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# THE NEW INSOLVENCY MORATORIUM: WHICH COMPANIES CAN INVOKE IT?


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### Biography

Kavan is ranked by the Legal500 and Chambers & Partners as a leading junior simultaneously in the fields of Insolvency and Property and Chancery-Commercial litigation, where quotes about him have included the following:

"*unfailingly brilliant*"; "*one of the best barristers in the area*";
"*exceptionally user-friendly*"; "*a delight to work with*"; "*clients love him*"
"*highly intelligent, quick to get to the bottom of an issue, articulate and charming*"
"*has a masterful grasp of the law*" and is "*as strong with strategic advice*"
"*a wonderful opponent - very able and slightly deadly*"
"*knows exactly how to present a case to a judge*" and "*gets amazing results*".

He is an author of 'Butterworth's Property Insolvency' and 'The Landlord and Tenant Factbook' amongst other texts, and has published articles recently, including in 'Butterworth's Journal of International Banking and Financial Law'. He has provided training for bodies including the PLA, ILA, R3 and the ICAEW, as well as in-house for leading law firms. His list of reported cases and full CV is available on the Chambers website.

## Introduction

1. When enacted, the Corporate Insolvency and Governance Act 2020 will introduce an additional corporate insolvency procedure into the Insolvency Act 1986, to sit alongside CVAs (Part I of the Act), Administration (Part II/s.8 and Sched. B1), Receivership (still Part III, although little used), Winding Up (Part IV) and Winding Up of Unregistered Companies (Part V). The new procedure will simply be called "the Moratorium". It will be found at the very start of the 1986 Act in a new 'Part A1' (containing 53 new sections numbered 'section A1' to 'section A53), with further detail set out in a new 'Schedule ZA1' (and, with less prominence, a new Schedule ZA2) to the 1986 Act.

2. "The Moratorium" will (on the one hand) be entirely new or novel for our legal system, in the sense that it will, for the first time:

   2.1. Allow a company to enter into a 'free-standing' legal process (not necessarily tied, for example, to the company's proposed entry into a CVA – as the old and rarely invoked 'Small Company Moratorium' was under the-soon-to-be-repealed Schedule A1; nor tied, for example, to the company's entry in to Administration, in the way that follows on from the short interim moratorium that is created by the filing of a notice of intention to appoint) – being a process which protects the company from creditor action, whilst giving it a 'breathing space' to formulate and/or implement a plan for how it might secure its recovery as a going concern.

   2.2. Allow the directors of the company to largely retain control of its affairs in the meantime (as opposed to handing those over to an Insolvency Practitioner of one kind or other), applying the concept of a 'debtor in possession' regime, of the kind which has long been seen and lauded under Chapter 11 of the US Bankruptcy Code and which has, at its heart, the goal of rescuing companies (rather than just their saleable business and assets) as a going concern.

3. On the other hand, the new Moratorium is not a new concept, in the sense that:

   3.1. It has been over 4 years since the Secretary of State for Business (then the Rt. Hon. Sajid Javid MP) signed off on the Government's law reform consultation paper on 26.5.16 entitled 'A Review of the Corporate Insolvency Framework', proposing the introduction of such a new Moratorium regime.

   3.2. It has been almost 2 years since the Government published its further official paper in relation to such proposals, entitled 'Insolvency and Corporate Governance – Government Response', signed off by then Minister for Small Business, Kelly Tolhurst MP, on 26.8.18. That papers announced that:

   > "5.4 The Government will seek to introduce new legislation to implement measures in line with the Government responses set out below [including the new Moratorium] *as soon as parliamentary time permits*".

   3.3. It has been some 3 years since the EU Restructuring Directive (EU) 2017/1132 and almost a year since the amending EU Directive of 20.6.19 (which require implementation by continuing Member States by a primary deadline of 17.7.21), and which pushed Member States towards the inevitable adoption of preventative restructuring frameworks.

   So, this has been a long time in the making.

4. From the outset, the Moratorium is likely to be frequently invoked by companies in financial strain. It may well overtake Administration by number of instances invoked (although it may equally work alongside it, with the former leading into the latter where appropriate).

5. It will represent a significant new inroad into the freedom of creditors to take enforcement action against debtor companies (as detailed in the next paper

below). The flipside is that there is every potential for it to significantly increase the number of companies that are successfully rescued as a going concern, not least just by virtue of the time which it affords to companies to properly plan any appropriate restructuring. In 2018, an R3 (and ICAEW-sponsored) research project into the viability of CVAs examined over 500 arrangements and identified a minimum failure rate of around 66%, and evidence of higher prospects of success where a pre-arrangement moratorium had afforded more time to sensibly plan the restructuring. The Moratorium will not just be a precursor to CVAs or schemes though, and may also work through the pursuit of solvent recapitalisations and informal work-outs and agreements with creditors and/or equity investors.

6. For all these reasons, it will be important for practitioners to be quickly up to speed with the Moratorium and how it works. The next paper, by my colleague Anna Lintner, will consider the detailed working of the New Moratorium, including:

    6.1. how it is obtained;

    6.2. how long it lasts; its effects on the company and on creditors;

    6.3. the role of the Insolvency Practitioner ('the Monitor');

    6.4. and the terminology adopted in the legislation.

7. However, this paper will first consider an important preliminary question: which companies will be eligible to invoke it?

8. There are 5 key points which all practitioners should be aware of in this respect. I have outlined those below, together with some detailed notes on each.

## (1) The Moratorium may be invoked by both UK and Overseas Companies

9. The new UK Moratorium will not be restricted to UK-incorporated companies but may also be invoked by an overseas company (as long the court would have jurisdiction to wind it up):

    9.1. Section A5 IA 1986 will expressly provide for a Moratorium to be sought by such an overseas company.

    9.2. "Overseas company" simply means "a company incorporated outside the United Kingdom": see section 436(2) IA 1986, applying the definition in section 1044 of the Companies Act 2006.

    9.3. Section A5 requires the directors of an overseas company to apply to "the court" for a Moratorium, and "the court" means the "court having jurisdiction to wind up the company": see section 251 IA 1986.

    9.4. So the new Moratorium will be available (on application to the court) to companies incorporated outside the UK, as long as the court would have jurisdiction to wind them up.

    9.5. Within Part V of the IA 1986, section 221(1) and 220 provide as follows:

    > "221.— Winding up of unregistered companies.
    >
    > (1) Subject to the provisions of this Part, *any unregistered company* may be wound up under this Act; *and all the provisions [of Regulation (EC) No 1082/2006* of the European Parliament and of the Council and] of this Act […] about winding up apply to an unregistered company with the exceptions and additions mentioned in the following subsections."
    >
    > [N.B. The references to the 2006 EC Reg. on Insolvency Proceedings should instead be read a references to the EU Regulation on Insolvency Proceedings 2015 (Recast).]

> "220. Meaning of "unregistered company"
>
> For the purposes of this Part "unregistered company" includes any association and any company, with the exception of a company registered under the Companies Act 2006 in any part of the United Kingdom."

9.6. From the reference in section 221, it should follow that, for so long as the EU Regulation continues to apply, an overseas company would want to establish either a COMI here or that proceedings could nonetheless be opened here as territorial or secondary proceedings in the usual way under article 3.

10. Quite apart from all of that, the court is given a discretion as to whether to grant a Moratorium, and it can be expected to exercise that discretion in the same manner as it exercises its jurisdiction to wind up foreign companies – therefore depending on the existence of a sufficient connection with this jurisdiction and a reasonable possibility of a winding up order benefiting the petitioner (and the presence here of the petitioner or other creditors or another basis for the court to exercise jurisdiction over such interested parties).

11. The Government's Explanatory Notes confirm that the intention is as follows:

> "104. An overseas company will only be eligible for a moratorium if it is one which could be wound up under Part 5 of the Insolvency Act 1986; it is anticipated that the courts will exercise the same discretion when considering such an application as they would when considering the winding up of an overseas company."

12. As noted in the next paper, there is a difference in the *procedure* by which the Moratorium may be invoked for an overseas as opposed to a UK company. The directors of an eligible overseas company must always apply to court for a Moratorium, enabling the court to prevent inappropriate 'forum shopping', whereas the directors of an eligible UK company (not subject to a winding up petition) may simply file documents at court to obtain the Moratorium.

## (2) Companies will be ineligible for the Moratorium if they *are currently* subject to any of *9* insolvency procedures

13. A company may not invoke the new Moratorium procedure if it is *currently* subject to, or in, any of the following:

    13.1. a Moratorium (thereby preventing repeated/ abusive use of the procedure without end);

    13.2. a CVA;

    13.3. administration;

    13.4. an interim moratorium brought about under Sched. B1 para. 44 by an application for the appointment of administrators or the filing of a notice of intention to appoint;

    13.5. the appointment of an administrative receiver;

    13.6. provisional liquidation;

    13.7. liquidation; or

    13.8. an extant public interest winding up petition under section 124A (or a winding up petition against a European Society or European Cooperative Society under sections 124B or C) IA 1986;

    see Schedule ZA1 IA 1986 para. 2(1)(a), 2(2)(a) and 2(3)(a)-(g).

14. It is important to note that a company is *not precluded* from seeking a Moratorium just because it is subject to an outstanding creditor's winding up petition. Such a petition does not affect its eligibility, but does mean that the directors will have to apply to court rather than invoking the Moratorium by an out of court filing: see sections A3(1)(a) and A4 IA 1986. Temporary/transitional provisions modify that procedure somewhat for the first month that the legislation will be in force: see Schedule 4 to the 2020 Act para. 1 and 6.

## (3) Companies will be ineligible for the Moratorium if *in the last 12 months they were* subject to any of *3* insolvency procedures

15. A company may not invoke the Moratorium if at any point in the last 12 months it was subject to, or in:

    15.1. a Moratorium;

    15.2. a CVA; or

    15.3. administration:

    see Schedule ZA1 IA 1986 para. 2(1)9b), 2(2)(b) and 2(3)(a)-(b).

16. Transitional provisions disapply the above for the first month of the Act's life: see paragraph 20.2 below. There is also one very limited permanent exception to the rule that the company must not have been subject to a previous Moratorium within the last 12 months: where for example the previous Moratorium was terminated by the Monitor under section A38, then an interested party applied to court to challenge that decision of the Monitor under section A42 on the ground that it has unfairly harmed its interests, the court may make an order under section A42(6) to enable the company to institute another Moratorium inside the 12 month period without being disqualified on that basis.

## (4) Companies will be ineligible if they operate in certain sectors

17. A company will be ineligible to invoke the Moratorium procedure if it operated in any of 13 specified sectors, covering: insurance companies; banks; electronic money institutions; investment banks and firms; market contracts and charges; participants in designated systems; payment institutions; operators of payment systems, infrastructure providers etc; recognised investment exchanges, clearing houses and CSDs; securitisation companies; parties to capital market arrangements; PPP project companies; or if it is an overseas company whose functions correspond to any such company earlier mentioned.

## (5) Insolvent companies, not just those at risk of insolvency, can invoke the Moratorium

18. The next paper will detail the requirement for directors of a company (wishing to invoke a Moratorium) to certify that "in their view, the company *is*, or is likely to become, unable to pay its debts", to be spelt out in section A6(1)(d) IA 1986. However, it is worth noting at this stage that this represents a fundamental change from what the Government had been proposing over the last 2 years prior to last Wednesday 20 May 2020. In the Government's 2018 Paper ('Insolvency and Corporate Governance – Government Response', 26.8.18), it confirmed as follows (emphasis added):

    "5.28 After careful consideration, the Government believes *the test for entry into a moratorium should exclude companies that are already insolvent*. This approach addresses concerns raised by many respondents centred on the belief that a moratorium could be mis-used by directors to delay an inevitable insolvency, increasing creditor losses in the process. It also addresses concerns surrounding the likely failure of the proposed test to encourage earlier action on the part of the company's directors.

    5.29 A company seeking the protection of a moratorium must have legitimate reasons for seeking protection. The Government thinks *the test on financial state should be one of prospective insolvency*, that is, based upon the requirement that a company *will become* insolvent *if action is not taken*. This approach ensures that the moratorium process cannot be abused by healthy companies with relatively minor and short term cash flow issues."

19. Marking a significant shift from that, the inclusion of the word "*is*" in section A6(1)(d) confirms that the Moratorium will be available to companies which are already unable to pay their debts, and not just those facing a risk of insolvency in the near or reasonably near future (a.k.a. prospectively insolvent).

## Finally – a note about the temporary/transitional provisions

20. The new permanent provisions regarding the Moratorium (in Part A1 of the Insolvency Act 1986, sections A1 to A53) will be subject to a few temporary modifications for the first month after the relevant provisions come into force. These are set out in Schedule 4 to the 2020 Act and include the following 3 modifications of note:

    20.1. First, the directors of a company wishing to invoke the Moratorium would normally have to apply to court (rather than being able to use the out of court filing route) where the company was subject to an outstanding creditor's winding up petition. For that first month, that is modified so that the directors should adopt the out of court route only, unless the company in question is an overseas one: see Schedule 4 CI&GA 2020 para. 6(1)(a).

    20.2. Second, for the first month under the 2020 Act, a company will not be disqualified from invoking the Moratorium on account of having been subject to any of the 3 specified insolvency procedures in the past 12 months (previous Moratorium, CVA, or administration): Schedule 4 para. 6(1)(c).

    20.3. Third, the Monitor (i.e. the Insolvency Practitioner in question) is ordinarily required to certify that a Moratorium is "likely…[to] result in the rescue of the company as a going concern", both in support of the initial filing for a Moratorium (section A6(1)(e) IA 1986) and in support of any extension of the period of the Moratorium (section A10(1)(d) and A11(1)(d)). The Monitor is also under duties to monitor matters during the course of any Moratorium to see whether the it remains likely to result in the company's rescue as a going concern (section A35) and to terminate it if that is no longer considered to be the case (section A38).

For the purposes of a company invoking the Moratorium within the first month under the Act (and in relation to Moratoria obtained within that relevant period), the phrase "it is likely that a moratorium for the company would result in the rescue of the company as a going concern" is modified by adding the words "or would do so if it were not for any worsening of the financial position of the company for reasons relating to coronavirus".

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