Tuesday, June 9, 2020

As set out in the first blog in this series, the Corporate Insolvency and Governance Bill (the “Bill”) introduces a new debtor-in-possession moratorium to give companies breathing space in order to try to rescue the company as a going concern.

The first blog outlined how the moratorium will work and the second blog focused on the key provisions that secured lenders should be aware of. This blog will outline issues for other stakeholders – the insolvency practitioner ("IP") monitoring the moratorium (the "monitor"), creditors, suppliers, the debtor company and its directors.

**The Monitor**

In a moratorium, directors remain in control and continue to trade in the ordinary course of business. The monitor does not have the same level of control as in an administration, for example, so an element of trust in the directors is required i.e. that they will report to the monitor as appropriate and abide by the restrictions on the company. Such trust may be difficult to gauge, particularly in the current climate where prospective monitors are unlikely to be meeting directors face-to-face.
In order to enter, extend and continue a moratorium, the monitor must be of the view that the moratorium is or remains likely to “result in the rescue of the company as a going concern.” During the “COVID Period” (i.e. for the month following the act coming into force, unless extended) a caveat is added to the end of the test, to the effect that the moratorium could still result in a rescue if any worsening of financial position due to COVID-19 were disregarded. There is no clear guidance on what “likely” means in this context – does it mean more likely than not? A 50%+ chance? On the balance of probabilities? In addition, reaching these conclusions may require the monitor to carry out a reasonable degree of investigation and enquiry to justify their decision. Finally, the COVID-19 aspect of the test, whilst introduced to help companies obtain the benefit of the moratorium during this time, may add undesirable complexity – how can a monitor be sure what worsening in financial position is due to COVID-19 or not?

IPs may also be wary of obtaining payment of their fees and should consider arranging a suitable pre-moratorium fee payment strategy. Fees for the moratorium period will be payable as an expense of the moratorium (and would also be given super priority in any subsequent insolvency within 12 weeks). However, the monitor’s fees are at the bottom of the moratorium expense list and so IP’s need to be wary that the IP may not get paid or may even have to repay fees if a moratorium fails and there are unpaid suppliers, employees, finance costs etc from the moratorium trading period. In addition, pre-moratorium fees are within the category of debts benefitting from a payment holiday. Although the monitor can consent to the payment of pre-moratorium debts above certain thresholds, such consent must only be on the basis that payment will support the rescue of the company on a going concern basis and it is unlikely that the monitor could sanction payment of their own fees in these circumstances.

A monitor may be more willing to take the risk on fees, if they were to take the role of administrator/liquidator in any subsequent insolvency. Although there is nothing in the draft legislation preventing this, IPs should consider any subsequent insolvency appointment in line with the prior professional relationship rules and any guidance provided by their regulatory bodies.

The monitor’s actions (and omissions) can be challenged and the court may make such order as it thinks fit (although the court cannot order the monitor to pay compensation as part of such order). However, this will not prevent a subsequently appointed administrator or liquidator from pursuing claims against the monitor on behalf of the company for negligence or other causes of action. In addition, administrators and liquidators will have an express right to review a monitor’s remuneration.

**Creditors Generally**

Most pre-moratorium debts (including pre-moratorium rent and trade supplies, but excluding employee-related costs and moratorium rent) suffer a payment holiday during the moratorium. This means that debtor companies are not obliged to pay most debts to creditors (and are even restricted from paying pre-moratorium debts, above £5,000 or 1% of the value of the unsecured debts at the start of the moratorium, without the monitor’s consent).
In addition to the probable lack of payment, creditors are also subject to certain restrictions on enforcement action:

- Pre-moratorium creditors cannot apply to court to enforce their debt;
- Creditors cannot commence insolvency proceedings;
- No steps can be taken to enforce security or repossess hire-purchase goods (without court consent);
- No proceedings or other legal processes (except certain employment claims) can be commenced or continued without court consent;
- Landlords cannot forfeit leases without court consent; and
- No security can be taken over the company’s property (without the Monitor’s consent).

These restrictions may significantly impact creditors with retention on title (“ROT”) claims. In summary, ROT clauses in contracts prevent title to goods from passing until the goods have been paid for, and if the goods are not paid for, there may be certain rights to the proceeds of sale of those goods or an ability to reclaim the goods. The moratorium legislation provides for remedies for hire-purchase goods, but ROT is not addressed.

A ROT creditor will likely be a pre-moratorium creditor for which a payment holiday applies, whilst they could apply to court to enforce their ROT claim, they are likely to have to persuade the court that their interests outweigh the interests of creditors as a whole. This may be difficult when the purpose of the moratorium is to rescue the company and stock may be required to facilitate that. Therefore, the company could potentially be free to deal with the ROT stock in the ordinary course of business, but would not necessarily be obliged to pay the ROT supplier as a moratorium expense. This could have the (potentially unintended) consequence of the moratorium adversely affecting the rights of ROT creditors.

**Trade Suppliers**

Suppliers’ pre-moratorium debts will likely be subject to a payment holiday (see above), so it is important to monitor companies in your supply chain and ensure payment is kept to terms where you think there may be cash flow or solvency issues. As set out below, debtor companies are subject to certain publicity requirements, so websites and business documents should be checked to assess whether a customer is subject to a moratorium.

The Bill also introduces an *ipso facto* regime (see our blog for more detail), which may mean that a supplier is forced to supply during the moratorium and cannot change payment terms post insolvency. Any goods or services supplied during the moratorium must be paid as a moratorium expense, but suppliers should be aware of the ipso facto provisions and assess how this will impact their business.

**The Debtor Company/ Directors**

The moratorium poses many benefits for companies: (most) creditor pressure is removed; the company has a payment holiday for most trade debts; the moratorium is more streamlined and cost-effective than other insolvency processes; and it may be used as a standalone tool or as a gateway into a formal insolvency process.
However, directors should be aware of some drawbacks of the moratorium and carefully consider what is best for the company, in line with their directors duties (please see our guide for an overview of directors’ duties during COVID-19).

The Bill imposes certain publicity requirements on companies – companies must display the name of the monitor and that a moratorium is in force at the business premises, on each and every website and business document issued by or on behalf of the company (e.g. invoices, orders, business letter, order forms) and notify creditors to obtain credit over £500 (this includes being paid in advance for goods/services). Directors may therefore wish to consider the impact on goodwill and relationships with suppliers and ensure that this is managed appropriately.

Although the directors continue to run the business during the moratorium, there are various restrictions on what can or cannot be done without the monitor’s consent (e.g. paying pre-moratorium debts above a certain threshold, disposing of property and granting security over property). The business model will therefore need analysing and adapting to ensure that these restrictions are complied with. In addition, the monitor is required to continually assess whether the moratorium will result in the rescue of the company as a going concern. In order to do so, directors are obliged to provide certain information to the monitor when requested and failure to cooperate could result in early termination of the moratorium. It is therefore important that appropriate reporting mechanisms are in place to provide this information and communicate effectively with the monitor.

© Copyright 2020 Squire Patton Boggs (US) LLP

Source URL: https://www.natlawreview.com/article/uk-insolvency-law-changes-new-moratorium-and-other-stakeholders