

## **A Review of the Corporate Insolvency Framework: A new moratorium to help business rescue?**

### Introduction

With a view to making Britain the best place in the world to start and grow a business, on 25 May 2016 the Government launched “*A Review of the Corporate Insolvency Framework: A consultation on options for reform*”<sup>1</sup> (the “Consultation”). Motivated by a manifesto pledge to put the UK in the top five of the World Bank’s Doing Business ratings, the Consultation puts forward four key proposals to encourage rescues of viable businesses: the introduction of a pre-insolvency restructuring moratorium; the protection of essential supplier contracts during restructuring; the ability to bind and cram-down secured creditors in a restructuring; and exploring options for rescue financing. This article will consider the central plank to the reforms, the introduction of a new restructuring moratorium. Experienced readers will remember similar proposals being made in 2010 (“*Proposals for a Restructuring Moratorium*” (the “2010 Proposals”)),<sup>2</sup> with questions remaining whether the issues arising then have been addressed.

### The benefits of a moratorium

The perceived benefit of a moratorium for a company in financial distress is not a new concept. Reflecting on the work of the Cork Committee in his autobiography, Sir Kenneth Cork considered that many companies in financial difficulty “needed a period when the dogs were called off and they were able to recover a degree of equilibrium.”<sup>3</sup> It was envisaged that a Company Voluntary Arrangement (“CVA”) could be used in conjunction with administration to allow an insolvent company to renegotiate its debts and continue to trade, with protection from creditor action during negotiations.<sup>4</sup> In reality, the stigma attached to being in a formal insolvency process, together with the burdensome process for entering administration prior to the Enterprise Act 2002 reforms, stymied this intention.

Presently, pre-insolvency process moratoria are available in two situations. Firstly, certain small companies may initiate a moratorium of up to 28 days pursuant to the little-used Schedule A1 of the Insolvency Act 1986 (“the Act”) to allow the approval and implementation of a CVA, subject to meeting specified criteria. This can be extended by up to two months. Secondly, where a company or its directors intend to appoint an administrator out of court pursuant to paragraph 22 Schedule B1 of the Act, a moratorium of up to ten business days is initiated under paragraph 44 where notice of the intention to appoint is given to relevant parties. There are instances of directors using this process strategically, by filing several consequential notices of intention to appoint to create a longer-term moratorium. Broadly speaking, these moratoria prevent creditors from taking action

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<sup>1</sup> Available at [www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework](http://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework) Last accessed 28 June 2016

<sup>2</sup> Available at <http://webarchive.nationalarchives.gov.uk/20140109094217/http://www.bis.gov.uk/insolvency/consultations/restructuring> Last accessed 26 June 2016

<sup>3</sup> Cork, K. *Cork on Cork* (Macmillan, London, 1988) p.195

<sup>4</sup> *Insolvency Law and Practice, Report of the Review Committee* 1982 Cmnd. 8558, para 423 *et seq*

against the company. Both moratoria are relatively short and intended to act as a gateway to a formal non-terminal insolvency procedure.

### The Current Proposal for a Restructuring Moratorium

At present there are three main options available to companies looking to restructure their liabilities: a consensual agreement with creditors; a CVA; and a Scheme of Arrangement under the Companies Act 2006. A common feature of each is that prior to entering into a restructuring agreement, there will be some initial negotiation with creditors as the proposal is developed. During this period, there is an inherent risk of creditors, alerted to the financial difficulties faced by the company, taking steps to benefit themselves at the expense of other creditors and, ultimately, the proposed rescue.

The Consultation recognises these difficulties, and that the currently available moratoria have not addressed these problems. A pre-insolvency restructuring moratorium that would act as a gateway to a variety of restructuring options, both statutory and non-statutory, is therefore proposed. This aims to address three key issues that can undermine successful restructuring: reducing the cost and risk of restructuring; improving the prospect of reaching agreement with creditors; and encouraging directors to take action early.

The Consultation opens proposing a moratorium available to all entities which have access to CVAs and administration. Closer inspection, and reference to the supporting Impact Statement, suggests it is intended for a small number of large companies with complex ownership and financing structures. Companies engaged in the finance or insurance sectors, or that are or have recently been in an insolvency process, would not be eligible.

### The structure of the moratorium

The proposed moratorium would run for up to three months, with the possibility of extension subject to creditor approval. The directors would remain in control, subject to oversight from a supervisor. Directors would be subject to the usual duties and obligations, though would be relieved from any liability for wrongful trading under s.214 of the Act whilst the moratorium is effective. During the moratorium, a variety of actions would be prevented, in line with those in Schedule A1 of the Act.

It is proposed that the moratorium would be an extra-judicial process. Where companies meet the abovementioned eligibility criteria, together with certain qualifying conditions, they will nominate a supervisor and the moratorium will commence by the filing of certain documents with the court and Companies House. Creditors would have the ability to challenge the moratorium within 28 days if their interests are unfairly prejudiced or there is a dispute over the qualifying conditions having been met.

The qualifying conditions seek to ensure that companies have the prospect of emerging from the moratorium as a going concern and creditors are prepared to support a debt restructure. Companies

must show that there are sufficient funds to meet their obligations during the moratorium. In addition, companies must demonstrate that there is a reasonable prospect at the outset of agreeing a compromise or arrangement with its creditors. Supervisors would need to be satisfied that these conditions are met, based on information provided by the directors.

In addition to confirming that the qualifying conditions are met at the outset, supervisors should ensure these continue to be met throughout. Directors would be obliged to provide information and supervisors would be entitled to attend company meetings. Should the qualifying conditions cease to be met, supervisors would bring the moratorium to an end, most likely leading to a formal insolvency process in which the supervisor could not hold office. There is, therefore, significant onus on the supervisor to protect the interests of the creditors and the integrity of the moratorium process. Despite this, the supervisor need not be a qualified insolvency practitioner, but could be a solicitor or accountant with 'relevant expertise' in restructuring.

To further assist the prospect of a successful outcome, the company would be able to make use of another aspect of the Consultation during the moratorium, by applying for important supply contracts to be designated as essential. The application would be made when filing for the moratorium, and would be conditional on paying the debts owed to the supplier throughout the moratorium. Suppliers would have the right to challenge this decision.

The aim of enabling company rescue, by facilitating the negotiation and actioning of restructuring plans through the protection of a moratorium period, is, at first blush, a positive proposal. The Consultation seeks to address the recommendations of the World Bank, in setting out a system of limited but specific duration that strikes a balance between creditor protection and insolvency proceeding objectives.<sup>5</sup> There are, though, a number of questions raised by the Consultation that need to be considered. Some guidance can be found through a consideration of previous suggestions for reform.

### Learning from history?

Proposals for further reform to, and indeed expansion of, the availability of a moratorium to companies in financial difficulty is not new. Consultations were launched in 2009 and 2010, with the latter bearing significant similarities with the proposals in the Consultation. It has been suggested that the 2010 Proposals were not followed through due to the departure of key staff at the Insolvency Service, rather than a wider view that the plans were unworkable.<sup>6</sup> Accordingly, a review of the proposals in the 2010 Proposals and the responses received<sup>7</sup> can provide some insight into the likely success of the Consultation proposals.

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<sup>5</sup> The World Bank, 'Principles for effective insolvency and creditor/debtor rights systems' (Revised 2015), p.19 Available at [siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015\\_Revised\\_ICR\\_Principles\(3\).pdf](https://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf) Last accessed 28 June 2016

<sup>6</sup> R3, 'A Moratorium for Businesses: Improving Business & Job Rescue in the UK' (April 2016) p.5

<sup>7</sup> Available at <http://webarchive.nationalarchives.gov.uk/20140109094217/http://www.bis.gov.uk/insolvency/consultations/restructuring> Last accessed 26 June 2016

### *Purpose of the moratorium*

The moratorium proposed by the 2010 Proposals was substantively for the same purpose and duration as under the current proposals, save that it would be restricted to companies seeking either a contractual or statutory compromise.

Several respondents to the 2010 Proposals questioned the need for the proposed moratorium, with anticipated uptake by around a dozen companies a year. This was particularly a concern given the significant anticipated costs of introduction and implementation. Whilst the Consultation suggests that the moratorium would be widely available, promoting the accessibility for SMEs, the supporting Impact Statement anticipates only 10-20 companies annually would seek such refuge. It would seem a very costly process to pursue for the benefit of such a small number of companies, especially in light of the significant underestimation of costings underlying the 2010 Proposals. The Consultation does suggest that the availability of a statutory moratorium could in itself benefit informal moratoria, though this seems wishful thinking rather than a clear benefit.

### *Eligibility criteria*

The qualifying conditions remain unchanged. Respondents to the 2010 Proposals sought clarification around these qualifying conditions, which has not been provided. How these would be framed in legislation and applied by the courts would impact on uptake. For example, companies must satisfactorily demonstrate there is a reasonable prospect of agreeing a compromise or arrangement with creditors. It is suggested that at the very least, support in principle from the largest secured creditors should be sought. This mirrors the wording in the 2010 Proposals, but does not allude to what support in principle covers. Furthermore, gaining support from a secured creditor for a restructuring is not directly indicative of being able to reach agreement with the body of unsecured creditors, given their disparate interests.

The requirement to meet current obligations as they fall due, as well as any new obligations that are incurred during a moratorium, also remains and raises further doubts. The language adopted is very wide, extending beyond trading debts. This could include interest, amortisation, rent, dilapidations and more. In fact, it is wider than the requirement to pay debts during the moratorium to the newly designated essential suppliers, which should have enhanced protection. Again, clarification has not been provided, and the uncertainty could inhibit the use of the moratorium, given the potentially large sums involved.

If it becomes apparent that the qualifying conditions cease to be met, supervisors are under an obligation to bring the moratorium to an immediate end. This is retained from the 2010 Proposals. Respondents to the 2010 Proposals suggested that in such circumstances a short period be allowed for recovery of this position. This could reduce the risk of ransom creditors disrupting the moratorium, and forcing the company into a formal insolvency process. The failure to address this might appear short-sighted. The proposals on essential supply contracts could prevent some ransom situations, but certainly would not provide the additional protection suggested by respondents, given the small number of essential suppliers.

### *Oversight of the moratorium*

The 2010 Proposals envisaged a process overseen by an insolvency practitioner acting as a monitor, who would be an officer of the court, but with the directors retaining day-to-day control. This role has been watered down by the Consultation to that of a supervisor, who need not be a qualified insolvency practitioner. This appears to overlook the responses to the 2010 Proposals, as the majority of respondents suggested the role of the monitor be enhanced, irrespective of the resultant cost increase. Given the weight of responsibility placed on the supervisor, to ensure that the proposals are on track and pre-conditions continue to be met, the vague requirement that the office could be held by a solicitor or accountant with 'relevant experience' seems unsatisfactory. In proposals published in April 2016, R3 promoted the role of oversight of a shorter moratorium by insolvency practitioners, highlighting the need for such expertise. Commercial decisions as to whether companies should exit a moratorium may be too weighty for the role as defined. This relaxation also appears inconsistent with the SRA no longer being a recognised professional body for insolvency work. Whilst there is no mention in the Consultation of accountability of the supervisor, as there was in the 2010 Proposals, they would be unlikely to be given *carte blanche* in their actions.

The extension of the supervisor role to non-insolvency practitioners is aimed at increasing competition, reducing costs, and making the moratorium more accessible to SMEs (though this is mentioned only towards the end of the Consultation and runs contrary to the Impact Statement). Responses to the 2010 Proposals suggested that corporate rescue professionals be allowed to take appointments, to reduce the stigma attached to the process and widen the pool of candidates. Given the restriction on supervisors taking subsequent appointments to avoid any perceived conflict, as was suggested in responses to the 2010 Proposals, this would appear sensible, but with clarification needed as to the criteria for accepting an appointment. Such a restriction may, however, put off many insolvency practitioners from acting as supervisor, in the hope of securing appointment in any subsequent, and more lucrative, insolvency process. This could have the undesired consequence of the moratorium not being overseen by the most suitable professionals. The professional conduct rules, which provide guidance as to when insolvency practitioners can take consecutive appointments, could surely be adapted to address any issues here.

### *Commencing the moratorium*

The 2010 Proposals required court sanction of the moratorium to protect the creditors. Significant importance was attached to the involvement of the court by respondents, in both the initiation and extension of the process, particularly to ensure protection of creditors. Despite such positive responses, this has been eschewed for an extra-judicial process by the Consultation. The court will only be involved should creditors claim unfair prejudice or that pre-conditions have not been met. Whilst a reduction on the burden placed on the courts is understandable, this raises concerns when considered alongside the abovementioned issues regarding oversight of the process.

## Conclusion

The desire of the Government to address the current failure of the corporate rescue regime is laudable. The preservation of viable companies would no doubt be of more benefit to the wider economy than simple business rescue or, worse still, liquidation. Whether the proposed moratorium can address this problem in its current form is doubtful, however. Far more detail is needed, and outstanding issues raised in response to the 2010 Proposals need to be addressed, for the proposed moratorium to achieve the stated aims. There are also a number of suggestions proposed in the recent R3 proposals that could benefit the Consultation, such as a freely accessible register of all ongoing moratoria.

The proposals in the wider Consultation to allow companies to bind all creditors in restructuring plans, for the introduction of rescue finance, and the preservation of essential supply contracts all seek to address issues raised in past consultation responses. Though beyond the scope of this article, these represent positive developments. Perhaps, rather than the introduction of further procedures into a crowded marketplace, the existing processes need to be utilised, with the aid of new support mechanisms, to help achieve company rescue.