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UK Corporate Insolvency and Governance Act: Key changes for corporate trustees

Director – Transaction Management at Ocorian, Abigail Holladay and Charlotte Drake and Jayesh Patel of Stephenson Harwood LLP highlight the key implications of the Corporate Insolvency and Governance Act 2020 for corporate trustees.

Introduction

The Corporate Insolvency and Governance Act 2020 (the **Act**) received Royal Assent on 25 June 2020, introducing what has been described as the most significant reforms under English law for a generation.

The Act is intended to facilitate increased protection for companies encountering financial difficulties and represents a shift towards a more debtor-friendly insolvency regime. It makes both permanent changes to the insolvency landscape (largely implementing proposals for insolvency law reform introduced in 2018), and some more temporary changes designed to address (or, at least try to mitigate) certain issues arising from the coronavirus pandemic. It is hoped that the coronavirus-related changes will be short lived, with certain temporary relaxations expressed to expire on 30 September 2020 (although the Act allows for this date to be further extended).

The Act introduces a number of significant and permanent measures and corporate trustees will need to get up to speed with them quickly. This briefing aims to provide an analysis of those measures.

The capital markets exceptions to the moratorium and the ban on *ipso facto* clauses

The moratorium

The Act introduces a new "standalone" moratorium which is intended to give companies struggling financially a 20-business day opportunity to consider a rescue plan. This is extendable to 40 business days, with further extensions possible with the agreement of creditors or the court. The company will remain under the control of the directors during the moratorium (a so-called *"debtor in possession"* procedure), but the process will be overseen by a monitor, who needs to be a licensed insolvency practitioner. The moratorium will give a distressed company a payment holiday for certain debts, restrict what the company and its directors can do (unless they obtain the consent of the monitor or the court) and limit what enforcement action creditors can take.

What impact would a moratorium have on a transaction involving a corporate trustee?

Relevant to bond trustees, there is an exception for parties to capital market arrangements. This exception is convoluted and difficult to navigate. However, a party to a capital market arrangement involving a debt of at least £10m, the issue of a capital market investment (which includes any bond which is rated, listed or traded or designed to be) and which involves the grant of security or guarantees, will not be eligible to apply for a moratorium.

Even where a bond issuer is eligible to apply for a moratorium, it would still need to make payments due under the bonds during the moratorium. This is because debts under *"an arrangement involving a capital market investment"* (which includes any bond which is rated, listed or traded, or designed to be rated, listed or traded) do not enjoy a payment holiday during a moratorium. Furthermore, if a company in a moratorium is unable to pay debts for which it has no payment holiday, the monitor is obliged to bring the moratorium to an end.

There is also an exception for securitisation companies which means that they are not eligible to apply for a moratorium.

Relevant to security trustees in syndicated lending transactions, a company in a moratorium would still need to make payments due under its loans during the moratorium. This is because the payment holiday provided by the moratorium does not apply to most financial services contracts (which is broadly defined in the Act).

Ban on *ipso facto* clauses

The legislation also introduces a new prohibition on provisions providing for the termination or amendment of a contract for the supply of goods and services to a company by reason of the company entering into a *"relevant insolvency procedure"*. Such clauses (commonly referred to as "*ipso facto*" clauses) would be rendered ineffective upon insolvency. A *"relevant insolvency procedure"* includes the new moratorium procedure and a court order convening a meeting relating to the new restructuring plan (discussed below). It also includes the other more familiar insolvency proceedings; a CVA; the appointment of an administrator; administrative receiver or provisional liquidator; and the liquidation of the company. It does not include a scheme of arrangement.

The ban on *ipso facto* provisions should not impact most financial transactions which involve a corporate trustee. In relation to bond issues, the ban does not apply to a contract where the company or supplier under the contract is a securitisation contract, or to an arrangement involving the issue of a capital market investment (which is a broad definition, including any bond which is rated, listed or traded, or designed to be rated, listed or traded). There are also exceptions to the ban for contracts where either the company or the supplier is a person involved in financial services, or if the relevant contract is a "financial contract". The definition of a financial contract is broad and includes contracts for the provision of financial services consisting of lending, financial leasing or providing guarantees and commitments, securities contracts, commodities contracts and swap agreements.

The restructuring plan

The Act introduces a new restructuring plan which has a number of similarities to the existing scheme of arrangement, such as the requirement of a court sanction. However, there are some important differences:

Cross-class cram-down and disenfranchisement

A crucial difference is that the new restructuring plan introduces a "cross-class cram-down". This is a feature of Chapter 11 of the US Bankruptcy Code and is intended to address the problem often encountered in schemes of arrangement, where one class of creditors or members can cause the scheme to fail.

The cross-class cram-down enables dissenting creditors to be bound by the plan, if sanctioned by the court as fair and equitable, and if the court is satisfied that none of the dissenting creditors as a whole is any worse off under the plan than they would be in the event of a *"relevant alternative"*. The *"relevant alternative"* means whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned. This could be insolvent liquidation, but it may not be. Much will depend on the company's financial state at the time. It is also necessary for 75% of a class of creditors or members who would receive payment or have a genuine economic interest in the company to vote in favour of the plan.

There has been speculation over the extent to which the new cross-class cram-down provisions could be used to "cram up". Theoretically, if the court is satisfied that if the plan was sanctioned, none of the members of the dissenting class would be any worse off than they would be in the relevant alternative, the legislation should enable an "in the money" class of junior creditors to cram up more senior creditors.

Finally, while attracting less attention than the cross-class cram-down provisions, under the new restructuring plan the court also has the power to exclude creditors or members (or a class of them) from voting if it is satisfied that none of the members of the class has a genuine economic interest in the company.

It seems inevitable that valuation evidence will be extremely important to a court in making the assessment both of what the *"relevant alternative"* is, as well as in determining where value in a transaction breaks and whether any members of a class of creditors or members has a genuine economic interest in the company. There could be much to lose for a disenfranchised or crammed down creditor group, and valuation evidence will almost certainly provide fertile ground for disputes between creditors. It is therefore certainly not difficult to see that a bond trustee, as trustee for the class, could easily get drawn into these types of dispute.

Numerosity

Schemes of arrangement have a so-called "numerosity" requirement, requiring a majority in number to vote in favour of the scheme. This requirement has not been carried across to the new restructuring plan. Otherwise the voting threshold for approval is the same as that for a scheme (namely 75% or more in value of creditors in each class who vote – subject to the cross-class cram-down provisions described above).

Distress tests

There are two pre-conditions which need to be met before a restructuring plan can be proposed. The first is 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. The second is that the purpose of the compromise or arrangement is to eliminate, reduce, prevent or mitigate the effect of those financial difficulties.

There are no such "distress tests" for a scheme of arrangement. Some have speculated that the inclusion of the cross-class cram-down and the loss of the numerosity requirement in the new restructuring plan means that the scheme of arrangement will be used far less frequently in the future. However, the fact a scheme can be used in circumstances where there is no requirement to confirm financial distress, means that a scheme could remain an attractive option for those companies which do not need or want to satisfy the "distress tests".

Disclosure requirement

The legislation includes the same "material interest" disclosure requirement for trustees as that which already exists for schemes of arrangement. Also, as with a scheme, if the trustee fails to comply with its obligations in connection with the disclosure of its material interests it will commit a criminal offence.

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Abigail Holladay is a Director of Transaction Management in our specialist restructuring team. The team has extensive commercial and practical expertise to work closely with our clients' advisers to deliver responsive, independent and practical restructuring solutions to distressed and defaulted transactions. Contact our restructuring team here or get in touch via Abi's details below to find out how we could help you mitigate the risks of your distressed scenario:

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