach, as the judge considered that this would be a sufficiently significant or substantial change over the relevant period. As to the word "substantial", the courts too have been reluctant to define this by reference to numerical methods. In other contexts, consideration of the word "substantial" has been determined "not merely as a mathematical calculation, but in the exercise of a broad judgment and by common-sense considerations" (*Goel v Sagoo* [1970] 1 QB 1 at 9 per Fenton Atkinson LJ, CA (approving the decision of the

Biog box
Charlotte Eborall is a barrister practising from 3 Verulam Buildings, Gray's Inn, London. Email: ceborall@3vb.com

judge at first instance in relation to what formed a "substantial portion" of rent) and has been said to be "like a chameleon, taking its colour from the environment" (*R v Monopolies and Mergers Commission, ex p South Yorkshire Transport Ltd* [1993] 1 WLR 23 at 29-30 per Lord Mustill, HL (who referred also to the "protean" nature of the word and that it can accommodate a wide range of meanings depending on its context).

That said, and taking the approach from other contexts, anything greater than 10% should be scrutinised more closely as to whether it may be considered a "substantial" part of the business (see s 191(2) of the Companies Act 2006, under which, for the purpose of restrictions on "substantial property transactions" an asset is of the requisite value if (inter alia) it exceeds 10% of the company's asset value).

CESSATION OF BUSINESS IN OTHER CONTEXTS

Although there is little authority considering a cessation of business clause in the event of default context, guidance may be drawn from the following situations:

(i) Tax

Whether a company has ceased to trade has been the subject of certain revenue and customs decisions:

- In *Spring Capital Ltd v Revenue and Customs Commissioners* [2019] UKFTT 699 (TC), the court reiterated the fact-sensitive nature of the enquiry. At [81], it was noted that: "The fact that a company begins to reduce its trading activity with a view to ceasing to trade does not mean that it thereupon ceases to trade. Its trade continues, albeit at a reduced level, until its activities become so diminished that it can fairly be said that the trade has ceased. The date on which the cessation of a trade occurs must, in my view, **always be a question of fact and degree to be assessed in the light of all the circumstances**".
- In *Potter v Revenue and Customs Commissioners* [2019] UKFTT 554 (TC), the court considered that a cessation of business must mean something with more finality: see [60]: "If there comes a time when it is clear that there is no realistic possibility of the efforts to drum up new business leading to future trading transactions, it can no longer be said that the trading activities are being carried out for the purposes of a trade, or for the purposes of a trade that the company is preparing to carry on. At that point, the company must cease to be a trading company".

(ii) Employment law

In *Wood v Caledon Social Club Ltd* [2010] 3 WLUK 374, the court held that there had been a temporary cessation of a bar operation as a result of it being closed between 16 September and 6 October.

(iii) Company Law, crystallisation of a floating charge

There are suggestions in several cases that crystallisation occurs when the company ceases to carry on business or ceases to be a going concern. The two situations are similar but not identical. A company may cease to be a going concern without ceasing to carry on business. In *Re Woodroffes (Musical Instruments) Ltd* [1986] Ch 366, Nourse J held that "crystallisation occurred in the latter case but not the former".[8]

CONCLUSION

Whilst each case will depend upon its own facts and circumstances, and the specific drafting of the clause, the above discussion demonstrates that a disposal of as little as 10% of the business may fall within a cessation of business clause.

Companies considering a divestment of assets or shares should therefore review their financing documentation to assess whether their proposals are susceptible to such a dispute. When agreeing new financings, it would be prudent for companies and their legal advisers to consider the inclusion and, if included, the drafting, of cessation of business clauses to avoid such scenarios occurring.

Meanwhile, Essity has publicly stated that it is "robustly defending the claim".[9] In a recent jurisdiction hearing,[10] Essity was unable to persuade the court that there was no serious issue to be tried that a court would grant the UBO investors the declaratory relief they sought. Those proceedings continue. ■

1 *Caxton International Limited and others v Essity Aktiebolag (Publ) and anor*, FL-2204-000021 (issued on 12 December 2024 in the High Court of Justice, Chancery Division).
2 *Financial Times*, 'Hedge funds target quick profit from obscure corporate bond clause': https://www.ft.com/content/9b0656e8-eae8-4bc7-9702-793e7bec30ab; Bloomberg, 'WH Smith Sale of Store Could Mean Default Event', Jefferies Says: https://www.bloomberg.com/news/articles/2025-01-29/wh-smith-sale-of-stores-could-mean-default-event-jefferies-says?embedded-checkout=true.
3 Under s 122(1)(d) Insolvency Act 1986, a company may be wound up by the court if it does not commence its business within a year from its incorporation or *suspends its business* for a whole year.
4 Recently cited in the General Division of the High Court of the Republic of Singapore in *Grimmett, Andrew v HTL International Holdings Pte Ltd* [2022] SGHC 137 at [81].
5 *Re Tomlin Patent Horse Shoe Co Ltd* (1886) 55 LT 314 (the cessation of business was satisfactorily explained by the fact that the company did very little business in the winter months).
6 *Re Middlesborough Assembly Rooms Co* (1880) 14 Ch D 104, CA (A company formed for building, using, and letting assembly rooms resolved by majority to halt progress when the market was (temporarily) depressed).
7 *Re Middlesborough Assembly Rooms* (1880) 14 Ch D 104, CA.
8 See also *William Gaskell Group Ltd v Highley* [1993] BCC 200; [1994] 1 BCLC. 197 Ch D (ceasing to carry on business for the purpose of crystallisation is a question of fact).
9 https://www.essity.com/media/news-features/2025/information-in-connection-with-an-ongoing-dispute-regarding-certain-bonds-issued-by-essity/
10 [2025] EWHC 1477 (Ch) (Fancourt J).

Further Reading:

- Teniola Onabanjo: Covid-19 and Suspension of Business/Operations Events of Default Clauses (2020) 11 JIBFL 756.
- Lexis+® UK: LexisPSL Banking & Finance Practical Guidance: Practice Note: Events of default in debt capital markets transactions.