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Restructuring Across Borders

England and Wales:

Corporate restructuring and insolvency procedures | June 2021

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Contents

Introduction

When a corporate borrower faces financial difficulties there are a variety of restructuring and insolvency options available.

The five principal restructuring and insolvency regimes for companies under English law are:

- moratorium;
- receivership (including administrative receivership);
- voluntary arrangements, schemes of arrangement and restructuring plans;
- administration; and
- liquidation (also known as winding-up).

A distressed borrower may wish to make use of the moratorium introduced into the Insolvency Act 1986 by the Corporate Insolvency and Governance Act 2020 to protect it from creditor action and give it a "payment holiday", meaning that it can avoid paying certain liabilities that fell due prior to the moratorium for the duration of the moratorium.[1]

From a creditor's perspective, the choice of procedure will depend upon whether the borrower has granted security. If security has been granted, receivership may well be the most appropriate choice, although the Enterprise Act 2002 had a significant impact on the secured lender's right where it has full fixed and floating charges to appoint an **administrative receiver** (discussed below). Receivership may be classified as a self-help remedy for secured creditors as a means of enforcing their security. A secured creditor who cannot appoint an administrative receiver may instead seek to appoint an administrator.

If no security has been granted, the choice of procedure will depend largely on whether there is a business to be rescued. If there is, an informal bank rescue or workout outside of any of the formal insolvency procedures (ie a restructuring of the company on an informal, consensual basis by agreement between the company and its principal lenders or creditors) may be appropriate, possibly with the use of the new moratorium. Alternatively, a restructuring or rescue may be conducted using one of the formal rescue procedures (ie a voluntary arrangement, scheme of arrangement, restructuring plan or administration).

A voluntary arrangement, **scheme of arrangement** and **restructuring plan** involves a compromise of the company's debts with its creditors on a statutory basis and, in the case of a scheme and a restructuring plan, with the sanction of the court. **Administration** is the collective insolvency proceeding under the Insolvency Act 1986 for dealing constructively with a company's difficulties. Administrators may be appointed by the court and out of court in certain circumstances.

If there is no business to be rescued, it may be more appropriate to put the company into **liquidation**, the formal dissolution procedure for English companies.

In 2020, prompted in large part by the Covid-19 pandemic, the United Kingdom implemented major reforms to the corporate insolvency framework through the introduction of the Corporate Insolvency and Governance Act 2020. The moratorium and restructuring plan mentioned above were introduced, as was a ban on the operation of ipso facto clauses, restricting the ability of suppliers of goods and services to terminate or otherwise alter contracts on the basis that the counterparty has entered into an insolvency proceeding.

For our views on the potential impact of Brexit on the UK's cross-border insolvency and restructuring regime, please see our client bulletin "**Cross-border recognition of insolvency and restructuring proceedings post-Brexit**".

[1] For a detailed overview of the measures introduced by the CIGA, please see our detailed bulletin (set out in an easy to use Q&A format) available **here**.

Moratorium

The moratorium provides companies with a statutory protection from creditors. It was introduced by the Corporate Insolvency and Governance Act 2020 by way of an amendment to the Insolvency Act 1986. Whilst in force, the directors remain in control of the company but an independent monitor (usually an accountant) is appointed to oversee the moratorium process. The moratorium prevents creditors from taking certain actions, such as: initiating insolvency procedures (including administration, liquidation, or administrative receivership); forfeiting a lease; enforcing security (other than financial collateral); and commencing or continuing legal process against the company and its property. Another major benefit for a debtor who obtains a moratorium is that it will have a statutory payment holiday during which it will not be required to meet payment obligations in respect of certain pre-moratorium debts (with exclusions for financial contracts). A further consequence of entry into the moratorium is that it triggers the ban on the operation of ipso facto clauses (contained in section 233B of the Insolvency Act 1986) – this means that, unless an exclusion applies, contractual counterparties will not be permitted to terminate or otherwise alter the terms of contracts solely by reason of the company having entered the moratorium.
The moratorium could be a powerful tool in the hands of a distressed debtor to provide some breathing space while it negotiates a restructuring although the exclusions from the payment holiday could curtail its effectiveness.

Receivership

Receivership is, essentially, a self-help remedy for secured creditors, although the Enterprise Act 2002 severely restricted the circumstances in which a secured lender can appoint an administrative receiver (see below). It is not a collective insolvency procedure but a method by which a secured creditor can enforce its security, realise the assets secured and obtain repayment. The receiver appointed acts principally in the interests of his appointor and not for the general body of creditors.

Secured creditors will generally wish to appoint an administrative receiver, if able to do so. An **administrative receiver** has wide powers, granted by statute, to carry on running the business. The objective will usually be to sell the business as a going concern. An administrative receiver can only be appointed by the holder of security which includes a floating charge and who is able to appoint over the whole or substantially the whole of the company's property.

Since 15 September 2003, when the relevant provisions of the Enterprise Act 2002 came into force, there has been a general prohibition on the appointment of an administrative receiver, subject only to limited statutory exceptions. The secured lender's right to appoint an administrative receiver is now limited to the following exceptions. Circumstances in which the lender has "grandfathered" security (ie a floating charge which was created prior to 15 September 2003), security created in the context of certain capital market arrangements, public-private partnership projects where step-in rights are involved, utility projects which involve step-in rights for the secured creditor, certain project finance exceptions, a company which is a registered social landlord for the purposes of Part 1 of the Housing Act 1996, certain market charges falling under Part VII of the Companies Act 1989 or certain security falling within the Financial Markets and Insolvency (Settlement Finality) Regulations 1999, certain urban regeneration projects which involve step-in rights or an arrangement with a protected railway company, water company or other specific companies.

Therefore, in most cases where security has been taken after 15 September 2003, the lender will not be able to appoint an administrative receiver and consequently will not be able to block the appointment of an administrator – sometimes previously viewed as adverse to a secured lender – but will instead be entitled to appoint an administrator of its choice (see below).

Where a creditor has a fixed charge over only some of a company's property, there may still be circumstances in which it is beneficial for that creditor to appoint a fixed charge receiver over only that asset for the purpose of enforcing the security, realising that asset and distributing proceeds to the charge-holder. However, it should be noted that where an administrator is subsequently appointed over that company, the administrator can require any previously appointed receiver to vacate office.

A company that is facing financial difficulty and suspects that a secured creditor is about to appoint a receiver may look to make use of the statutory moratorium discussed above in order to prevent the appointment and any enforcement of security.

The appointment of an administrative receiver also triggers the ban on the operation of *ipso facto* clauses contained in section 233B of the Insolvency Act 1986.

Schemes of arrangement, restructuring plans and voluntary arrangements

Where a company is essentially profitable but its debt burden and interest burden are too great, it may be able to persuade its creditors to either convert some of their debt into equity or to reschedule its payment obligations by extending the maturity/payment dates and to continue funding the company. This is a simple example of a restructuring which might be effected through a voluntary arrangement, restructuring plan or a scheme of arrangement. Restructurings can be pursued through the formal procedures set out in the Insolvency Act and the Companies Act but can also be effected on a simple contractual basis. Many rescue and support operations are conducted out of court in this way.

A company voluntary arrangement (**CVA**) is the formal procedure (essentially, a contract between the company and its creditors) provided for by the Insolvency Act which enables a company to agree with its creditors how its debts should be dealt with. The procedure is very flexible and there are no constraints on the form and content of the arrangement subject to certain basic information that must be included and certain safeguards for secured and preferential[2] creditors and landlords that must be adhered to. A supervisor (an insolvency practitioner) is appointed to oversee the implementation of the arrangement, though the exact nature of the supervisor's role will depend upon the terms of the appointment as set out in the arrangement itself.

The arrangement, if approved by the requisite majorities of shareholders and creditors (broadly, more than 50% by value and more than 75% by value respectively of those attending the meeting or taking part in the relevant decision procedure, as applicable) takes effect and binds all creditors who would have been entitled to vote at the meeting or in the relevant decision procedure, whether they attended/took part, voted or even had notice of the meeting or decision procedure.

A CVA can be proposed under the protection of the statutory moratorium detailed above, thus giving the debtor a breathing space within which to negotiate and implement the CVA.

An alternative to a voluntary arrangement is the scheme of arrangement under sections 895-901 (Part 26) of the Companies Act 2006 or a restructuring plan under sections 901A-901L (Part 26A) of the Companies Act 2006. Both a scheme of arrangement and a restructuring plan are a compromise or arrangement between a company and its creditors or members (or any class of them). A scheme of arrangement requires the agreement of over 50% in number and 75% in value of creditors and/or members (or each class of them) in order to become binding on all of them, when sanctioned by the court. A restructuring plan requires the agreement of 75% in value (no numerosity test) of each class. However, the main difference between a scheme of arrangement and a restructuring plan is that a restructuring plan can be imposed on dissenting classes through a "cram down" mechanism. In order to effect a cram-down: (a) at least one class of creditors or members who would receive a payment or have a genuine economic interest in the company in the event of the "relevant alternative" to the restructuring plan must approve the plan; and (b) the court must be satisfied that none of the dissenting classes are any worse off under the plan than they would be in the "relevant alternative". The "relevant alternative" is the whatever would happen to the company absent the plan and could be, for example, the commencement of insolvency proceedings.

The terms of the scheme or plan will vary from case to case but will, quite likely, require creditors to accept a percentage of the debts due to them and/or may involve a write-off of debt and/or a debt for equity swap. As with a CVA, a scheme or plan can be proposed under the protection of the statutory moratorium detailed above.

[2] In respect of insolvency proceedings commenced on or after 1 December 2020, HMRC will be a secondary preferential creditor after ordinary preferential claims (which include certain employee claims) with respect to taxes collected by the company on HMRC's behalf. This includes VAT, PAYE income tax, employee's NIC's and construction industry scheme deductions.

The decision whether to use a CVA, a scheme of arrangement or a restructuring plan will depend on the facts and circumstances of each case; considerations will include whether there are secured creditors; whether recognition of the procedure is required in other jurisdictions; and expected levels of creditor consent. A CVA cannot affect the rights of secured or preferential creditors without their consent (so no cram-down of secured or preferential creditors within a class), but a scheme may give rise to class issues that it might be possible to avoid in a CVA or overcome through the cross-class cram down available with a plan. A scheme and a plan will generally be more time-consuming, cumbersome and consequently more expensive to put together. A CVA may carry the stigma of being an "insolvency proceeding". A CVA (once it takes effect) and a restructuring plan (once a convening order is made) trigger the operation of ban on ipso facto clauses (contained in section 233B of the Insolvency Act 1986), whereas a scheme of arrangement does not.

Following the end of the UK-EU transition period on 31 December 2020, the UK no longer benefits from automatic recognition of certain proceedings under the EU Insolvency Regulation. As a consequence, if a company needs its chosen restructuring tool or insolvency process to be recognised in an EU Member State, the company will need to consider the potential pathways to recognition in that EU Member State. For our views on the potential impact of Brexit on the UK's cross-border insolvency and restructuring regime, please see our client bulletin "**Cross-border recognition of insolvency and restructuring proceedings post-Brexit**".

If recognition of the proceedings will be required in the U.S., CVAs, schemes of arrangements and restructuring plans are capable of recognition in the U.S. (under Chapter 15 of the US Bankruptcy Code).

Administration

Administration is a procedure pursuant to which a company's business may be restructured or its assets realised, under the protection of a built-in statutory moratorium (a protective breathing space from creditors). It is sometimes described as the UK equivalent of the US Chapter 11 procedure, but it is dangerous to take this analogy too far. Each company in a group must be dealt with individually.

An administrator is an insolvency practitioner and, once appointed, the administrator takes control of the company and all its assets, displacing the directors. An administrator owes a duty of care to all creditors of the company.

An administrator may be appointed by the court on the application of a creditor (including a secured creditor), the directors of the company or the company itself. The application must be supported by a witness statement evidencing the company's insolvency (or, in the case of an application by the holder of a "qualifying floating charge" (see below), evidence that the floating charge is enforceable) and a statement by the proposed administrator, consenting to act.

The court may make an administration order only if it is satisfied that the company is or is likely to become unable to pay its debts (or that the floating charge is enforceable, as applicable) and that making the order is reasonably likely to achieve the purpose of the administration.

An administrator may also be appointed without involving the court (ie out-of-court) by the holder of a "qualifying floating charge" or by the company itself or its directors. The holder of a "qualifying floating charge" must hold security, which includes a floating charge, over the whole or substantially the whole of the assets of the company and which meets certain drafting requirements. A qualifying floating charge holder can appoint out of court if the floating charge is enforceable – the company need not necessarily be insolvent. The company and directors can only appoint if the company is unable to pay its debts.

If a creditor (other than a qualifying floating charge holder) uses the court route into administration or the company or the directors use either the court route or the out-of-court route into administration, notice must be given to any holder of a qualifying floating charge. This enables the qualifying floating charge holder to get in first with an out-of-court appointment of an administrator of its own choosing or, if not prohibited, the appointment of an administrative receiver, thereby blocking the proposed appointment of the administrator by the company/directors/another creditor. The qualifying floating charge holder is only required to give notice to any prior qualifying floating charge holder.

An appointment out of court is a relatively straight-forward process and involves completing and filing (a purely administrative matter) the appointment and supporting documents with the court whereupon the appointment takes effect. Appointment documents are relatively straight-forward to complete, though care must be taken to ensure that they are completed correctly so as not to invalidate the proposed appointment. Many out-of-court appointments (including all of those made in London) will now be made online, using the court's e-filing system and appointment takes effect once the filing fee has been paid. However, urgent appointments by a qualifying floating charge holder must be effected by emailing or faxing the appointment documents to court if the court is not open for business at the time the appointment needs to be made.

There is a statutory three-stage purpose of administration. The primary objective is to rescue the company as a going concern, but the administrator may pursue the secondary objective of achieving a better result for the company's creditors as a whole than would be likely if the company were wound up without going into administration if the administrator considers that the primary objective is not reasonably practicable or that the secondary objective would achieve a better result for the company's creditors as a whole. The third objective, which will only apply if neither of the other two objectives is possible, is to realise property in order to make a distribution to one or more of the secured or preferential creditors but without "unnecessarily harming" the interest of the unsecured creditors. The administrator is required to produce proposals as to how the purpose of the administration is to be achieved within eight weeks of appointment.

Entry into administration triggers the ban on the operation of *ipso facto* clauses contained in section 233B of the Insolvency Act 1986.

Liquidation

Liquidation (or winding-up) is the dissolution procedure for companies under English law. In that sense, it might be thought akin to Chapter 7 in the United States. It is a procedure of last resort. ("Bankruptcy" is a term applied only to individuals in England, never to companies.)

Liquidation can take one of two forms: it can be a voluntary liquidation which occurs where the shareholders of the company pass a resolution to place the company into liquidation. Alternatively, the company or a creditor may present a petition to the court for a compulsory winding-up and, if the company is insolvent, a winding-up order will be made by the court in due course.

The liquidator, who is an insolvency practitioner, takes control of the company and collects, realises and distributes its assets. Shareholders, creditors and the court have different degrees of control depending on the type of liquidation. Once the process has been completed, the company is dissolved.

Entry into liquidation triggers the ban on the operation of *ipso facto* clauses contained in section 233B of the Insolvency Act 1986.

Ipso Facto

English law is usually a great champion of freedom of contract and so, for many years, if a contract entitled a party to terminate on the grounds of the other's insolvency or increase the pricing terms or require payment in advance as a result of such insolvency, this was something permitted and supported by English law – the terms of the contract were paramount.

With effect from 26 June 2020, this is no longer the case as a matter of English law. The Corporate Insolvency and Governance Act 2020 introduced a ban on the operation of *ipso facto* clauses – or, put more simply, the ability of a contractual counterparty to terminate, vary or exercise any other contractual right on the basis that a counterparty had entered into an insolvency proceeding. There are wide exceptions, though, for certain types of counterparty and certain types of contract.

This represents a huge shift change for English law and a significant fetter on the principle of freedom of contract.

Unless an exception applies, there is now a prohibition on the termination of any contract for the supply of goods and services to a company, or 'doing any other thing' in respect of that contract, by reason of the company entering into an 'insolvency procedure'. An 'insolvency procedure' includes where:

(a) a moratorium comes into force for the company under the new moratorium procedure;

(b) the company enters administration;

(c) an administrative receiver of the company is appointed;

(d) a company voluntary arrangement takes effect in relation to the company;

(e) the company goes into liquidation or a provisional liquidator is appointed; or

(f) a convening order is made by the court in respect of a restructuring plan.

The prohibition on the termination or variation of any contract for the supply of goods and services does not apply to schemes of arrangement under Part 26 of the Companies Act 2006.

The 'any other thing' language is extremely broad. It means that any other contractual rights triggered by or exercisable upon the commencement of an 'insolvency procedure' permanently cease to have effect except with company or office-holder consent, or a hardship order (discussed below). This would affect provisions such as the ability to charge default interest, acceleration, or any other contractual consequence.

Counterparties retain the ability to terminate or vary a contract on grounds other than insolvency (for instance non-payment) where the default occurs following the commencement of the insolvency procedure but a termination right triggered prior to the insolvency procedure will be suspended if it has not been exercised before the commencement of the insolvency procedure. The right to terminate for a pre-proceeding default would be suspended even where the right is based on fraud or wilful default and completely unrelated to the financial condition of the debtor.

Notwithstanding the above restrictions, a supplier can terminate or vary a supply contract if:

(a) the relevant office-holder (ie the administrator, administrative receiver, liquidator or provisional liquidator) consents to the termination;

(b) the company consents to the termination;

(c) prior to 30 June 2021, the supplier is a small entity at the time the insolvency proceeding commences; or

(d) the court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission for the termination of the contract. There is no definition of "hardship" in the legislation and so it remains to be seen how the courts will interpret this.

Although a supplier cannot terminate or vary a contract once the *ipso facto* provisions come into operation, they should continue to be paid in accordance with their original supply terms and, where the relevant insolvency procedure is administration, liquidation or provisional liquidation, the office-holder should ensure that these amounts are paid as expenses of the procedure (ie ranking ahead of pre-insolvency unsecured and floating charge claims). If the company ceases to pay for goods during the insolvency procedure, this would usually give rise to a termination right, which could be exercised by the supplier; it is therefore in the interests of the debtor company to continue paying for the supplies that it requires.

Previously, where debtors needed a continued supply of goods and services following entry into an insolvency procedure (such as in a trading administration), suppliers would use the need for the continued supply as leverage to obtain payment of any arrears relating to the pre-insolvency period. That will no longer be possible as a supplier is now prohibited from making it a condition of any future supply of goods and services that any pre-insolvency outstanding charges are paid. This seems to be the case regardless of whether there is an ongoing supply contract or a series of contracts for "spot" deliveries. So although the company may choose to pay the supplier, there is no obligation to do so. Furthermore, as detailed above, where the company enters into an insolvency procedure, prior termination rights are temporarily suspended.

Certain entities are excluded from these provisions and will not be subject to them where they themselves are in distress or where they are a supplier to a business in distress. The list of excluded entities is a long one and includes deposit-taking and investment banks and insurance companies so any contracts with these types of entity would be excluded.

These provisions apply only to contracts for the supply of goods and services and there are a number of excluded contract types, such as financial contracts, which include loan agreements, financial leasing, swap agreements and derivatives and capital market arrangements. There is also a carve-out for any set-off or netting arrangement. This means that lenders will be permitted to draw-stop facilities, accelerate loans, charge default interest, exercise contractual set-off rights and otherwise exercise their contractual rights associated with an event of default under the facility. Although intercreditor agreements are not included, it is hard to see how these are contracts for the supply of goods or services.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

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Further information

For further information on any of the above insolvency procedures, please refer to our more detailed factsheets available in the “England and Wales” section of our Restructuring Across Borders website (see below).

Allen & Overy has an online service for clients focusing on debt restructurings and insolvency issues. Developed by Allen & Overy’s market-leading Restructuring group, “Restructuring Across Borders” is an easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in various jurisdictions, including Europe and the U.S.

To access this resource, please click **here**.

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