INSOL International

Permanent changes to the UK's corporate restructuring and insolvency laws in the wake of Covid-19

October 2020

INSOL SPECIAL REPORT

Permanent changes to the UK's corporate restructuring and insolvency laws in the wake of Covid-19

Contents

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44 (0) 20 7248 3333 Fax: +44 (0) 20 7248 3384

October 2020

Acknowledgement

The Corporate Insolvency and Governance Act 2020 makes major changes to the United Kingdom's corporate restructuring and insolvency laws. Some of these changes are time-limited and represent an immediate response to the Covid-19 crisis. However, other changes are designed to be more permanent and bring UK law more into line with Chapter 11 of the US Bankruptcy Code and the changes envisaged by the European Restructuring Directive which EU Member States are expected to implement by July 2021.

This report provides a technical analysis of the three major permanent changes to companies and insolvency laws introduced by the Corporate Insolvency and Governance Act 2020. It consists of four substantive parts followed by a conclusion. The first part examines the new "standalone" moratorium on the enforcement of claims against a company. The second part examines the new flexible "restructuring plan" procedure and compares its intended scope and operation with the existing scheme of arrangement procedure in the Companies legislation and the company voluntary arrangement procedure in the Insolvency legislation. The third part addresses the new restrictions on termination and so-called *ipso facto* clauses in supply contracts. The fourth part addresses the effect of the new provisions on creditors and lenders in particular.

INSOL International sincerely thanks Professor Gerard McCormack, the INSOL Scholar for 2020 / 2021, for this timely paper on the latest UK reforms.

October 2020

Permanent changes to the UK's corporate restructuring and insolvency laws in the wake of Covid-19[*]

By Professor Gerard McCormack, Professor of International Business Law at the University of Leeds and INSOL International Scholar for 2020 / 2021[**]

1. Introduction

The Corporate Insolvency and Governance Act 2020 (the 2020 Act) makes major changes to the UK's corporate restructuring and insolvency laws.

Some of these changes, such as the relaxation of wrongful trading liability for company directors and a restriction on winding up petitions, are time limited and an immediate response to the Covid-19 crisis.

Other changes, however, are designed to be more permanent and bring UK law more into line with Chapter 11 of the US Bankruptcy Code and the changes envisaged by the European Restructuring Directive[1] which EU Member States are expected to implement by July 2021, though they may request a one year extension. The UK is no longer an EU Member State and is not expected to implement the Directive but the changes ensure that the UK is, in any event, compliant. The UK parliamentary materials have also acknowledged the importance of keeping the UK at the forefront of international insolvency indicators such as the World Bank Doing Business project and the United Nations Commission on International Trade Law (UNCITRAL) *Legislative Guide on Insolvency Law*.[2]

This report provides a technical analysis of the three major permanent changes to companies and insolvency laws introduced by the Corporate Insolvency and Governance Act 2020. It focuses on:

- the new "standalone" moratorium on the enforcement of claims against a company;
- the introduction of the new flexible "restructuring plan" procedure and how it compares with, and differs from, existing restructuring procedures; and
- new restrictions on termination clauses on supply contracts.

[*] The views expressed in this Special Report are those of the author and do not necessarily represent the views of INSOL International or any of its affiliates.

[**] Prof McCormack is also Visiting Professor at the University of Vaasa, Finland. The author would like to thank Andrew Keay, David Milman and Jennifer Marshall for their assistance in various ways in the compilation of this report.

[1] Directive 2019/1023.

[2] See the impact assessment on the Act https://publications.parliament.uk/pa/bills/cbill/58-01/0128/IA200519.pdf: "Existing UK insolvency law has some options for business rescue, but there are gaps when compared, for example, to best practice standards published by the World Bank and recent EU directives set out in the 2019 EU Restructuring Directive… Adoption of these additional rescue support measures will strengthen the UK's insolvency framework and bring it up to international best practice." See also, *Commons Library analysis of the Corporate Insolvency and Governance Bill [HC 2019-21*] BRIEFING PAPER Number 8922, 1 June 2020 at p 11 and fn 23 – available at https://researchbriefings.files.parliament.uk/documents/CBP-8922/CBP-8922.pdf.

This report will address the likely impact of the new regime on "normal" commercial companies and their particular application to financial services firms and financial contracts. These changes are the most significant and far-reaching reforms to the relevant UK law since the Enterprise Act 2002 revamped the administration procedure, and possibly since the Insolvency Act 1986 completely revolutionised UK insolvency and restructuring law.[3]

These changes were first heralded in a UK Insolvency Service consultation *A Review of the Corporate Insolvency Framework* published in May 2016 and before the "Brexit" referendum on the UK's continued membership of the European Union. The proposed changes were then subsumed into a wider reform project on Corporate Governance and Insolvency and most recently taken forward in a September 2018 Government response to that consultation.[4]

This report will consider how the provisions in the Corporate Insolvency and Governance Act 2020[5] have evolved from the earlier UK consultations in 2016 and 2018. It will also consider the changes in their international and comparative context. It will draw out critical comparisons between the new UK regime and equivalent provisions in the US Chapter 11 and the European Restructuring Directive 2019/1023.

This report consists of four substantive parts followed by a conclusion. The first part examines the new "standalone" moratorium on the enforcement of claims against a company. The second part examines the new flexible "restructuring plan" procedure and compares its intended scope and operation with the existing scheme of arrangement procedure in the Companies legislation and the company voluntary arrangement procedure in the Insolvency legislation. The third part addresses the new restrictions on termination and so-called *ipso facto* clauses in supply contracts. The fourth part addresses the effect of the new provisions on creditors and lenders in particular. The final part concludes.

2. "Standalone" company moratorium

The 2020 Act introduces a new moratorium procedure for a company in financial distress and is available on making certain e-filings with the court.[6] This is essentially a "debtor-in-possession" process with the aim of facilitating the rescue of a company as a going concern. The moratorium protects the company's directors who remain in place and continue to run the business with the protection of the moratorium. It gives the company breathing space and, subject to some exceptions, prevents creditors from pursuing payment or taking

---

3 See the comments in parliament of the Conservative Peer Baroness Neville-Rolfe "The main provisions in the Bill bring forward long-planned changes in insolvency law. It is a little cheeky to use what is essentially an emergency measure for these reforms. However, I confess to doing the same many years ago when I led the work on the Food Safety Act. This reforming legislation had been in the famous Whitehall drawer for nearly 10 years when Mrs Edwina Currie precipitated a crisis by wrongly asserting that most eggs had salmonella. Our Bill then secured an immediate slot." HL Hansard 9th June 2020, col 1680.

4 https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework.

5 The 2020 Act also reintroduces the power to make provision to prohibit or impose requirements on the disposals of property to connected parties in a so-called "prepack" administration. This power existed pursuant to the Small Business, Enterprise and Employment Act 2015, but expired on 26 May 2020. The 2020 Act in s 8 reintroduces the power which will now expire at the end of June 2021 unless it is exercised before then.

6 See the new ss A3 and A6 in the Insolvency Act 1986 as introduced by the 2020 Act.

enforcement action while the company explores its rescue and restructuring options.

A "monitor" oversees the moratorium. The "monitor" is designated by section A34 as on officer of the court and, in accordance with the rule in *Ex parte James*,[7] should behave honourably. The term "monitor" is however, defined in section A54 in somewhat circular fashion as the person who has the functions of the monitor in relation to the moratorium. The assumption underlying the legislation is that the monitor will be a qualified and licensed insolvency practitioner[8] but there is the possibility that, in the future, a broader pool of suitably qualified professional such as accountants or turnaround "experts" might become monitors.[9] It should also be noted, however, that there is no statutory prohibition on a monitor accepting a subsequent insolvency appointment in relation to a company such as that of administrator or liquidator.

It is not necessary to obtain the consent of secured creditors or even to provide notice to them prior to filing the documents at court. During the parliamentary debate there was much discussion of the role of creditors, and of the monitor, in the process of obtaining a moratorium. In dealing with proposed amendments to the legislation, the relevant Minister explained to the former Law Lord, Lord Hope:[10]

> " . . . the monitor needs to have contact details for the company's creditors at a very early stage in the moratorium to enable the monitor to comply with their duty to notify creditors of the moratorium. In order that the proposed monitor can make the statements required under section A6 … that the company is an eligible company and that it is likely that a moratorium would result in the rescue of the company as a going concern, they will need to undertake enquiries into the financial position and prospects of the company. These enquiries will need to be undertaken before the practitioner consents to act as monitor. If the proposed monitor is not able to access sufficient information to make these statements, then they should not agree to take on the appointment. The extent of the enquiries will depend on the size and complexity of the company, but as a minimum I would expect the proposed monitor to ascertain the assets, liabilities and ongoing financial commitments of the company. In making their enquiries the monitor has to exercise some independent critical judgement."

The moratorium is available for an initial 20 days which is extendable in the same manner for a further 20 days and can then be extended with the consent of pre-moratorium creditors for up to 12 months from the date of initial filing.[11] The court has a discretion to extend the moratorium where a scheme or arrangement or new-style restructuring plan is being considered. The moratorium will be automatically extended where the company proposes a

---

7 (1803) 32 ER 385.
8 Section 388 of the Insolvency Act is modified by the 2020 Act, Sch 3, para 21.
9 See generally Glen Davis QC, "The Role of the Monitor in a Rescue Moratorium", *South Square Digest* special issue on Corporate Insolvency and Governance Act 2020 at p 18 and available at https://southsquare.com/wp-content/uploads/2020/07/Digest_Magazine_Mini_Digital-CIGA.pdf.
10 See data.parliament.uk/DepositedPapers/Files/DEP2020-344/Lord_Hope_letter_to_Lord_Callanan.pdf.
11 The moratorium is also extendable on application to the court but here there is no time limit.

company voluntary arrangement (CVA). It should be noted that the CVA does not necessarily have to be considered by the court at all. The moratorium is automatically brought to an end if the company enters an insolvency process, for example, the appointment of liquidators or administrators.

The moratorium is freestanding. It is not a gateway to a particular insolvency procedure and may not lead to any insolvency process at all if the company can be rescued during the moratorium, or can come up with a restructuring plan which is accepted by its creditors.

The government's explanatory notes on the legislation highlights the fact that possible rescue outcomes could include:[12]

- recovery of the company without further action or process;
- sale and / or refinancing outside insolvency;
- CVA under Part 1 of the Insolvency Act 1986;
- scheme of arrangement under Part 26 of the Companies Act 2006; and
- implementing a restructuring plan under the new Part 26A of the Companies Act 2006.

2.1 Key points of the moratorium

The new law on the moratorium is contained in section 1(1) of the 2020 Act which inserts a new Part A1 before the CVA provisions in Part 1 of the Insolvency Act 1986. Section 1(2) provides that Schedule 1 of the 2020 Act inserts into the Insolvency Act 1986 a new Schedule ZA1 on eligible companies. Section 1(3) provides that Schedule 2 to the 2020 Act inserts into the Insolvency Act 1986 a new Schedule ZA2 on contracts involving financial services.

The moratorium provides an initial breathing space of 20 business days to a company.[13] If certain conditions are satisfied, (including payment of all moratorium debts and pre-moratorium debts for which the company does not have a payment holiday), the directors may file for an extension of a further 20 business days.[14] Any extension beyond 40 business days will require the consent of the company's pre-moratorium creditors (amongst other conditions) or the court. The revised end date for the moratorium with creditor consent cannot be longer than one year from the beginning of the initial period.[15] There are no time limits, however, on an extension by the court. The court may order that the moratorium should be extended to such date as is specified in the order.[16]

The moratorium will come to an end if the company enters into administration or liquidation, or if a scheme or plan is sanctioned. In addition, the monitor may bring the moratorium to an end if of the view that it is no longer likely to result in the rescue of the company as a going concern, that a rescue has been

12 See https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf at para 7.
13 2020 Act, s A9.2.
14 *Idem*, s A10.
15 *Idem*, s A12.3.
16 *Idem*, s A13.4.

achieved, that the company is unable to pay its debts that have fallen due, or the monitor is unable to carry out its duties.[17]

The moratorium is unavailable to companies in insolvency proceedings on the filing date, or which had a moratorium in force, or been subject to insolvency proceedings, within the 12 months preceding the filing date.[18] Where a company has a winding up petition pending, a court application for the moratorium is required and, in considering and granting it, the court will need to be satisfied that the moratorium would achieve a better result for the company's creditors as a whole without being wound up.[19]

There are certain companies excluded by the Act, such as banks, insurance companies, investment banks / firms, and public / private partnerships. Perhaps most controversially, Schedule ZA1, paragraph 13 provides that a company is not eligible if, on the filing date, (a) it is a party to an agreement which is or forms part of a capital market arrangement, (b) a party has incurred, or when the agreement was entered into was expected to incur, a debt of at least £10 million under the arrangement (at any time during the life of the capital market arrangement), and (c) the arrangement involves the issue of a capital market investment. This exclusion gives rise to the possibility that a UK company may prefer a bank loan, rather than accessing the capital markets, in order to preserve its ability to enter into a moratorium. It should be noted, however, that the list of companies that are excluded from entering a moratorium may be amended by regulations that are made subject to the affirmative resolution procedure.[20]

As far as foreign registered companies are concerned, the position is less clear-cut. Such a company is only eligible for a moratorium if it is one that could be wound up under Part 5 of the Insolvency Act 1986.[21] According to the explanatory notes at paragraph 104, it is anticipated that the courts will exercise the same discretion when considering a moratorium application as they would when considering the winding up of a foreign registered company. Even during the Covid-19 crisis, such a company will need to apply to court for a moratorium, to ensure that it is subject to the proper jurisdiction of the UK courts. Essentially this means benefit to creditors and "sufficient connection" to the UK in the form, for instance, of UK-governed law or UK jurisdiction clauses in relevant contracts. The "sufficient connection" test has been established in cases such as *Re Drax Holdings Ltd*[22] and *Re Rodenstock GmbH*,[23] where a sufficient connection was deemed to exist by virtue of the fact that the company's credit facilities contained English choice of law and jurisdiction clauses and also by reason of expert evidence that the relevant foreign courts would recognise the scheme. In practice, a loan facility governed by English law will be enough to pass the "sufficient connection" test.[24]

17 *Idem*, ss A9 and A38.
18 *Idem*, Sch ZA1, para 2.
19 *Idem*, s A4.
20 *Idem*, ss A50, A55 and Sch ZA1, para 20.
21 *Idem*, Sch ZA1, para 18.
22 [2004] 1 WLR 1049.
23 [2011] EWHC 1104 (Ch), [2011] *Bus LR* 1245.
24 *In Re Magyar Telecom BV* [2013] EWHC 3800 (Ch).

2.2 Effect of the moratorium

The management remains in control of a company during the moratorium period but the company will be subject to restrictions in relation to the incurring of credit, the granting of security and the disposal of property. These restrictions that apply during the moratorium are similar to the restrictions that accompany the opening of administration proceedings in respect of a company and these restrictions can only be lifted with the consent of the court.

During the moratorium period, certain actions by creditors are precluded:[25]

- floating charge-holders cannot crystallise their charge or appoint an administrator;
- creditors (and the company's members) cannot commence insolvency proceedings;
- no steps can be taken to enforce security (without consent of the monitor or court) or repossess hire-purchase goods (without court consent);
- no proceedings or other legal processes (except certain employment claims) can be commenced or continued during the moratorium without court consent;
- landlords cannot forfeit leases without court consent;
- no security can be taken over the company's property (without the monitor's consent); and
- pre-moratorium creditors cannot apply to court to enforce their debt.

In addition, there are numerous restrictions and obligations on the company and its directors.[26] These include a £500 restriction on credit, an inability to enter into certain types of contract and a threshold on payment of pre-moratorium debt without the monitor's consent. A company is not permitted to make any payment, or series of payments, to any creditor in respect of any pre-moratorium payment obligations for which it has a payment holiday that exceeds, in aggregate, £5,000 or 1% of the total owed to unsecured creditors when the moratorium began, unless the monitor consents to such payment or a court order is obtained. Once the moratorium has commenced, the directors must notify the monitor as soon as reasonably practicable. After being notified, the monitor must send a notice to all known creditors and the Registrar at Companies House.

The moratorium provides the benefit of a payment holiday from certain "pre-moratorium debts" but these are essentially trade debts – debts under contracts for the supply of goods or services.[27] The following will still have to be paid:[28]

---

25 2020 Act, ss A20-A23.
26 *Idem*, ss A25-A33.
27 *Idem*, s A53.
28 *Idem*, s A18.

- the monitor's remuneration and expenses (although pre-moratorium remuneration and expenses are explicitly carved out;[29]

- goods or services supplied during the moratorium;

- rent (for the moratorium period);

- wages, salary and redundancy payments (not limited to those falling due during the moratorium); and

- debts or other liabilities arising under a contract or other instrument involving financial services. This means that the usual capital repayments and interest due to lenders will still be payable (unless otherwise agreed with the lender).

The Insolvency Rules may make provision as to what is, or is not, to count as the supply of goods or services for these purposes and the Secretary of State may also make regulations that amend the list. The company is expected to continue making payment on the excluded pre-moratorium debts for the period of the moratorium. If the company does not, the monitor is required to bring the moratorium to an end.

The measures introduced by the Act will not affect the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015.[30] These regulations implement the Aircraft Protocol of the Convention on International Interests in Mobile Equipment (known as the Cape Town Convention) in the UK (the Cape Town Regulations). Therefore, certain enhanced creditor protections afforded to aircraft creditors with a registered international interest in an aircraft object (Cape Town Creditors) are not overridden by the new measures. Under the Cape Town Regulations, after the first 60 days of an insolvency process (called the "waiting period") a Cape Town Creditor can enforce its security and repossess an aircraft object; the disposal of an aircraft object is also permitted. Cape Town Creditors will, as a result, continue to have such ability to enforce and repossess, as the prohibition of the use of termination clauses (or doing any other thing) relating to an insolvency or formal restructuring process would not apply to a Cape Town Creditor, meaning that, in theory, a Cape Town Creditor is in a superior position to another operating lessor or secured aircraft lender (that is not a financial services company) without a Cape Town registered interest.[31]

2.3 Debtor-in-possession and the role of the monitor

The moratorium brings into play a debtor-in-possession type reorganisation procedure that is overseen by a qualified insolvency practitioner wearing the hat of "monitor". Entitlement to the moratorium is largely delegated to the judgment of the monitor.

The documents that must be filed with the court before the moratorium comes into force consist of notices and statements confirming that the company is

29 *Idem*, s A18.7
30 SI 2015/912.
31 See 2020 Act, Sch 12, para 21: "Nothing in section 233B affects the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (SI 2015/912)."

eligible and that directors wish to obtain a moratorium; the proposed monitor is qualified and consents to act; the company is, or is likely to become, unable to pay its debts; and, in the proposed monitor's view, it is likely that a moratorium would result in the rescue of the company as a going concern.[32] The notice need not specify however, by which route "rescue as a going concern" is intended to be achieved. In this connection, the explanatory notes that accompany the legislation[33] state at (at paragraphs 5 and 6):

> "The aim of the moratorium is to facilitate a rescue of the company, which could be via a company voluntary arrangement (CVA) (a procedure under Part 1 of the Insolvency Act 1986 that enables a company that is in financial difficulty, but not necessarily insolvent, to make a binding compromise and arrangement with its creditors), a restructuring plan …or simply an injection of new funds. The intention is that the moratorium will result in better, more efficient rescue plans that benefit all of a company's stakeholders. There will no requirement to have a particular outcome in mind at the time of entry into a moratorium. The objective is to provide a streamlined moratorium procedure that keeps administrative burdens to a minimum, makes the process as quick as possible and does not add disproportionate costs onto struggling businesses."

The monitor provides general oversight during the moratorium process.[34] The monitor is an officer of the court and may apply to the court for directions about the carrying out of the monitor's functions.[35] The monitor is required to assess whether a rescue of the company as a going concern is likely and is required to bring the moratorium to an end if it can no longer achieve its purpose.[36] This includes non-co-operation by the directors of the company who fail to provide any information required by the monitor for the purpose of carrying out the monitor's functions.

It should be noted, however, that the company itself chooses who should act as monitor. Unlike the position with the administration order procedure under the Insolvency Act, a qualified floating charge holder has no veto on the identity of the person appointed as administrator, though the company may consider it wise to consult and take soundings on possible monitors.

The company itself will settle the remuneration of the monitor, though this may be the subject of some negotiation between the proposed monitor and the company. There is provision however, for subsequent challenges to a monitor's remuneration by an administrator or liquidator in subsequent insolvency proceedings. The Insolvency Rules may confer on an administrator or liquidator the right to apply to the court on the ground that the remuneration charged by the monitor in relation to a prior moratorium for the company, was excessive.[37]

32 *Idem*, s A6.
33 See https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.
34 2020 Act, ss A34 to A41.
35 *Idem*, s A37.
36 *Idem*, s A38.
37 *Idem*, s A 43.

2.4 Temporary modifications of the new Part A1 Insolvency Act 1986 moratorium regime

Section 3 and Schedule 4 of the 2020 Act make temporary modifications to Part A1 of the Insolvency Act 1986 (moratorium) and other temporary provision in connection with the Covid-19 crisis. In particular, the conditions for obtaining and extending a moratorium are relaxed and there is a temporary rule-making power.

These relaxations and other provisions applied initially until 30 September 2020, but there is power to extend that period by up to six months if it is considered it reasonable to do so to mitigate an effect of coronavirus. The directors can obtain a moratorium by filing documents at court even if the company is subject to an outstanding winding-up petition and the threshold question which the monitor must consider at the outset is modified, so that any worsening of the financial position of the company for reasons relating to coronavirus is to be left out of account. The same applies for seeking an extension of the moratorium.

The monitor's monitoring under section A35 of the 2020 Act is also modified in relation to a moratorium which comes into force during the relevant period, so that any worsening of the financial position of the company for reasons relating to coronavirus should be disregarded, it is likely that the moratorium would result in the rescue of the company as a going concern. The same applies in respect of a monitor's duty to terminate a moratorium under section A38 of the 2020 Act. The expression "reasons relating to coronavirus" has been left imprecise, ill-defined and potentially very wide.[38]

2.5 International comparisons – US Chapter 11 and European norms

Chapter 11 of the US Bankruptcy Code and the European Restructuring Directive both have moratoria / stays and debtor-in-possession norms.

Under the Directive, where there is a likelihood of insolvency but not where the debtor has reached the stage of insolvency as understood under national law, Member States must provide debtors with access to a preventive restructuring framework or procedures.[39] The framework is intended to enable business debtors to restructure with a view to preventing insolvency and ensuring their viability. Member States may introduce a viability test, but this test is only intended to assess viability and the conduct of the test should not detrimentally affect the debtor's assets.[40]

The Directive has a debtor-in-possession norm, though there are three qualifications to this norm.[41] The first is that a regime of only partial debtor control seems to be acceptable and so, if a Member State required the automatic appointment of a restructuring professional in all cases to act alongside the debtor, this would seem to pass muster. Secondly, the appointment of a restructuring professional on a "case-by-case basis" is

---

38 It should be noted that amendments have now been made under the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020, SI 2020/1031 and the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Early Termination of Certain Temporary Provisions) Regulations 2020, SI 2020/1033.

39 European Restructuring Directive, Art 4(1).

40 *Idem*, Art 4(3).

41 *Idem*, Art 5.

expressly permitted, though the factors that would warrant such an appointment are not articulated. Thirdly, there are certain circumstances where Member States shall require the mandatory appointment of the restructuring practitioner in every case.[42]

Where a mandatory appointment is envisaged, the role of the restructuring practitioner seems to be limited to that of assisting the debtor and creditors in negotiating and drafting the restructuring plan. This role is more limited than that in the general definition of "restructuring practitioner" who may be (a) somebody assisting the debtor in drafting or negotiating a restructuring plan; (b) supervising the debtor during the period and reporting to the relevant authorities and (c) assuming partial control of the debtor's affairs.[43] Therefore, there is not one conception of the restructuring practitioner who may be variously a manager, monitor or supervisor.

There is provision in Article 6 of the Directive for a stay of individual enforcement actions. The stay is intended to give debtors a respite on claims from creditors and to facilitate negotiations on a restructuring plan.[44] There may be little prospect of debtor rehabilitation if creditors deprive the debtor of assets that may be essential to the carrying on of the debtor's new or rehabilitated business. From the wording of Article 6, it appears that the stay is not intended to be automatic; in other words, kicking in as a matter of course once restructuring proceedings are opened or where there is an application to open restructuring proceedings. It seems, however, that there is nothing to stop Member States from instituting a mandatory automatic stay and thereby meeting their obligations under Article 6, provided that there are appropriate provisions that allow the stay to be lifted in certain circumstances.

The European Restructuring and Insolvency Directive has been spoken of as Europe's response to the US Chapter 11.[45] The objective of Chapter 11 is said to be "to provide a debtor with the legal protection necessary to give it the opportunity to reorganize, and thereby to provide creditors with going-concern value rather than the possibility of a more meagre satisfaction of outstanding debts through liquidation".[46] Warren and Westbrook suggest that Chapter 11 deserves a prominent place in "the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the world."[47] Chapter 11 has been cited as a great success by its proponents and certainly as a model for European restructuring laws. In general, the principal features of Chapter 11 are:

---

42 For criticism, see H Eidenmüller, "The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union", (2019) 20 *European Business Organization Law Review* 547 at pp 559 to 560; "This requirement restricts contractual freedom, reduces flexibility and makes the restructuring process more complicated and costly. Engaging advisors or experts should have been left to the participating stakeholders …"

43 European Restructuring Directive, Art 2(1)(12).

44 Idem, Art 6(1).

45 See the Clifford Chance briefing paper on the proposal (at p 4) - https://onlineservices.cliffordchance.com/online/freeDownload.action?key.... See also http://www.euractiv.com/section/euro-finance/opinion/a-chapter-11-law-for-europes-entrepreneurs/.

46 *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436 at 1442.

47 See E Warren and JL Westbrook, "The Success of Chapter 11: A Challenge to the Critics", (2009) 107 *Michigan Law Review* 603 at 604.

- The management of the debtor is not displaced in favour of an outside insolvency practitioner and the management itself can prepare a restructuring plan and submit the plan to the creditors.

- An officer may be appointed by to monitor the rehabilitation process, but the officer's powers are not as far-reaching as those under a management-displacement regime.

- A moratorium exists to protect the debtor from its creditors.

Under Chapter 11,[48] early stage proceedings allow value to be preserved in an ailing business when there is still value that might be preserved. In the US, a typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court. The petition has to be accompanied by a list of creditors and also a summary of the debtor's assets and liabilities. Technically there is no requirement that the company should be "insolvent" and so-called strategic bankruptcies are a conspicuous part of the US scene. In other words, companies may have a number of reasons, other than insolvency strictly so-called, to invoke the protective cloak of Chapter 11.[49] For instance, a company may be faced with large potential tort liabilities and attempts to reach a global settlement with plaintiffs have broken down. Well-publicised examples of this include the *Johns-Manville* case[50] involving asbestos-related liabilities where the court stated that a business foreseeing insolvency was not required to wait until actual inability to pay debts before entering Chapter 11.

Applications for Chapter 11 relief must however be made in "good faith". This means that the application must have been filed with the intention of achieving a corporate restructuring, or to bring about a liquidation or sale of the company. If this is not the case, then creditors may apply to have the Chapter 11 petitions dismissed. *SGL Carbon Corporation*[51] is a case in point where a Chapter 11 petition was dismissed on the basis that the company had failed to manifest a genuine "reorganizational purpose".

The debtor-in-possession presumption is based on a number of factors; most notably, on the fact that existing management is most likely to be familiar with the debtor's business, thereby saving on expense and time compared with the situation where an outside practitioner is automatically appointed and has to get acquainted with the nature of the debtor's business operations in a necessarily short period of time. The "carrot" of remaining in control of the business is also a factor that may induce existing management to address the causes of the debtor's difficulties at a sufficiently early time when restructuring is still a realistic possibility, rather than waiting too long until the prospect of rescue is remote. Risk-averse management may become less motivated to work hard under a

---

48 See generally TH Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge Ma, Harvard University Press, 1986) at pp 1-19, who sees bankruptcy as addressing a collective action problem, an "over-fishing" or "tragedy of the commons" problem as it were. See also H Eidenmüller, "What is an insolvency proceeding?" (2018) 92 *American Bankruptcy Law Journal*; S Paterson, "Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century", (2015) 35 *Oxford Journal of Legal Studies* 1 (2015); S Madaus, "Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law" (2018) 19 *EBOR* 615; N Tollenaar, *Pre-Insolvency Proceedings: A Normative Foundation and Framework* (Oxford, Oxford University Press, 2019).

49 See also T Tajti, "Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States", (2018) 6 *China-EU Law Journal* 1.

50 (1984) 36 Bankruptcy Rep 727.

51 (1999) 200 F 3d 154.

strictly enforcing regime that removes them from office. Management are not penalised by automatic displacement in favour of outsiders.[52]

Under Chapter 11, an outside bankruptcy trustee can be appointed to take over management of a company for cause, though their appointment is exceptional.[53] Alternatively, a US court may appoint an examiner instead of an outside trustee, though, again, it seems that such an appointment is not the norm.[54] The examiner carries out the investigations that have been entrusted to it by the court that are appropriate in the particular circumstances of the case and often examiners are called upon to consider possible causes of action that a company may have.[55] The appointment of an examiner does not displace the existing management who may continue to conduct the day-to-day operations of the company in tandem with whatever functions the court assigns the examiner.[56]

Having a policy of debtor-in-possession goes hand in glove with encouraging a company to invoke the reorganisation procedures when there are signs of financial distress rather than waiting until the disease may become terminal.[57] The major American Bankruptcy Institute (ABI) report on Chapter 11 favoured strongly retention of the debtor-in-possession model. It said:[58]

> "The ability of the debtor in possession to continue to operate through its prepetition management team facilitates the company's seamless transition into chapter 11 and allows the debtor to avoid the additional time, cost, and resulting inefficiencies of bringing in an outsider who is not familiar with the debtor's business specifically or the debtor's industry generally. The prepetition management team may also have industry relationships or 'know-how' that would benefit the debtor's restructuring efforts."[59]

During the period of Chapter 11 protection, creditors are embargoed from prosecuting their claims and the debtor is provided with an opportunity to work out a structured settlement plan. The stay has been described[60] as one of the

---

52 For a discussion of incentives to initiate proceedings, see H Eidenmüller, "Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts, and the Incentives for Shareholders/Managers" (2006) 7 *EBOR* 239.

53 According to the ABI Chapter 11 Commission report (www.commission.abi.org/full-report at p 27) "chapter 11 trustees are the rare exception rather than the rule".

54 At first glance, however, s 1104(c)(2) appears to require the appointment of an examiner where the company's unsecured, non-trade and non-insider debt exceeds $5m, ie in every medium to large case.

55 See generally JC Lipson, "Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies" (2010) 84 *American Bankruptcy Law Journal* 1.

56 The ABI Chapter 11 Commission report (www.commission.abi.org/full-report at p 32) recommended that the US Bankruptcy Code should be amended to delete any reference to an "examiner" and to incorporate the concept of a more flexible "estate neutral". However, this recommendation has not yet been implemented.

57 D Hahn in "Concentrated Ownership and Control of Corporate Reorganisations" (2004) 4 *JCLS* 117 at 127.

58 See www.commission.abi.org/full-report at p 22.

59 Reference was made to D A Skeel, Jr, "Markets, Courts, and the Brave New World of Bankruptcy Theory" [1993] *Wis L Rev* 465, 517 and n 188 (1993) "In the non closely held firm context, immediate removal of management would create significant indirect costs both before and during the bankruptcy".

60 HR Rep No 595, 95th Cong, 1st Session 340 (1977). The statement continued: "The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation

"fundamental debtor protections provided by the bankruptcy laws". The US stay is automatic and imposes a freeze on proceedings or executions against the debtor and its assets and has worldwide effect.[61] The US courts have inferred extraterritorial effect from the language of the Bankruptcy Code provisions[62] and they have also held that the bankruptcy estate comprises property of the debtor wherever situated throughout the world.[63] The long arm of the US automatic stay jurisdiction is illustrated by a series of Chapter 11 cases involving foreign shipping companies.[64]

In Chapter 11, however, a secured creditor, along with anybody else affected by the statutory stay, can apply to have it lifted and there is a specific requirement of "adequate protection" for the holders of property rights who are adversely affected by the stay.[65] Chapter 11 provides examples of "adequate protection" although the concept itself is not defined.[66] It should however be noted that it is only the value of the collateral that is entitled to adequate protection.[67] An under-secured creditor may find itself footing the bill for an unsuccessful restructuring attempt. It is prevented from enforcing the collateral by the automatic stay, yet it is not entitled to interest during what may be a long drawn out Chapter 11 process.

Section 362 of the US Bankruptcy Code sets out the effect of the stay and includes very broad language prohibiting the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the Chapter 11 proceedings, or to recover a claim against the debtor that arose before the commencement of those proceedings. It also includes any act to obtain possession of property of the debtor's estate or of property from the estate or to exercise control over property of the estate.

The current version of Chapter 11 also shows the effect of lobbying by special interest groups. There are exemptions from the stay that seem difficult to justify or rationalise in the abstract and are more the product of political expediency. More generally, section 362(b)(4) exempts from the stay commencement or continuation of an action or proceeding by a governmental entity to enforce the regulatory or police power of the governmental entity. The goals of business restructuring, however laudable or praiseworthy, should not excuse compliance

procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that."

61 For a recent example see *In re Nortel Networks Inc* (2011) 669 F3d 128.

62 See *Nakash v Zur (In re Nakash)* (1996) 190 BR 763, where the automatic stay was enforced against a foreign receiver in respect of the foreign assets of a foreign debtor.

63 See *Hong Kong & Shanghai Banking Corp v Simon (In re Simon)* (1998) 153 F3d 991 at 996: "Congress intended extraterritorial application of the Bankruptcy Code as it applies to property of the estate".

64 For an early example see *In re Global Ocean Carriers Ltd* (2000) 251 BR 31 which concerned a shipping company headquartered in Greece and where it was held that the unearned portions of retainers provided to US counsel constituted property that was sufficient to form the basis for a US bankruptcy filing.

65 US Bankruptcy Code, s 361.

66 The examples given are cash payments, additional or replacement security interests on other property and, unusually expressed, something that will give the creditor the "indubitable equivalent" of its security interest.

67 See *Re Alyucan* (1981) 12 BR 803 where the court rejected the view that the preservation of a certain collateral-to-debt ratio was part of the creditor's property interest that warranted protection. See also *United Savings Association of Texas v Timbers of Inwood Forest Associates Ltd* (1988) 484 US 365, where the Supreme Court held that the adequate protection provision did not entitle an under-secured creditor to compensation for the delay caused by the stay in enforcing the security.

with other laws. Section 959(b) of the US Bankruptcy Code reflects the same sentiment stating: "[A] trustee … appointed in any cause … including a debtor in possession, shall manage and operate the property in his possession … according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

3. New restructuring plan procedure – "Part 26A schemes"

The 2020 Act introduces a new restructuring procedure, to "eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties" which have affected or will affect the ability of a company to carry on its business as a going concern. In many ways, the new procedure is similar to the existing scheme of arrangement procedure contained in the companies legislation that dates back to 1870 and is now found in Part 26, Companies Act 2006.[68]The new restructuring procedure is contained in a Part 26A added to the Companies Act 2006.[69] The parallels with the scheme of arrangement are much closer than with the company voluntary arrangement (CVA) under the Insolvency Act sections 1-7. CVAs are relatively straightforward in that they do not need to come before the court for approval and creditors are not divided into classes, but neither secured creditors nor preferential creditors become bound with a CVA unless with their consent.[70]

In the past, the existing UK scheme of arrangement has been highly praised and, indeed, spoken of as a model for the "early stage" restructuring procedures envisaged by the EU's Restructuring Directive.[71] It has been suggested that a procedure modelled on the UK scheme would make restructuring "procedures less cumbersome, less costly and speedier than they are currently in some Member States."[72] Certainly, the procedure does not have any bankruptcy or insolvency stigma since it is a procedure based on company law rather than insolvency law. It is activated by the filing of documents with the court and an application to the court to convene meetings of relevant creditors and shareholders to approve the scheme. In fact, the scheme procedure can be used for various purposes such as share takeovers but its use includes that by companies of doubtful solvency to restructure their debts or rearrange their affairs. It has proved extremely attractive as a restructuring vehicle of choice for companies incorporated outside the UK, since the UK courts have jurisdiction to

68 See generally C Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd ed, Sweet & Maxwell 2017); G O'Dea, J Long and A Smyth, *Schemes of Arrangement Law and Practice* (Oxford University Press 2012); J Payne, *Schemes of Arrangement; Theory, Structure and Operation* (Cambridge University Press 2014).

69 See 2020 Act, s 7 and Sch 9. For a detailed analysis, see generally Robin Dicker QC and Adam Al-Attar "Cross-Class Cram Downs", *South Square Digest* special issue on Corporate Insolvency and Governance Act 2020 at p 34 and available at https://southsquare.com/wp-content/uploads/2020/07/Digest_Magazine_Mini_Digital-CIGA.pdf. See also new *Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)*, available at https://www.judiciary.uk/wp-content/uploads/2020/06/Schemes-Practice-Statement-FINAL-25-6-20.pdf.

70 Insolvency Act 1986, s 4(4).

71 S Madaus, "The EU recommendation on business rescue - only another statement or a cause for legislative action across Europe?" [2014] *Insolvency Intelligence* 81 at 84, suggesting that the Commission obviously had this tool in mind.

72 See SWD (2014) 61 at p 38.

sanction a scheme if the company is deemed to have "sufficient connection" with the UK irrespective of where it was incorporated.[73]

The UK scheme, while once described as a blunderbuss and somewhat cumbersome,[74] is now used as a powerful debt restructuring tool and altering in various ways the financial obligations of companies. Snowden J said in *Re Van Gansewinkel Groep BV:*[75]

> "The use of schemes of arrangement in this way has been prompted by an understandable desire to save the companies in question from formal insolvency proceedings which would be destructive of value for creditors and lead to substantial loss of jobs. The inherent flexibility of a scheme of arrangement has proved particularly valuable in such cases where the existing financing agreements do not contain provisions permitting voluntary modification of their terms by an achievable majority of creditors, or in cases of pan-European groups of companies where co-ordination of rescue procedures or formal insolvency proceedings across more than one country would prove impossible or very difficult to achieve without substantial difficulty, delay and expense."

Like the new procedure, the scheme involves "debtor-in-possession'.[76] The company management can prepare a restructuring plan and submit it to creditors, though obviously in practice there is likely to be a high degree of interaction and consultation with creditors in formulating the detailed terms of the plan and making sure that it is likely to meet with creditor approval.

Essentially, the scheme procedure, like the new restructuring plan procedure, involves an arrangement between a company and its creditors and / or members with some element of "give and take" on both sides. The sanctioning of a scheme is a three-stage procedure with, firstly, an application to the court to convene relevant meetings of creditors or members of a company. Secondly, the relevant class meetings are held and the scheme is required to be approved by 75 per cent in value and a majority in number of creditors within each class. The third stage involves the scheme coming before the court for approval. The court must be satisfied that the scheme proposed is a reasonable one such that a reasonable member of the class concerned and acting in respect of its own interests could have voted for it.[77]

---

73 See *Re Seat Pagine Gialle SpA [2012] EWHC 3686; Primacom Holdings GmbH v Credit Agricole* [2011] EWHC 3746; *Re Rodenstock GmbH* [2011] EWHC 1104 and see generally LC Ho, "Making and enforcing international schemes of arrangement" (2011) 26 *Journal of International Banking Law and Regulation* 434; J Payne, "Cross-Border Schemes of Arrangement and Forum Shopping" (2013) 14 *European Business Organization Law Review* 563.

74 Sir Kenneth Cork, *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982), para 419 and see also The Insolvency Service, *Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstructions Mechanisms* (May 2000), para 43.

75 [2015] EWHC 2151, [5].

76 It should be noted that CVAs and schemes of arrangement may be coupled with administration in which case they are no longer debtor-in-possession. See generally on debtor-in-possession versus creditor-in-possession: D Hahn, "Concentrated Ownership and Control of Corporate Reorganizations" (2004) 4 JCLS 117; S Franken, "Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited" (2004) 5 *EBOR* 645.

77 See *Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723, 736.

The existing scheme, however, lacks a facility which the new procedure contains, namely a cross-class creditor cram-down. While dissenting creditors within a class may be "crammed-down", there is no scope for dissenting classes of creditors in their entirety to be "crammed-down". This fact makes the composition of creditor classes very important in the context of a scheme of arrangement. It also leads to more complicated strategies.

It has been held that it is only necessary to get the consent of those with an economic interest in the proposed restructuring. Schemes might therefore be used to "squeeze out" creditors who are "out of the money" as in *Re MyTravel plc*[78] and *Re IMO Carwash.*[79] In broad essence, company assets are transferred to a "newco", together with some liabilities of creditors who are "in the money", but "out of the money" creditors are left stranded with claims against the "oldco" which no longer has any assets. Such schemes are usually implemented as part of a "pre-packaged" administration and are generally referred to as "prepack" or "business transfer" schemes.

Under the "business transfer" scheme, the assets or business of the company is normally transferred to a new creditor owned company with the latter assuming an agreed amount of the company's existing liabilities equalling to or exceeding the value of the business or assets being transferred. The transfer is carried out by administrators who are appointed once the scheme has been sanctioned. There is no need, however, to obtain the approval of junior creditors who no longer have any economic interest in the business, given the current value of the business. These junior "out of the money" creditors are left behind in the old scheme company with their rights unaltered but now essentially valueless since the "oldco" has been stripped of assets.

Business transfer schemes may be complex but they also give rise to questions of fairness and procedural propriety.[80] The courts consider the question of valuation at the sanction stage but there may be difficult questions about where in the debt structure the value "breaks"; how one assesses value and what the relevant comparator for assessing fairness and value is – whether it is liquidation value, going concern value, or something else? [81]

While clearly modelled on the existing scheme of arrangement, the new restructuring plan procedure will allow the cross-class cram-down of a company's restructuring proposals on both secured and unsecured creditors.[82]

---

78 See *Re My Travel Group plc* [2004] EWHC 2741 (Ch) and *Re Tea Corp Ltd* [1904] 1 Ch 12. For a general discussion, see CL Seah, "The Re Tea Corporation Principle and Junior Creditors' Rights to Participate in a Scheme of Arrangement: A View from Singapore" (2011) 20 *International Insolvency Review* 161.

79 This case is also referred to as *Re Bluebrook* [2009] EWHC 2114 (Ch).

80 See generally M Crystal QC and R Mokal, "The Valuation of Distressed Companies: A Conceptual Framework Parts 1 and 11" (2006) 3 *International Corporate Rescue* 63 and 123; N Segal, "Schemes of Arrangement and Junior Creditors – Does the US Approach to Valuations Provide the Answer?" (2007) 20 *Insolvency Intelligence* 49.

81 In the UK, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (n 4) states at [9.9]: "The cram-down of a rescue plan onto 'out of the money' creditors is currently possible in the UK only through a costly mix of using a scheme of arrangement and an administration. The Government believes that developing a more sophisticated restructuring process with the ability to 'cram-down' may facilitate more restructurings, and the subsequent survival of the corporate entity as a going concern."

82 https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework, para 5.148.

3.1 Conditions for getting a restructuring plan approved

The new Part 26A Companies Act 2006 option to implement a restructuring plan can be used where two statutory conditions are met: firstly, that the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern and, secondly, a compromise or arrangement is proposed between the company and its creditors, or any class or them, or its members, or any class of them (that is, the restructuring plan itself).[83]

The explanatory notes on the legislation suggest that the commonality between the restructuring plan and the scheme of arrangement should allow courts to draw on the existing body of case law where appropriate.[84] The new restructuring plan clearly has a more limited remit than the scheme but there are no set parameters as such in the legislation on what the plan should cover. It will therefore be up to the plan proponent to strike the right balance between compromising sufficient claims to enable the company to mitigate the financial difficulties that have led to the plan being proposed, and the plan being acceptable to those creditors and members (or relevant classes of creditors and members) who will need to vote in favour of it. The plan proponent will most likely be the company itself in conjunction with the monitor, although technically a creditor or member could propose a plan.

Unlike schemes of arrangement, which require 75% by value of the relevant creditors who are compromised by the scheme to vote in favour of it, a restructuring plan contains a cross-class cram-down procedure. A restructuring plan can nevertheless be approved by the court if there is a “dissenting class”, that is, less than 75% of a particular class of creditors have approved the plan, if these two conditions are met:

- **Condition A:** The court is satisfied that if the plan were to be approved, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.

- **Condition B:** The plan has been agreed by at least 75% in value of a class who would receive a payment, or have a genuine economic interest in the company, if the relevant alternative were to occur.

The “relevant alternative” is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned by the court.[85]

It should be noted, however, that under section 901H.5, the court may not sanction the compromise or arrangement if it includes provision in respect of any relevant creditor who has not agreed to it. A “relevant creditor” means a creditor in respect of a moratorium debt, or a creditor in respect of a priority pre-moratorium debt, that is, a debt that has not been “holidayed” by the moratorium.[86] There are strong similarities here with the existing CVA procedure

[83] Companies Act 2006, s 901A.
[84] HL explanatory notes at para 16 and available at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.
[85] Companies Act 2006, s 901G.4.
[86] *Idem*, s 901H.2.

where a proposal cannot affect the rights of secured creditors without their consent.[87]

Unlike the position for the traditional Part 26 scheme, there is no additional numerosity requirement, that is, a majority in number of affected persons. The utility of this additional test is questionable. Numerosity requirements can generally be overcome by the splitting of debts. This may be done through the assignment of part of the debt to a "friendly" assignee who is likely, or may indeed be legally compelled, to vote in accordance with the assignor's wishes. The debt splitting and assignment process may be legally complex, however, and will add to delay and expense.[88]

As in a scheme of arrangement, class classification is likely to be a hot topic in any restructuring plan though the dynamics are different in the two contexts. In a scheme all classes need to assent, whereas with a plan needs only a single assenting class. With a scheme, classes are generally determined based on a test of "those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest". This will likely need to be determined on a case-by-case basis. With a scheme, a "rights and interests" distinction has also resolved some of the difficult issues over class composition by narrowing the number of classes that have to be formed.[89]

The courts have distinguished between legal rights and private interests not derived from legal rights. In one of the classic cases, the judge cautioned against giving small groups veto powers over the decision-making procedures in a restructuring process, stating that the court had to give a meaning to the term "class" that would "prevent the … [provisions] being so worked so to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest."[90]The relevant test for what constitutes a separate class is based on the similarity or dissimilarity of the creditor's legal rights against the debtor and not on the similarity or dissimilarity of the interests that may be derived from these legal rights. If creditors held divergent views that were based on private interests not derived from their legal rights against the debtor, this was not sufficient ground for saying that the creditors formed separate classes.[91]

---

87 Insolvency Act 1986, s 4(4).

88 For criticisms of numerosity or "headcount" requirements, see J Payne, *Schemes of Arrangement; Theory, Structure and Operation* (Cambridge: CUP, 2014) at pp 61-68. See generally American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter Full Report at pp 261 to 263, available at www.commission.abi.org/full-report.

89 *In Re Lehman Brothers International (Europe)* [2018] EWHC 1980 (Ch) Hildyard J distinguished (para 69) between the legal rights which scheme creditors have against the company and their separate commercial or other interests or motives (whether or not these are related to the exercise of such rights). Moreover, a material difference in legal rights did not necessarily preclude their respective holders from being included in a single class. To require separate classes, the rights of the holders had to be "so dissimilar as to make it impossible for them to consult together with a view to their common interest". He said that this formulation introduced a subjective assessment that may have influenced changing judicial perceptions over the years on class constitution. There was now a judicial inclination not to be "too picky about different classes" and thus ending up "with virtually as many classes as there are members of a particular group."

90 *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573, at pp 582 to 583.

91 See the recent decisions in *Re Lehman Brothers International (Europe)* [2018] EWHC 1980 (Ch) and *Re Noble Group Ltd* [2018] EWHC 3092 (Ch). These decisions demonstrate the flexibility and versatility of the UK scheme of arrangement jurisdiction and the facilitative role of the courts.

In a plan, any creditor or member whose rights are affected by the plan must be permitted to participate in the process, but those who have no genuine economic interest in the company may be excluded. Affected members and creditors must be given sufficient information to be able to vote on the plan.[92] A restructuring plan sanctioned by the court is binding on all creditors / members, or the relevant classes of creditors / members, and the company. It appears that the court has absolute discretion on whether to sanction a plan. Certainly no criteria as such are specified in the legislation.[93] It remains to be seen whether, and to what extent, the Part 26 tests will also be used in the new restructuring plan (Part 26A) context,[94] particularly where a cross-class cram-down is involved. Valuation issues are likely to be particularly important at the sanction stage (and possibly at the initial convening stage), including consideration of what is the likely alternative if confirmation is refused,[95] and whether those with a genuine economic interest have been excluded from participation in the process.[96] "Part 26A is a new set of provisions intended to achieve outcomes that could not be achieved under Part 26, and the Court is likely to recognise that …"[97]

3.2 International precedents

3.2.1 Restructuring plans and cram-down under the US Chapter 11

What the 2020 Act has to say about restructuring plans should be compared with the US Chapter 11. The Chapter 11 system is founded on certain fundamental assumptions such as that businesses in financial distress are generally worth more as going concerns than if they are liquidated piecemeal. Moreover, their financial distress should be resolved through adjustment of their contracts with shareholders, trading partners and other stakeholders. The traditional view of a successful Chapter 11 outcome is that it results in a reorganisation plan agreed by a majority of creditors. For example, Stevens J remarked in the US Supreme Court in *Bank of America v 203 North LaSalle Street Partnership:*[98] "Confirmation of a plan of reorganization is the statutory goal of every chapter 11 case. Section 1129 provides the requirements for such confirmation, containing Congress' minimum requirements for allowing an entity to discharge its unpaid debts and continue its operations."

The past decades, however, have seen significant changes in Chapter 11 practice, including a marked rise in the number of pre-packaged Chapter 11 filings – so-called "prepacks" - and also with creditors gaining increased influence over the Chapter 11 process through contractual arrangements with the debtor.[99] 'Prepacks' are seen to have significant advantages over both a

---

92 Companies Act 2006, s 901D.
93 *Idem*, s 901F or s 901G.
94 *Idem*, s 901F.
95 Possibly an alternative plan or a sale of the business rather than a liquidation/administration.
96 See HL Explanatory Notes at para 205 'When determining the "relevant alternative" the court should consider what would be most likely to occur in relation to the company if the restructuring plan were not sanctioned' and available at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.
97 See Robin Dicker QC and Adam Al-Attar, "Cross-Class Cram Downs", South Square Digest special issue on Corporate Insolvency and Governance Act 2020 34 at 43 and available at https://southsquare.com/wp-content/uploads/2020/07/Digest_Magazine_Mini_Digital-CIGA.pdf.
98 (1999) 526 US 434 at fn 4 of his judgment.
99 See DG Baird and RK Rasmussen "The End of Bankruptcy" (2002) 55 *Stan L Rev* 751, who comment: "Corporate reorganizations have all but disappeared. Giant corporations make headlines when they file for Chapter 11, but they are no longer using it to rescue a firm from imminent failure. Many use Chapter 11 merely to sell their assets and divide up the proceeds." See also DG Baird and RK Rasmussen

traditional Chapter 11 and a corporate restructuring that takes place fully out of court through reducing the costs and disruption to all parties. With a pre-pack, an agreement can be reached that satisfies the majority of creditors and then Chapter 11 is used for the purpose of implementing the agreement. The process reduces the leverage of minority groups of creditors who could otherwise hold up an out-of-court workout. Nevertheless, a pre-pack is not likely to be successful in resolving complex, litigious disputes among many different creditor groups with sharply divergent interests.

Cram-down of affected parties within a class and also the cram-down of whole classes of creditors is a feature of the US Chapter 11.[100] A class of creditors, including secured creditors, can be crammed down in the US, that is, forced to accept a restructuring plan against its wishes provided that at least one other class of impaired creditors has accepted the plan.

Creditors in Chapter 11 are protected by the "best interests test"[101] and also by an extensive list of conditions set out in section 1129. The restructuring plan must not discriminate unfairly and has to be fair and equitable.[102] This requires that creditors who are similarly situated should be treated in a comparable fashion. *A fortiori*, it would for example be unfair discrimination for a junior creditor to receive a higher interest rate than that imposed on a senior creditor on the same property. The fair and equitable standard means that an unreasonable risk of the plan's failure should not be imposed on the secured creditor. Secured creditors are effectively entitled to payment of the amount secured in full over time.[103]

Unsecured creditors are protected by the absolute priority principle.[104] This means that shareholders cannot, in principle, be paid before the creditors unless the creditors consent or the shareholders are providing some new or additional value.[105] Section 1129(b)(2)(C)(ii) provides that the "holder of any claim or interest that is junior to the claims of such class [of unsecured creditors] will not receive or retain under the plan on account of such junior claim or interest any property".

The "absolute priority" principle was explained in detail by the US Supreme Court in *Czyzewski v Jevic Holding Corp.*[106] The court said that the Bankruptcy Code sets forth a basic system of priority that ordinarily determines the order in which the court will distribute assets of the debtor's estate. Secured creditors

---

"Chapter 11 at Twilight" (2003) 56 *Stan L Rev* 673 and DG Baird "The New Face of Chapter 11" (2004) 12 *American Bankruptcy Institute Law Review* 69.

100 For a general discussion of the issues, see J Payne, "Debt Restructuring in English Law: Lessons From the United States and the Need for Reform", (2014) 130 *LQR* 282.

101 US Bankruptcy Code, s 1129)(7)(A)(ii).

102 See US Bankruptcy Code, s 1129(b)(i): "the court, on request of the proponent of the plan, shall confirm the plan … if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

103 US Bankruptcy Code, s 1129(b)(2)(A).

104 But for a suggestion that the "absolute priority" principle in the US is less absolute than it might superficially appear, see M Roe and F Tung, "Breaking bankruptcy priority: How rent-seeking upends the creditors' bargain" (2013) 99 *Virginia Law Review* 1235 and also S Lubben, "The Overstated Absolute Priority Rule", (2016) 21 *Fordham Journal of Financial and Corporate Law* 581.

105 See B Markell, "Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations", (1991) 44 *Stan L Rev* 69 at 123, arguing that this priority scheme is recognised as "the cornerstone of reorganization practice and theory".

106 (2017)137 S. Ct. 973. For an analysis, see J Lipson, "The Secret Life of Priority: Corporate Reorganization after JEVIC", (2018) 93 *Washington Law Review* 645.

are highest on the priority list in that they must receive the proceeds of the collateral that secures their debts.[107] Special classes of creditors, such as those that hold certain claims for taxes or wages, come next in a particular order followed by lower priority creditors, including general unsecured creditors. Equity holders are at the bottom of the priority list and they receive nothing until all previously listed creditors have been paid in full.[108] In the liquidation of a debtor's assets under Chapter 7 of the Bankruptcy Code, a distribution must follow this prescribed order.[109] There is somewhat more flexibility for distributions in Chapter 11 plans, which may impose a different ordering with the consent of affected parties. Nevertheless, the court may not confirm a plan with priority-violating distributions over the objection of an impaired creditor class.[110]

In short, the absolute priority principle requires that unless creditors are to be paid in full, or unless each class of creditors consents, the company's "old" shareholders are not entitled to receive or retain any property on account of their old shares.[111]

Law and economics scholars have argued that deviations from the priority are costly and will increase the cost of borrowing since lenders adjust their rates to reflect the fact that shareholders retain some value that would otherwise have gone to the lenders.[112] The argument is that the failure to enforce the absolute priority rule will affect investment decisions; drive up the cost of capital and distort allocations between equity and debt. On the other hand, however, it may be the case that these propositions are based on perfect market theories that are not necessarily sound in practice.[113]

Moreover, the absolute priority rule makes it rather difficult to award value under a restructuring plan to "old equity" and, in this connection, it should be noted that the US Small Business Reorganization Act 2019 is designed to protect the equity interest of the small business owner. The Act was passed with bipartisan US Congressional support and came into effect in February 2020. The Act introduces a new subchapter V into the US Bankruptcy Code which eliminates the rule that a shareholder cannot retain equity in a business unless creditors are paid in full. The provision allows existing owners of a business to retain their full "equity" ownership without providing any "new value" if the plan provides for the debtor to distribute all of its projected disposable income over at least three

[107] US Bankruptcy Code, s 725.
[108] *Idem*, ss 507 and 726.
[109] *Idem*, ss 725 and 726.
[110] *Idem*, ss 1129(a)(7), 1129(b)(2).
[111] For a history of absolute priority in the US, see eg D Baird, "Present at the Creation: The SEC and the Origins of the Absolute Priority Rule", (2010) 18 *Am Bankr Inst L Rev* 591; S Lubben, "The Overstated Absolute Priority Rule", (2016) 21 *Fordham J Corp & Fin L* 581 (2016), and see also the original US Supreme Court decision in *Case v Los Angeles Lumber Products Co* (1939) 308 US 106, 115-119. The US Supreme Court also introduced the idea of a "new value exception" to the absolute priority rule on the basis that distributions to shareholders were valid as long as the shareholder provides new value to the company of (at least) the same amount. See also American Bankruptcy Institute (ABI) *Commission to Study the Reform of Chapter Full Report* at pp 224-226 and available at www.commission.abi.org/full-report.
[112] See generally D Baird, "Priority Matters: Absolute Priority, Relative Priority and the Costs of Bankruptcy", (2016) 165 *U Penn L Rev* 785; AJ Casey, "The Creditors' Bargain and Option-Preservation Priority in Chapter 11", (2011) 78 *U Chi L Rev* 759; E Janger, "The Logic and Limits of Liens", (2015) *U Ill L Rev* 589.
[113] See S Lubben, "The Overstated Absolute Priority Rule", (2016) 21 *Fordham J Corp & Fin L* 581 and see also National Bankruptcy Review Commission Report *Bankruptcy: The Next Twenty Years* (1997) at p 566.

years and no more than five from the date the first payment is due under the plan.[114]

3.2.2 *Restructuring plans and cram-down under the European Restructuring Directive*

Article 4 of the Directive states that Member States shall ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure with a view to preventing insolvency and ensuring their viability and without prejudice to other solutions for avoiding insolvency.[115] "Restructuring" is defined in Article 2(1) as meaning measures that aim at restructuring the debtor's business. This includes "changing the composition, conditions or structure of a debtor's assets and liabilities or any other part of the debtor's capital structure, such as sales of assets or parts of the business and, where so provided under national law, the sale of the business as a going concern, as well as any necessary operational changes, or a combination of those elements." Unlike the original proposal which referred to a sale of parts of the business, the final version makes it clear that a sale of the entirety of the business is permitted.

Under the Directive there are certain conditions that have to be met before the court can confirm a restructuring plan. These include, where there are dissenting creditors, whether the plan complies with the "best interest of creditors" test.[116] This test applies even if the class as a whole is prepared to accept the plan. It means that no dissenting creditor is worse off under the plan than they would be in the next best alternative scenario if the plan was not confirmed. Dissenting creditors are well looked after, though it may be difficult to calculate in practice what these dissentients would receive if the plan was not approved but rather some alternative scenario was implemented. The court is also required to refuse confirmation of a plan if it does not pass a "feasibility test", that is, if it does not have a reasonable prospect of preventing insolvency or ensuring the viability of the debtor's business.

If all the relevant classes have not approved the plan, there is still room for judicial confirmation or "cross-class creditor cram-down" as it is called. In these circumstances, the plan must meet the "best interests of creditors" and "feasibility" tests. In addition, it must have been approved by at least one of the voting classes of affected parties,[117] provided that this voting class is not either (a) an equity holder class, or (b) a class that would not have received a payment

---

[114] On the Act, see the US Congressional testimony available at https://www.congress.gov/event/116th-congress/house-event/109657 and in particular the statement by the ABI Commission Co-Chair, Robert Keach: "Chapter 11 doesn't work for small and medium-sized businesses because the Bankruptcy Code …(d) makes it difficult for a small business owner to maintain an ownership interest in the business under the current Chapter 11." It should be noted that the relevant liability threshold was amended (temporarily) by the CARES Act passed as a result of the COVID-19 crisis.

[115] For a somewhat differently nuanced statement, see p 209 of the *UNCITRAL Legislative Guide on Insolvency Law*: "The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers. With different constituents involved in reorganization proceedings, each may have different views of how the various objectives can best be achieved."

[116] See European Restructuring Directive, Arts 10(2)(d) and 2(6).

[117] Member States may increase the minimum number of classes of affected / impaired parties required to approve the plan to more than one – Article 11(1) – but Recital 54 states explicitly that "Member States should not require the consent of all classes".

or retained an interest if the debtor was valued on a going-concern basis.[118] The proviso is designed to ensure that the approving class has some real "skin in the game".

The choices for Member States were increased when the original Commission proposal was going through the EU legislative process. The original proposal favoured the absolute priority principle, that is, senior classes of creditors should be paid in full under a restructuring plan before junior classes or shareholders receive or retain any value. The final version, which was heralded in an October 2018 draft agreed by the Council of Ministers,[119] introduces the possibility of "relative priority", that is, a restructuring plan may be approved if a senior class is treated more favourably than a junior class even if the senior class is not paid in full.[120] The introduction to the revised provision explained that the cross-class cram-down mechanism was new to a number of Member States and raised some concerns about the consequences of the absolute priority rule. These fears were therefore addressed by a compromise text which provided an alternative option for Member States allowing them to incorporate a different benchmark – a "relative priority rule" – so as to protect dissenting creditor classes.[121] Accordingly, Member States are given more flexibility in implementing cram-down.

The Restructuring Directive provision on "relative priority" ensures, however, that junior classes get much more than they would do in a US Chapter 11 regime. It entails that a dissenting class can be bound to a plan provided that the class is treated "more favourably" than any lower ranking class. Article 11(1)(c) provides that "dissenting voting classes of affected creditors are treated at least as favourably as any other class of the same rank and more favourably than any junior class". The relative priority rule compromises rather than respects priority. It allows for plans giving value to shareholders without trade creditors receiving payments in full, or plans that make provision for payment to unsecured creditors before preferential or secured creditors receive a full distribution. There is a reshuffling and curtailing of pre-existing rights.

---

[118] Article 11(1)(b)(ii).

[119] Directive on business insolvency: Council agrees its position (press release, 11/10/2018) - https://www.consilium.europa.eu/en/press/press-releases/2018/12/19/eu-agrees-new-rules-on-business-insolvency/.
For a detailed analysis of the evolution of the Directive through its various iterations see generally JCOERE (Judicial Co-operation Supporting Economic Recovery in Europe) Report 1: "Identifying substantive and procedural rules in preventive restructuring frameworks including the Preventive Restructuring Directive which may be incompatible with judicial cooperation obligations", Chapter 5, available at https://www.ucc.ie/en/media/projectsandcentres/jcoereproject/bannerimages/Chapter3FINALPDF.pdf.

[120] See generally Proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive, 15556/18, 2016/0359 (COD), "Confirmation of the final compromise text with a view to agreement", art 11.

[121] But for criticism see R de Weijs, A Jonkers and M Malakotipour, "The Imminent Distortion of European Insolvency Law: How the European Union Erodes the Basic Fabric of Private Law by Allowing 'Relative Priority' (RPR)", *Amsterdam Law School Research Paper No 2019-10*, available at https://europeanlawblog.eu/2019/03/15/the-imminent-distortion-of-european-private-company-and-insolvency-law-by-the-introduction-of-relative-priority-european-style/. See also RJ de Weijs, "Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt–Equity Divide", (2018) 15 *European Company and Financial Law Review* 403 to 444 and RJ de Weijs and M Baltjes, "Opening the Door for the Opportunistic Use of Interim Financing: A Critical Assessment of the EU Draft Directive on Preventive Restructuring Frameworks", (2018) 27 *International Insolvency Review* 223 to 254.

European style relative priority may be said to rest on three main and related foundations;[122] firstly, the debtor is not actually insolvent at the time that it enters the restructuring process; secondly, encouraging existing managers and shareholders to make use of the restructuring process and, thirdly, the valuation uncertainties and the realities of business.

Member States are not, however, obliged to implement a relative priority regime[123] and may adopt absolute priority instead. Moreover, the Directive softens the edges of absolute priority and allows for variations on absolute priority where these are necessary to achieve the aims of the restructuring plan and where it does not unfairly prejudice the rights or interests of any affected parties.

The absolute priority versus relative priority choice widens the possibilities of "forum shopping" / regulatory competition on the European restructuring scene. Existing management may push for a restructuring in a country that has relative priority at its heart, whereas creditors may push for an "absolute priority"-friendly country. Nevertheless, if the debtor is in need of a fresh financial injection, then the creditors may be able to control the restructuring venue despite the "law on the books".

3.2.3 The new UK restructuring plan procedure and "absolute priority"

The new restructuring plan procedure in the 2020 Act does not specifically address the policy of "absolute priority". In the 2018 government proposals there was a suggestion of introducing an additional measure of flexibility into the legislative test. It suggested that there may be very good reasons to deviate from absolute priority, for example where an essential supplier insists on payment ahead of others.[124] It said that US experience highlighted the potential for abuse of absolute priority "whereby sophisticated parties seek to benefit at the expense of others. The trend of predatory market players cheaply acquiring junior secured debt as existing bondholders sell out, and then using restructuring negotiations to extract maximum value for themselves, regardless of the interests of other creditors or the rescue of the debtor, is well documented. Allowing opportunistic creditors to exploit restructurings by blocking restructuring plans that the majority of creditors support, until they are given unreasonably favourable treatment, would not assist the Government's aim of improving the prospects for company rescue."[125]

The Government proposed to permit the court to confirm a restructuring plan even if it did not conform with absolute priority where non-compliance was considered necessary to achieve the aims of the restructuring; and was just and equitable in the circumstances.[126] The 2020 Act does not contain this additional measure of flexibility. The assumption may have been that it would introduce too much uncertainty into the law and impact negatively on the cost and availability of credit, in particular secured credit.

---

[122] See generally R Mokal and I Tirado, "Has Newton has his day? Relativity and realism in European Restructuring", *Eurofenix* 2018/19, comparing the move from absolute priority to relative priority with the move from Newtonian absolutism to Einsteinian relativism.

[123] See also Recitals 55 and 56 of the Directive.

[124] See 2018 Government response to the consultation at para 5.161.

[125] *Idem*, at para 5.162.

[126] *Idem*, para 5.164.

On the other hand, it could be argued a lot is left up to the judicial interpretation, and the developing practice, on the new rules in section 901G of the Companies Act 2006 where there is an application for judicial sanction where one or more classes dissent. A lot depends on how the key expressions of “genuine economic interest in the company” and “relevant alternative” are interpreted and applied. It should be noted, however, that in the event of problematic interpretations or practices, there is provision for regulations to be made that would amend the relevant section for the purpose of (a) adding to the conditions that must be met, or (b) removing or varying any of those conditions.[127]

4. Termination of contracts

The 2020 Act contains a new set of provisions on termination clauses in contracts that restrict the operation of such clauses. Many contracts contain so-called *ipso facto* clauses allowing, for instance, suppliers to terminate or modify a long-term supply arrangement if the counterparty enters formal insolvency or restructuring proceedings, or more generally experiences financial difficulties. In extreme cases, this approach may be seen as suppliers holding “rescue to ransom”, demanding payment of outstanding debts as a condition of further supply.

If one prioritises business rescue, or at least gives a higher priority to business rescue, then one should strike at so-called “ransom payments” with a view to ensuring continuity of supplies. Section 233 of the Insolvency Act 1986 reflects this philosophy but confines the approach to contracts for the supply of water, gas and electricity. However, changes in the business world revealed the limitations of this approach and section 233 was widened in 2015 by the Insolvency (Protection of Essential Supplies) Order 2015[128] to ensure continuity in the supply of a wider range of utilities, including IT goods or services, to insolvent businesses.

The initial 2016 UK Insolvency Service consultation took the process a stage further. It pointed out that there are other supplies of goods and services that may also be essential to the survival of a particular business.[129] It gave the example of a printing company that needs special paper in order to continue its operations. “If this paper was only available from one supplier, that supplier would be an essential supplier to the printing company. Alternatively, a garage or dealership that only services one make of car would consider the supply of parts from this manufacturer essential.”[130] A response to the consultation by the Chancery Judges referred to the malleability of the concept of “essential contracts”.[131] It suggested a legislative fleshing out of the concept. The factors mentioned include the following, but the list is not exhaustive:[132] whether the product or service can be regarded as necessary (as distinct from being merely

[127] Companies Act 2006, s 901G.6.
[128] SI No 2015/989 made under sections 92 to 95 of the Enterprise and Regulatory Reform Act 2013. A new s 233A was introduced into the Insolvency Act.
[129] *Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (UK Insolvency Service, 2016) at para 8.8. See also para 5.97 *Insolvency and Corporate Governance Government Response* available at https://www.gov.uk/government/consultations/insolvency-and-corporate-governance stating that the UK government no longer intends to apply the designation of essential supplies as the basis for legislative reform.
[130] *Idem* at 8.9.
[131] See UK Insolvency Service, *A Summary of Responses: A Review of the Corporate Insolvency Framework* (September 2016) at p 650 – para 19 of the response by the Chancery Judges.
[132] *Idem* at para 20.

advantageous or convenient) for the survival of the business; availability of substitute sources of supply; the time that is likely to be needed to access the product or service elsewhere; whether, and to what extent, the source of supply is integrated into the operations of the business through, for example, shared tooling or "just in time" scheduling; regulatory considerations and shared intellectual property rights.

The 2016 Insolvency Service consultation contained proposals under which the debtor would be allowed to designate certain contracts as "essential" and prevent the counterparties to those contracts from terminating for a period of up to 12 months,[133] though counterparties were allowed to go to court after the event and challenge the designation of a contract as "essential". However, the proposals were criticised for tipping the balance too far in favour of the debtor, since counterparties might find themselves having to support distressed debtors when they may not desire to do so.[134]

The proposals were subsequently amended in 2018[135] and the provisions in the 2020 Act reflect more the 2018 understanding.[136] The existing "essential supply" provisions in sections 233 and 233A of the Insolvency Act 1986 were retained and a new more general set of provisions added in a new 233B on termination and *ipso facto* clauses in contracts for the supply of goods and services.[137] The new provisions apply when a company becomes subject to a "relevant insolvency procedure" designed to encompass administration, administrative receivership, company voluntary arrangements (CVAs), liquidation and provisional liquidation as well as the two new procedures established by the 2020 Act, that is, the statutory moratorium and the restructuring plan. The scheme of arrangement is not however, included.

Subject to a large group of "exempted contracts",[138] the provisions apply to any clause in a contract for goods and services, which either automatically terminates the contract (an *ipso facto* clause) or entitles the supplier to terminate the contract upon a company becoming subject to a relevant insolvency procedure. The Act also attempts to prevent suppliers from doing "any other thing" upon a company becoming subject to relevant insolvency procedure and the explanatory notes to the Act indicate that this is aimed at preventing suppliers from changing payment terms.[139] For example, this will prevent

---

133 *Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (UK Insolvency Service, 2016) at paras 8.7 to 8.9.

134 A Cohen, Clifford Chance briefing note, "Restructuring in the UK: Proposals for Reform" – https://www.cliffordchance.com/briefings/2016/06/restructuring_intheukproposalsforreform.html.

135 See para 5.97 *Insolvency and Corporate Governance Government Response* available at https://www.gov.uk/government/consultations/insolvency-and-corporate-governance. "The Government no longer intends to require the designation of essential suppliers by a debtor company. Instead, the Government will legislate to prohibit the enforcement of 'termination clauses' by a supplier in contracts for the supply of goods and services where the clause allows a contract to be terminated on the ground that one of the parties to the contract has entered formal insolvency. This is an approach that is common among a number of other states with highly-ranked insolvency regimes."

136 The 2020 Act in s 14 introduces a new s 233B of the Insolvency Act 1986 that applies to contracts for the supply of all other types of goods and services (unless exempted) and other than those that fall within s 233 and s 233A. Certain "essential" supplies, which are already subject to ss 233 and 233A, are not also subject to s 233B, thereby avoiding overlap between the new and existing provisions.

137 For a detailed analysis see generally F Toube QC and G Peters "Ipso Facto reform", *South Square Digest* special issue on Corporate Insolvency and Governance Act 2020, at p 54, available at https://southsquare.com/wp-content/uploads/2020/07/Digest_Magazine_Mini_Digital-CIGA.pdf.

138 See Sch 12 to the Insolvency Act 1986, inserting a new Sch 4ZZA into the Insolvency Act 1986.

139 See the explanatory notes available at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf, p 8, para 34 and also the statement "Where an event permitting the exercise of

suppliers with termination rights placing onerous conditions on trade, or making the continuation of supply conditional on higher payments. The generality of this wording may, however, have wider implications. The question arises whether, for instance, it covers acceleration clauses. Perusal of the parliamentary debates suggests that while accelerated financial debt should not gain super-priority status, acceleration clauses are not *per se* prohibited.

There is an express provision that precludes the supplier from making the payment of pre-insolvency debt arrears a condition of continuing supply and that there is no mechanism whereby an insolvency practitioner, the officeholder, could be held to guarantee personally the payment of ongoing supplies.[140] This is in contrast to the provisions that concern “essential suppliers”, which enable a supplier to hold an officeholder personally liable for the payment of ongoing supplies.[141]

There are certain circumstances however, where the supplier is able to terminate the contract:

- the officeholder consents (in an administration, administrative receivership, liquidation and provisional liquidation);

- the company consents (in a CVA, statutory moratorium or a restructuring plan); or

- the court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission.[142]

Moreover, the new statutory prohibition only affects the termination provisions that apply upon a company becoming subject to a relevant insolvency procedure. The supplier still has the right to terminate the contract on other grounds, unless these grounds arose before the relevant procedure commenced, but if the supplier had not exercised the right to terminate before the event, the supplier will be unable to exercise it for the duration of the insolvency.

There is also a time-limited exemption for “small suppliers” to help them mitigate the effects of the COVID-19 crisis.[143] Such suppliers are exempt if their distressed counterparty enters the relevant insolvency procedure within one month of the Act coming into force (a period now extended). A supplier is categorised as “small” if it generally satisfies at least two of the following criteria: (i) annual turnover of less than £10.2 million; (ii) balance sheet assets of £5.1 million or less; and (iii) no more than 50 employees.

In the impact assessment that accompanies the 2020 Act and tries to quantify its economic benefits, most of the benefits are seen to come from the

the right occurred before the restructuring or insolvency procedure commenced but the supplier had not exercised the right to terminate before the restructuring or insolvency event, the supplier will be unable to exercise it for the duration of the insolvency”.

140 See Insolvency Act 1986, s 233B(7).

141 *Idem*, s 233(2)(a).

142 *Idem*, s 233B(8).

143 See 2020 Act, s 15 as amended by the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020, SI 2020/1031.

termination provisions in supply contracts.[144] These provisions nonetheless suffer from certain ambiguities and certainly require detailed interpretation. One might highlight the ambiguous nature of what constitutes “financial hardship” and what is meant when suppliers are precluded from doing “any other thing”.

It should also be noted that financial services providers are generally exempt from the *ipso facto* provisions.[145] Therefore, lenders can cancel non-committed facilities such as overdrafts and invoice discounting and should also be able to rely on provisions in the facilities, for instance, to charge default interest or to impose an independent bank review, and these would seem to be payable as moratorium expenses.

The entry into a moratorium will in many cases constitute an event of default that brings about an automatic acceleration of the entire debt.[146] Even where acceleration is not automatic, it may be open to lenders to issue a notice that accelerates the debt to make it payable on demand during the moratorium period and thus gain an element of control since the company is unlikely to be able to pay the debt if the entire debt becomes due and payable during the moratorium period. The company is unlikely to be able to pay and the monitor will either have to bring the moratorium to an end, as it is difficult to believe that rescue of the company as a going concern is still possible, or the company will have to negotiate with the lender to agree a stay.[147] If a stay is not agreed, then the monitor will terminate the moratorium and the lender can begin enforcement processes such as the appointment of an administrator.

4.1 International comparisons

4.1.1 US Bankruptcy Code provisions

The US Bankruptcy Code has more general set of provisions allowing a debtor in US insolvency proceedings to “cherrypick” executory contracts.[148] In particular, section 365(e) invalidates *ipso facto* clauses in executory contracts. The provision covers clauses that provide for the termination of the contract conditional on the insolvency or financial condition of the debtor. More generally, the debtor may assume or reject executory contracts, effectively deciding to continue contracts that are advantageous to the debtor’s business but rejecting contracts that are actually or potentially unprofitable and leaving counterparties with an unsecured damages claim against the debtor. There is no definition of

---

144 See the impact assessment on the Act - https://publications.parliament.uk/pa/bills/cbill/58-01/0128/IA200519.pdf. See also Regulatory Policy Committee opinion on BEIS’ impact assessment of the Corporate Insolvency and Governance Bill and available at https://www.gov.uk/government/publications/corporate-insolvency-and-governance-bill-rpc-opionion stating: “[t]he impacts on business are large and subject to considerable uncertainty and the evidence for these impacts is limited in places…”.

145 See the newly added s 233B(10) to the Insolvency Act 1986, which inserts a new Sch 4ZZA into the Insolvency Act and which provides for exclusions from the operation of s 233B. The content of the new schedule is set out in Sch 12 of the Corporate Insolvency and Governance Act 2020. The exclusions cover financial contracts, meaning a contract for the provision of financial services consisting of (i) lending (including the factoring and financing of commercial transactions); (ii) financial leasing; or (iii) providing guarantees or commitments.

146 But see s A22 of the 2020 Act on floating charges – crystallisation is prohibited during the moratorium – and s A23 on the enforcement of security: “Security granted by a company during a moratorium in relation to the company may be enforced only if the monitor consented to the grant of security under section A26.”

147 2020 Act, s A38.

148 See also recommendations 69 to 86 of the *UNCITRAL Legislative Guide on Insolvency Law*.

such contracts in the US[149] but the American Bankruptcy Institute (ABI) *Commission to Study the Reform of Chapter Full Report* proposed a codification of the widely accepted "Countryman" definition:[150] "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other".

The debtor may assume or reject an executory contract at any time before the confirmation of a restructuring plan.[151] The court, however, on the request of any party to such a lease or contract, may order that the determination to assume or reject should be made within a specified period[152] and the effect of assumption means that the rental payments become entitled to administrative expense priority. If the debtor is in default of its obligations at the time of assumption, it must cure the default or provide adequate assurance of prompt cure; compensate the other contracting party for any actual pecuniary loss resulting from the default, or provide adequate assurance of prompt compensation; and, finally, provide adequate assurance of future performance under the contract.[153] As Judge Calabresi said in *Re Klein Sleep Products Inc*:[154]

> "Bankruptcy law also aims to avoid liquidation altogether when that is possible. Although the Code offers no magical potion to restore a debtor's financial health, it does provide some useful medicine designed to help a debtor get back on its feet and heading towards convalescence. It does this by allowing a debtor to attempt to reorganise rather than fold and by creating incentives for creditors to continue to do business with the debtor while reorganisation proceeds. The Code does this, at least in part, by assuring these post-bankruptcy creditors that, if the debtor fails to rehabilitate itself and winds up in liquidation, they can move to the front of the distributive line, ahead of the debtor's pre-bankruptcy creditors. Special priority is therefore accorded to expenses incurred under new contracts with the debtor, as "administrative expenses" of the estate. The same priority is given to expenses arising under pre-existing contracts that the debtor 'assumes' – contracts whose benefits and burdens the debtor decides, with the bankruptcy court's approval, are worth retaining."

The US executory contracts regime contains carve outs for particular types of transaction, such as financial markets contracts and intellectual property licenses.[155] For instance, section 365(n) contains specific provisions on intellectual property rights. If the debtor chooses to reject a contract under which it is the licensor of intellectual property rights, the licensee may elect to retain its

---

149 For the classic definition in the US, see V Countryman, "Executory Contracts in Bankruptcy" (1972) 57 *Minnesota Law Review* 439; (1973) 58 *Minnesota Law Review* 479. For a general discussion, see also American Bankruptcy Institute (ABI) *Commission to Study the Reform of Chapter Full Report* at pp 112 to 115 and available at www.commission.abi.org/full-report/.
150 See www.commission.abi.org/full-report/ at p 112.
151 On possible reforms, see American Bankruptcy Institute (ABI) *Commission to Study the Reform of Chapter Full Report* at pp 130 to 131.
152 US Bankruptcy Code, s 365(d)(2).
153 Idem, s 365(b)(1)(C).
154 (1996) 78 F3d 18.
155 For a discussion of this aspect, see generally American Bankruptcy Institute (ABI) *Commission to Study the Reform of Chapter Full Report* at pp 122 to 129.

rights under the license agreement, including the benefit of any exclusivity provision, by continuing to make royalty payments due under the agreement. The public policy basis of this carve out was considered by the US Bankruptcy Court[156] and at appellate level[157] in *Re Qimonda*. It was acknowledged that terminating the licenses would enhance the value to the debtor's estate, but this legitimate interest had to be weighed in the balance against the risk to licensees who had relied on the design freedom provided by the licensing agreements and invested substantially in research and manufacturing facilities as a result. The court spoke of a concern that terminating intellectual property licenses in a bankruptcy or restructuring context could create uncertainty and lead to a slower pace of innovation with detriment for the US economy.[158]

4.1.2 Restructuring Directive provisions on ipso facto clauses

The EU Restructuring Directive also contains provisions on termination clauses in supply contracts. Article 7 obliges Member States to ensure that creditors may not withhold performance or terminate, accelerate or in any other way modify executory contracts to the detriment of the debtor during the stay period.[159] This policy extends to creditors relying on contractual clauses that provide for such measures, solely by reason of the debtor's entry into restructuring proceedings or requesting the opening of such proceedings, or the requesting or granting of a stay of individual enforcement actions.[160] Member States are allowed to limit the provision to "essential contracts which are necessary for the continuation of the day-to-day operations of the business." It may also be cushioned by an obligation to provide creditors at risk of unfair prejudice from the measure with appropriate safeguards.[161] Executory contracts are defined in Article 2(5) as contracts between debtors and counterparties under which both sides still have obligations to perform at the time the stay of individual enforcement actions is ordered or applied for. "Essential executory contract" is to be understood as an executory contract which is necessary for the continuation of the day-to-day operations of the business (including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill).

According to Recital 41, early termination endangers the ability of the business to continue to operate during restructuring negotiations and it references in this connection contracts for the supply of utilities, telecoms and card payment services. Recital 40 instances the fact that some suppliers may have *ipso facto* clauses in their supply contracts, giving them contractual rights to terminate the supply contract by reason of insolvency or relating proceedings affecting the debtor. It suggests that creditors should not be allowed to rely on *ipso facto* clauses that make reference to negotiations on a restructuring plan, a stay, or an event that is linked to the stay.

Under the Directive, a debtor will benefit from protection against *ipso facto* clauses, so that suppliers with contractual rights to terminate the supply contract solely based on the insolvency will not be able to invoke such rights. The

---

156 (2011) 462 BR 165.
157 (2013) 737 F3d 14.
158 (2011) 462 BR 165 at 185. It should be noted that at appellate level the case was decided in the same way but the grounds for decision were different.
159 Restructuring Directive, Art 7(4).
160 *Idem*, Art 7(5).
161 *Idem*, Art 7(4).

Directive provisions are not, however, hedged about with some of the detail found in the US Bankruptcy Code on this issue.[162] The application of the Directive provisions to lease and licence agreements gives rise to certain controversies that have not been fully resolved and the possible limitation to "essential contracts" also produces uncertainty. The Directive anticipates that the debtor would continue to meet its post-stay obligations, that is, it would make payments for further supplies according to standard contractual terms.[163] But what if the counterparty wishes to terminate the contract because of pre-stay arrears by the debtor? This would appear to be prohibited by Article 7(5) of the Directive which specifically precludes the modification of executory contracts to the detriment of the debtor for debts that came into existence before the stay. The language also seems sufficiently broad to encompass moving the debtor onto a higher cost tariff during the stay period by reason of existing arrears in payment, since this action is clearly to the detriment of the debtor. But the language may not be sufficiently watertight to counteract all possible strategies by the counterparty. The ban only covers actions "solely by reason of" and if there is another justification for the counterparty action, then this would not seem to be covered.

5. Effect of the 2020 Act on creditors and in particular on lenders

In many respects, the effect of the 2020 Act on the existing rights of creditors is obvious. The Act provides for a moratorium on creditor claims, restricts the operation of termination clauses in supply contracts and introduces the possibility of a cross-class creditor cram-down, with court sanction, which includes an entire class, or classes, of creditors, being crammed down. This impact, however, will be borne largely by trade creditors and, to a certain extent, pension scheme creditors (that is, effectively beneficiaries under a "final salary" pension scheme. The position of finance creditors is protected and in many ways enhanced.

The 2020 Act makes consequential amendments to the existing insolvency legislation to alter the priority of distributions where a company enters into administration or liquidation within 12 weeks of the moratorium ending. These changes rank moratorium debts and pre-moratorium debts that should have been paid during the moratorium ahead not only of unsecured creditors, but also ahead of preferential creditors, expense claims under paragraph 99 of Schedule B1 of the Insolvency Act 1986, and floating charge distributions in an administration.[164] The Act does not provide for the ranking within this class and instead makes provision for changes to the Insolvency Rules to govern the ranking. Since financial services debts are not "holidayed", they will effectively obtain super-priority. Creditors who are owed financial services debts will therefore overtake other creditors in any administration or insolvent liquidation which commences within 12 weeks after a moratorium. Moreover, any restructuring plan (or CVA proposals) applied for within the same period cannot

[162] US Bankruptcy Code, s 365.

[163] See Recital 39: "This Directive should not prevent debtors from paying, in the ordinary course of business, claims of unaffected creditors, and claims of affected creditors that arise during the stay of individual enforcement actions. To ensure that creditors with claims that came into existence before the opening of a restructuring procedure or a stay of individual enforcement actions do not put pressure on the debtor to pay those claims, which otherwise would be reduced through the implementation of the restructuring plan, Member States should be able to provide for the suspension of the obligation on the debtor with respect to payment of those claims."

[164] See the 2020 Act, s 2 and Sch 3, para 13, inserting a new s 174A into the Insolvency Act 1986 and also para 31 inserting a new para 64A into Sch B1 of the Insolvency Act 1986.

compromise moratorium expenses (or pre-moratorium debts without a payment holiday) without first obtaining the consent of each of these creditors.[165]

There are a number of important consequences. Firstly, if the moratorium debts or pre-moratorium debts which are not "holidayed" overtake any liquidator or administrator's fees, it is difficult to see why any liquidator or administrator would be willing to take an appointment. Secondly, if it is not possible during the moratorium to rescue the company, creditors owed financial services debts have an incentive to cause the company to enter administration or insolvent liquidation within 12 weeks of the moratorium ending, precisely so as to take advantage of the super-priority status. It is even conceivable that creditors which are owed financial services debts will require a company to file for a moratorium before entering a subsequent insolvency process, simply to produce this super-priority result. This could frustrate any longer term rescue of a company. Creditors owed financial services debts are not, however, the only creditors with the benefit of super-priority. Employees are also in this category.

All financial services debts will rank equally, thereby putting banks with floating charges on an equal footing with unsecured banks and other lenders to the company, including related parties or shareholders. Intra-group lending may be permitted under facility agreements so third party lenders may not have the ability to prevent the creation of such debt, which will rank alongside them and dilute their returns in an insolvency which quickly follows a moratorium.

In the 2020 Act, as originally drafted, super-priority would have disproportionately benefited accelerated and "on demand" financial services debts. There was nothing to prevent a creditor which was owed a financial services debt from accelerating the debt or demanding its payment, even after the moratorium had commenced. In the ordinary course of events, a bank may only have been entitled to periodic repayments, but if the debt was accelerated all amounts due to the bank would become due and payable at the top of the insolvency waterfall. Amendments were therefore introduced to prevent creditors from gaming the system through a moratorium. The Act now excludes pre-moratorium financial services debts from having super-priority status where such debt has been accelerated for payment during the moratorium.[166] The Government Minister suggested that this ensures that the correct incentives are in place for the moratorium to work effectively. He said:[167]

> "The amendments … do not prevent a financial services creditor exercising a termination or acceleration clause; nor do they remove the requirement that if the accelerated debt is not paid then the monitor must bring the moratorium to an end. These are important provisions that will encourage lending to companies in difficulty and support the operation and stability of financial markets. The Government want to encourage financial services firms to keep lending to companies in distress.

[165] See Companies Act 2006, s 901H(6) of Part 26A, inserted by Sch 9 of the 2020 Act.

[166] See Insolvency Act 1986, new s 174A(4) and (11) where "relevant accelerated debt" is defined as meaning "any pre-moratorium debt that fell due during the relevant period by reason of the operation of, or the exercise of rights under, an acceleration or early termination clause in a contract or other instrument involving financial services". There is then a definition of "acceleration or early termination clause".

[167] See House of Lords Hansard, 23rd June 2020 col 151, available at https://hansard.parliament.uk/lords/2020-06-23/debates/B17932DC-10B4-43EE-AC03-FCD6494EA3FD/CorporateInsolvencyAndGovernanceBill.

> Including debts to these firms in the payment holiday concept could disincentivise them from doing so. That could leave some companies in a moratorium without the finance that they need to recover. In other words, it could jeopardise the very purpose of the moratorium in the first place."

The change means that while non-accelerated bank debt falling due and payable during the moratorium retains "super-priority", accelerated debt is carved out and will no longer be paid on a super-priority basis. In addition, any accelerated debt can also now be compromised and / or crammed down in a subsequent restructuring plan.

Nevertheless, in certain respects the 2020 Act weakens the position of defined benefit pension schemes and the Pension Protection Fund, and this detriment continues notwithstanding the amendments made during the passage of the legislation through the parliamentary process. Finance debts, as distinct from pension scheme liabilities, continue to be payable during a moratorium. Unsecured banking and finance debt is, in effect, granted "super-priority" status and, if the company enters administration or liquidation within 12 weeks of the moratorium terminating, there is an adverse impact on the level of recoveries that the PPF, acting as creditor for a defined benefit pension scheme, can achieve. The adverse impact is, however, less than it would have been had super-priority applied also to accelerated financial debt.

During the parliamentary debates, there were concerns raised that a restructuring plan could lead to the systemic dumping by ailing companies of their defined benefit pension schemes. It was also argued that the Act should not undermine the carefully constructed legislative framework put in place by the Pensions Act 2004, which sought to provide protections for pension schemes and the PPF where the scheme's sponsoring employer was in financial distress. Amendments were therefore made to ensure that the Pensions Regulator and the Pension Protection Fund get appropriate information in the case of both a moratorium and a restructuring plan and that the PPF can challenge, through the courts, the directors and the monitor of a company in a moratorium.[168] There is also a regulation-making power, which will allow the PPF to be given creditor rights in both procedures in certain circumstances. It was stressed, however, that the overriding objective of the 2020 Act was to rescue a company, which was ultimately the best outcome for a pension scheme and its members.[169]

The provisions in the 2020 Act should be contrasted with the new financing provisions in the US Bankruptcy Code. The 2020 Act encourages existing financial creditors to continue to support a distressed company rather than having provisions to encourage a new lender to come on the scene.

In the US, new financing is dealt with in section 364 of the Bankruptcy Code, which lays down that credit extended during the restructuring process has priority over existing unsecured claims.[170] If the extension of credit is in the

168 See Insolvency Act 1986, (new) s A45 and Companies Act 2006, s 901i.
169 Insolvency Act 1986, s A51 and Companies Act 2006, s 901i.
170 A lender may be able to exert substantial control over the Chapter 11 process by means of provisions in new finance agreements and commentators have spoken of a new "Chapter 11" with a greater emphasis on sales of the debtor's business as a going concern rather than on reorganisations in the traditional sense – see K Ayotte and E Morrison, "Creditor Control and Conflict in Chapter 11" (2009) 1 *Journal of Legal Analysis* 511, who find "pervasive creditor control".

ordinary course of business, then priority is automatic, whereas if the extension of credit is outside the ordinary course, then the priority must be authorised by the court prior to the granting of credit. Unless the lender agrees to the contrary, a company can get a restructuring plan confirmed only by ensuring that the new lender is paid in full at the confirmation stage and, even if the plan fails, "new" debts have priority over existing unsecured debts in the ensuing liquidation.

There may be a lot of cases where a company's assets are secured to such an extent that mere priority over existing unsecured creditors offers new lenders little chance of recovery in any subsequent liquidation. In these circumstances, meaningful priority means priority over existing secured creditors and section 364(d) provides that the court may authorise this in narrowly defined circumstances. The existing secured creditor is safeguarded by the fact that the company must prove that it cannot obtain the loan without granting such a security interest and that the secured creditor is adequately protected against loss. The case law suggests that the statutory requirements are strictly applied and that the "priming" of prior secured lending is permitted only in infrequent and exceptional instances.[171]

Nevertheless, a specialised market has evolved in the US for new financing in restructuring contexts. Bank lenders, it seems, are drawn to this form of finance by the lure of substantial upfront fees, higher margins and a strong package of covenants. There is also "increased activity from bespoke lenders such as hedge funds, private equity funds, institutional lenders and CLO funds drawn by the higher yields available or possible loan to own strategies".[172]

It has been argued that "the 'loan to own' principle in Chapter 11 restructuring is fast taking a hold of the objectives of debt purchasing by vulture funds in the US. By purchasing debt, professional debt investors in Chapter 11 cases facilitate control of the firm, with the potential acquisition of the equity as a viable outcome. In a 'loan to own' strategy, the investor extends DIP finance to the debtor in order to facilitate the investor's ultimate objective, ownership of the debtor's business, through a debt-for-equity exchange or sale transaction."[173]

The US new financing model has proved very influential internationally. For instance, the 2016 *Report of the Committee on Singapore as an International Debt Restructuring Centre* suggested that provisions for super-priority new finance should be introduced in Singapore.[174] It argued that such finance formed a vital plank to the new financing industry in the US, and the existence of similar provisions should encourage established players in the financing industry in the US to make available rescue financing in Singapore. It also said that "rescue financing often amounts to a small portion of the total debt and any prejudice caused to existing secured lenders must be balanced against the possibility that the rescue financing may improve restructuring prospects substantially".[175]

---

171 For consideration of some of the upsides and downsides of new finance during a restructuring period, see DA Skeel, "The Past, Present and Future of Debtor-in-Possession Financing" (2004) 25 *Cardozo Law Review* 1905.

172 *Potential economic gains from reforming insolvency law in Europe* (February, 2016) at p 18. The report was prepared by AFME, Frontier Economics and Weil, Gotshal and Manges LLP.

173 See INSOL International Small Practice Special Report, *Financing the Rescue Process – A Comparative Analysis of the Financing Regimes in Australia, Canada, South Africa, United Kingdom and United States of America* (London, October 2018) at p 11 para 3.4.

174 See the *2016 Report* at pp 37 to 39, available at https://www.mlaw.gov.sg/files/NotebySMSonRestructuringHubReport.pdf.

175 *Idem*, 38.

Following on from the recommendations in the 2016 Report, the 2017 Singapore reforms contains a new financing regime for companies in the course of restructuring proceedings, including the possibility of super-priority new finance overriding existing security interests. These reforms[176] follow closely those in section 364 of the US Bankruptcy Code. Under certain conditions, including the unavailability of credit on less favourable terms and adequate protection of the interests of existing secured creditors, the Singapore court may authorise the debtor to raise new financing, even on a super-priority basis, provided such financing is deemed necessary to enable the debtor to continue as a going concern, or the financing is necessary to achieve a more advantageous realisation of its assets of a company that obtains the financing, than on a winding up.[177] The law provides some detail as to what constitutes adequate protection – cash payments, additional or replacement security or something that is the "indubitable equivalent".[178]

It has been argued that a US style new financing regime should be transplanted to Europe, including the UK. This approach has been advocated on the basis that it would cure the perceived lack of incentives to finance value-generating projects which is referred to as "underinvestment" and also the fact that existing assets may be fully secured – "debt overhang".[179] The call for such a regime was made in a study by the Association of Financial Markets in Europe (AFME) / Frontier Economics that advocated EU legislative action.[180] The call has so far been resisted by the European Commission. The call also appears to have fallen on deaf ears in the UK where reforms were considered as part of a *Review of the Corporate Insolvency Framework* by the Insolvency Service.[181]

There may be a lack of an extensive and bespoke new finance market in Europe. There are obvious dangers, however, in assuming that if certain US style legal reforms are enacted, then certain consequences will more or less automatically flow. There is a role for history, culture and business traditions in the reform process and formal reforms that do not have a solid grounding in the norms and experiences of a particular country or countries, may not necessarily flourish. One of the reasons for not taking reform proposals forward in the UK has been the differences in business culture and economic environment between the US and UK. There has been some hesitation about bringing about a situation that essentially guaranteed a return to credit providers who advance funds on the basis of super-priority and irrespective of the commercial viability of the restructuring proposals. The decision on whether or not to lend to a distressed business, and on what terms, is a business judgment that may be best left to the market.

Moreover, under the World Bank Doing Business "Resolving Insolvency" indicators, the highest marks are given to countries that have a new financing framework but only where there is no provision for super-priority over existing

[176] Companies Act (Singapore), s 211E.
[177] *Idem*, s 211E(1).
[178] *Idem*, s 211E(6).
[179] SWD (2016) 357 final at p 158 refers to "debt overhang" as a situation where a firm's high debt levels act as a disincentive to new investment.
[180] *Potential economic gains from reforming insolvency law in Europe* (February, 2016) at p 18, available at https://www.afme.eu/Reports/Publications/Details/prudential-data-report.
[181] See UK Insolvency Service INSOLVENCY AND CORPORATE GOVERNANCE Government response (August, 2018) at para 5.177 to 186. Many respondents were concerned that any changes made to the order of priority would have a negative impact on the lending environment by increasing the cost of borrowing.

secured debt.[182] In general, the "Resolving Insolvency" indicators follow US Chapter 11 precepts but in this area there is a notable departure.

6. Conclusion

Without wishing to be overly critical of the Government, the Corporate Insolvency and Governance Act 2020 has been sold to parliamentarians and the general public under something of a false prospectus. The legislation was presented as an emergency response to the Covid-19 crisis and rushed through Parliament on an expedited basis. Nevertheless, the legislation introduces fundamental and far-reaching permanent changes to UK restructuring and insolvency law. The Act puts onto the statute book changes that were considered, debated, and consulted upon for many years. The implications of the Act and these changes will, however, also take many years to work out and possibly require many judicial decisions as well as clarifying legislation.

It is a truism that the 2020 Act moves UK law closer in the direction of Chapter 11 of the US Uniform Commercial Code. It has new provisions on a standalone restructuring moratorium, debtor-in-possession, cross-class creditor cram-down and termination clauses in executory contracts (that is, contracts still to be performed by the debtor). In the accompanying impact assessments, the quantified economic benefits of the changes are largely said to come from the restrictions on termination clauses. In reality, however, most of the attention and perceived economic advantages have centred on the restructuring moratorium.

These Chapter 11 characteristics are also a feature of the European Restructuring Directive. EU Member States have to implement this Directive by July 2021 and they can now, of course, also clad the relevant provisions in Covid-19 garb. The UK is no longer an EU Member State and there is no requirement that it should be Directive-compliant but the 2020 Act ensures that, in fact, it is compliant.

Brexit gives rise to wider questions about the international effectiveness of the 2020 Act. It is possible, in certain circumstances, for companies registered overseas to avail of the new moratorium. Therefore, it is envisaged that the moratorium should encompass, at least to some extent, the international activities of companies. But the Act is silent about the extra-territorial remit, in general, of the moratorium and of the other new and expanded procedures. Unless the UK and EU have an unlikely change of heart and negotiate a bilateral replacement treaty, the new Corporate Insolvency and Governance Act 2020 procedures will not be entitled to Europe-wide recognition under either the Insolvency Regulation[183] or the Jurisdiction and Judgments Regulation[184] after the Brexit implementation period completion day on 31st December 2020.[185]

---

[182] See the 2020 *World Bank Doing Business Report Data* notes at p 90: "Whether post commencement finance receives priority over ordinary unsecured creditors during distribution of assets. A score of 1 is assigned if yes; 0.5 if post commencement finance is granted super priority over all creditors, secured and unsecured; or 0 if no priority is granted to post commencement finance or if the law contains no provisions on this subject", available at https://openknowledge.worldbank.org/bitstream/handle/10986/32436/211440app.pdf.

[183] Regulation 2015/848.

[184] Regulation (EU) No 1215/2012.

[185] It may be, however, that the UK becomes accepted as party to the Lugano Convention and civil judgments are recognised elsewhere on that basis – see https://www.gov.uk/government/news/support-for-the-uks-intent-to-accede-to-the-lugano-convention-2007.

The most important question, however, concerns the effect of the 2020 Act on the broader British economy and on the financial consequences of Covid-19 and the likely resulting recession.[186] The moratorium, which initially lasts for 20 businesses days, mainly benefits small and medium-sized enterprises (SMEs). It provides relief from rent arrears and supplier payments. It has been argued that the new rules on a debt moratorium – essentially a repayment holiday – are largely unworkable for larger companies holding more complex debt structures that include high-yield bonds and bank debt. Bank loans have to be repaid before and during the moratorium period and, for companies with significant capital market debt, the moratorium cannot be used at all. Nevertheless, there were understandable concerns that changes would have a detrimental impact on the cost of borrowing in the UK if borrowers could get a potentially extensive repayment holiday from debt servicing costs. Therefore, for the moratorium to operate effectively, companies with substantial bank debt need to agree a repayment standstill with their lenders in advance of a moratorium filing.

[186] https://uk.reuters.com/article/new-uk-insolvency-law-fails-to-deliver/new-uk-insolvency-law-fails-to-deliver-idUKL8N2DA5W2.

INSOL International GROUP THIRTY-SIX

AlixPartners LLP
Allen & Overy LLP
Alvarez & Marsal
Baker McKenzie
BDO
Brown Rudnick LLP
Clayton Utz
Cleary Gottlieb Steen & Hamilton
Clifford Chance LLP
Conyers
Davis Polk & Wardwell LLP
De Brauw Blackstone Westbroek
Deloitte LLP
Dentons
DLA Piper
Duff & Phelps LLP
EY
Freshfields Bruckhaus Deringer LLP
FTI Consulting
Grant Thornton
Greenberg Traurig LLP
Harneys
Hogan Lovells
Houthoff
Huron Consulting Group
Jones Day
Kalo
King & Wood Mallesons
Kirkland & Ellis LLP
KPMG LLP
Linklaters LLP
Morgan Lewis & Bockius LLP
Norton Rose Fulbright
Pepper Hamilton LLP
Pinheiro Neto Advogados
PwC
Rajah & Tann Asia
RSM
Shearman & Sterling LLP
Skadden, Arps, Slate, Meagher & Flom LLP
South Square
Sullivan & Cromwell LLP
Weil, Gotshal & Manges LLP
White & Case LL

INSOL International™

6-7 Queen Street, London, EC4N 1SP
Tel: +44 (0)20 7248 3333   Fax: +44 (0)20 7248 3384

www.insol.org