Three Verulam Buildings Barristers

CIGA Guide update

Corporate Insolvency and Governance Act 2020 ("CIGA") Guide – Update

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Introduction

The Corporate Insolvency and Governance Act 2020 ("**CIGA**") was enacted on 25 June 2020. Since coming into force, certain of its provisions have been amended by way of statutory instrument, and others have received judicial gloss as the courts have begun to grapple with this significant piece of insolvency legislation.

Upon the enactment of CIGA, members of 3 Verulam Buildings produced a guide ("**the Guide**") to the key reforms introduced by the Act, a copy of which is **annexed** to this update. As promised in that Guide, with the anniversary of CIGA's enactment upon us, this update sets out the key developments to the legislation and its interpretation by the courts.

Specifically, this update focuses on (i) the new statutory moratorium, (ii) the new restructuring plans, (iii) the restrictions applied to the presentation of winding-up petitions, and (iv) the temporary suspension of liability for wrongful trading.

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Moratorium

The current indications are that extremely little use is being made of the free-standing statutory moratorium introduced by CIGA to afford financially distressed companies breathing space from creditor action. The Gov.uk website records that between 26 June 2020 and 31 May 2021, only four companies obtained such a moratorium[1].

In the circumstances, the effectiveness of this element of statutory protection must be seriously doubted. In our Guide, we expressed concern that the moratorium procedure has been restricted to too few companies and, even for those companies, the bar has been set too high. This appears to be borne out by the numbers which have been reported by the Insolvency Service.

Restructuring Plan

The introduction of the new Part 26A of the Companies Act 2006 (restructuring plans) was accompanied by a new *Practice Statement* [2020] 1 WLR 4493 covering that Part and Part 26 (schemes of arrangement). The Practice Statement offers guidance as to how the court expects applicants to canvass the opinions of persons affected by their proposals. In particular, applicants should circulate notices explaining the purpose of the plan, the intended class composition, matters relating to jurisdiction, and any reasons why the court may refuse to sanction the scheme. This should be done in sufficient time for the recipients to take advice and respond if they wish. In this way, any objections should emerge at an early stage.

The Insolvency Service has reported a slightly better uptake in restructuring plans than in moratoriums. Apparently, between 26 June 2020 and 31 May 2021 nine companies had such a plan registered at Companies House.

Since CIGA came into force, there have been a number of important cases under Part 26A. On the whole, they emphasise the similarities with Part 26. The following cases are particularly noteworthy in dealing with the more innovative aspects of Part 26A:

- In *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch), Trower J noted that the requirement that the plan should 'eliminate, reduce, prevent or mitigate' the effect of the financial difficulties should be expansively construed.
- In *Re Deepocean 1 UK Ltd* [2020] EWHC 3549 (Ch) (convening hearing), Trower J in particular considered Conditions A and B under s.901A of CA 2006. He held that the requirement in Condition B – to eliminate, reduce, or prevent, or mitigate the effect of the financial difficulties stated in Condition A – should not be interpreted narrowly. He held that although Condition A refers to financial difficulties which are sufficiently serious to affect the company's ability to carry on business as a going concern, Condition B does not require the purpose of the scheme to preserve the company's ability to continue as a going concern. Instead, two questions have to be addressed. The first is to identify the effects of the financial difficulties, the second is to determine whether the plan purports to reduce the impact of those financial difficulties. So, as in this case, where the proposed plan provides for a slightly enhanced dividend for creditors compared with the relevant alternative (eg liquidation or administration) Condition B is still satisfied. This is because although there is no mitigating effect on the company's ability to continue carrying on business there is a mitigating effect on the severity of the losses which the creditors would otherwise suffer. In short, the enhanced ability of the company to continue as a going concern is not the only purpose for which sanction may be granted. See the judgment at [44] to [49].
- In *Re Deepocean 1 UK Ltd* [2021] EWHC 138 (Ch) (sanction hearing), Trower J considered for the first time the 'cross-class cram down' under s901G, concluding that it was appropriate to approve the plan despite one class of unsecured creditors giving only 65% approval at the plan meeting (rather than the 75% otherwise required). Relevant considerations included the facts that (1) companies outside the plan would provide the benefits under the plan; and (2) the 'relevant alternative' to the plan was a liquidation or similar process, in which unsecured creditors would receive nothing or a nominal amount.
- In *Re Gategroup Guarantee Ltd* [2021] EWHC 775 (Ch), Zacaroli J sanctioned a restructuring plan despite the fact that the applicant was an English company created specially by a Swiss parent company to engage the jurisdiction of the court. This artificial approach was held to be 'good forum shopping' because it created the best outcome for all involved, since the only alternative was a value-destructive liquidation.
- In *Re Virgin Active Holdings Ltd* [2021] EWHC 814 (Ch), Snowden J ordered the disclosure of further financial information to address concerns about the adequacy of the explanatory statement under s901D. In a later hearing [2021] EWHC 1246 (Ch), Snowden J sanctioned the restructuring plan, implementing a cross-class cram down against some classes of unsecured creditors, many of whom had given 0% approval at the plan meeting (and in so doing Snowden J approved the approach taken in Deepocean).
- In *Re Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch), Trower J held that although the court did not require certainty that the scheme would come into effect, it did require some degree of assurance. Where the scheme's effectiveness was entirely at a third party's discretion, that would cut across the court's discretion and the approval of creditors. On the facts of this case, the viability of the scheme depended on whether a pension fund creditor was willing to extend a put option because that extension was required to guarantee a cash injection to fund the scheme. The court could not form a view as to whether the extension would be granted because discussions were still ongoing without any certainty of outcome. It was not appropriate to grant an order for sanction on a condition basis as that would be to abrogate discretion to the pension fund. Therefore, Trower J adjourned the sanction hearing to a return date to enable an agreement over the put option to be reached. See [42] to 43], [51] to [65] and [73] to [76].

Finally, as noted in the Guide, section 8 of CIGA dealt with a different kind of restructuring of companies in financial difficulty, by allowing the Secretary of State to make regulations for pre-pack administrations. That has now happened. The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 came into force on 30 April 2021. In short, the Regulations require either creditor approval or a 'qualifying report' before the administrators may dispose of all or a substantial part of the company's assets to a person connected to the company in the first 8 weeks of administration. The 'qualifying report' must come from an independent 'evaluator' and must explain whether the consideration is reasonable in the circumstances. Whether the use of such 'qualifying reports' suffices to address concerns about pre-pack administrations remains to be seen.

1 www.gov.uk/government/statistics/monthly-insolvency-statistics-may-2021/commentary-monthly-insolvency-statistics-may-2021

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Winding-up Petitions and Statutory Demands

Since CIGA was enacted, there have been two developments worthy of mention concerning winding-up petitions and statutory demands:

- First, The "relevant period" (a statutory demand served in which cannot form the basis for a winding-up petition) now ends on 30 June 2021 as a result of The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2021 (S.I. 2021, No. 375).
- Second, the restrictions on the ability to present winding-up petitions currently in force were considered in an unreported judgment given by ICC Judge Baister in a *A v B* on 18 March 2021. In that case, the court was required to determine at a preliminary hearing whether it was likely that the petitioner would succeed on its petition having regard to the restrictions imposed by CIGA.
- The first issue was the requirement imposed by paragraph 2 of part 2 of Schedule 10 to CIGA that the creditor have reasonable grounds to believe that COVID-19 had not had a financial effect on the company, or that the ground upon which the petition was presented would have applied even if COVID-19 had not had a financial effect on the company. The petitioner had relied on the company's inability to pay its debts as they fell due. Judge Baister held that on the evidence the court could be satisfied that the company was insolvent in November 2019, before the pandemic, and that that state of affairs had continued. Accordingly, the requirement had been met.
- The second issue was the requirement imposed by paragraph 5 of part 2 of Schedule 10 to CIGA that the court be satisfied that the company would have been unable to pay its debts as they fell due regardless of COVID-19 if it was to make a winding-up order under section 122 of the Insolvency Act 1986. Judge Baister held that that was a prospective test, inviting the court to look at the future and consider whether it was likely that the court would be able to make a winding-up order. He held that it would be wrong to form a view as the application before him was a preliminary hearing but, for the same reasons as applied to the first requirement, there was a likelihood of the winding-up order being made.
- In the circumstances, the Court permitted the petitioner to proceed with its winding-up petition against the company.

Temporary Suspension of Wrongful Trading Liability

As addressed in the Guide, CIGA temporarily suspended directors' liability for wrongful trading from 1 March 2020 to 30 September 2020. With a short break over October and November 2020, this was subsequently extended to 30 June 2021 by the Government as its response to the pandemic continued.

Specifically:

- The suspension was originally introduced under section 12 of CIGA in March 2020, expiring on 30 September 2020.
- The Government reintroduced the temporary suspension from 26 November 2020 until 30 April 2021 by way of The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020.
- This was extended to expire on 30 June 2021 by way of The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2021.

The UK government's recent announcement on 16 June 2021 regarding a further extension of some of the temporary measures introduced by CIGA did not include a further extension of the temporary suspension of wrongful trading liability.

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The annexed guide can be viewed here.

Three
Verulam
Buildings
Barristers

Contributors to the Guide and this update:

Jamie Riley QC

jr@3vb.com

Angharad Start

astart@3vb.com

Philip Hinks

phinks@3vb.com

James McWilliams

jmcwilliams@3vb.com

Anthony Pavlovich

apavlovich@3vb.com

Emmanuel Sheppard

esheppard@3vb.com

William Day

wday@3vb.com

3 Verulam Buildings
Gray's Inn, London WC1R 5NT
T +44(0)20 7831 8441
E chambers@3vb.com

www.3vb.com