INSOLVENCY AND CORPORATE GOVERNANCE REFORMS – SUMMARY OF THE GOVERNMENT's PROPOSALS 26TH AUGUST 2018

The full response can be found on the BEIS section of Gov.uk: https://www.gov.uk/beis

Background

The Government, as part of their focus on delivering a strong business environment in the UK, sought views on ways to reduce the risk of company failure occurring through poor governance or stewardship and improving the insolvency framework in such circumstances. In March 2018 the consultation on insolvency and corporate governance was issued. This followed an earlier consultation in 2016 on the Review of the Corporate Insolvency Framework. The paper issued by BEIS at the end of August 2018 summarises the views and comments received during the consultation and sets out the Governments' next steps. In some areas the Government will legislate for reform, however in others more consultation will be needed. Areas most likely to be legislated for are those relating to the 2016 consultation which seek to encourage greater business rescue and increase protections for creditors whilst maintaining a fair balance between the rights of the company seeking to be rescued and the rights of creditors seeking payment of the company's debts.

This paper sets out an overview of the proposals put forward by Government:

Action to increase protections for creditors, and achieve a fairer balance in insolvencies

The Government will seek to introduce new legislation to implement measures in line with the Government proposals as soon as parliamentary time permits.

1. **The introduction of a new moratorium to help business rescue.** This will give those financially distressed companies which are ultimately viable, a period of time when creditors (including secured creditors) cannot take action against the company, allowing it to make preparations to restructure or seek new investment.

   The moratorium would be open to small companies currently eligible for the Schedule A1 moratorium and the current small company CVA moratorium would be repealed. Using a moratorium would not be a pre-requisite for seeking the agreement of creditors to the restructuring plan proposal.

   ### Moratorium process

   Entry to the moratorium would be triggered by filing the necessary papers at court. This will resemble the current procedure for an out of court appointment as an administrator. The supervisor will need to file their consent to act and confirmation that they have assessed the eligibility tests and qualifying conditions and are satisfied these have been met. The supervisor will also be required to send notice to all known creditors of the company and register the company's entry into the moratorium at Companies House.

   A debtor company subject to a pending winding up petition would have to seek permission from the court to commence a moratorium and would not be able to follow the usual process of filing papers at court.

   Where the petition has been presented on public interest grounds however the company will be ineligible for a moratorium.

   ### Test for entry

   The procedure is only for companies that are solvent – companies that are already insolvent will be excluded.

   The test on financial state will be one of prospective insolvency, that is, based upon the requirement that a company will become insolvent if action is not taken. The test for entry should be that rescue is more likely than not, based on probabilities and assessed by the 'monitor'.

   Some form of consultation with key stakeholders in the restructuring process will be required but their agreement is not necessary to enter into a moratorium.

Companies entering the moratorium will have to show that they have sufficient funds to continue to trade and pay suppliers during the moratorium – it will be for the monitor to assess this.

Creditors may challenge the moratorium, either on the grounds of the qualifying conditions not being met (or the company being ineligible) or unfair prejudice to creditors at any time during the moratorium.

Duration of the moratorium

The moratorium shall be for an initial period of 28 days, which may be extended up to a further 28 days by the company, providing the monitor confirms the qualifying conditions continue to be met. The monitor will have to notify the creditors of the extension.

The moratorium may be extended beyond 56 days with approval of both secured and unsecured creditors. The required threshold for approval is more than 50% percent of secured creditors by value and more than 50% of unsecured creditors by value. The company may also apply to court to extend the moratorium if there are situations where seeking consent for an extension from creditors is impracticable.

In the event of a CVA proposal, the moratorium will automatically extend to cover the notice period for consideration of the CVA.

The moratorium will end either on the commencement of a formal insolvency procedure or the company agrees an informal restructuring with creditors. Where no definite outcome is reached, a moratorium will expire at the end of the 28 day period (or the extended period if appropriate).

The monitor will be required to terminate the moratorium if the company becomes unable to meet its obligations as they fall due.

At the end of the moratorium period creditors will regain their ability to take enforcement action against the company.

Role of the monitor

The role of monitor may only be undertaken by a licensed IP. However the Government may amend the list of qualified persons if and when it becomes appropriate to do so. The monitor will be an officer of the court.

The directors of the company remain in control of the company's operations during the operation. The role of the monitor therefore is limited to supporting the integrity of the moratorium process and ensuring that creditor interests are protected.

The monitor will be responsible for:

- Assessing the eligibility conditions at the commencement of the moratorium;
- Assessing and monitoring the qualifying conditions at the commencement of the moratorium;
- Terminating the moratorium where the qualifying conditions cease to be met;
- Sanctioning asset disposals outside the normal course of business and the granting of any new security over company assets.

The monitor will have powers to request any information from the company they may reasonably require in order to satisfy themselves that the eligibility tests and qualifying conditions are met at the commencement of the moratorium. Directors will have a legal duty to provide this information.

Monitors will be provided with immunity from claims stemming from erroneous termination providing they acted in good faith.

The monitor's fees are to be a contractual matter between the monitor and the company appointing them. However, if the company subsequently enters formal insolvency, an administrator or liquidator would have an express power to challenge the monitor's fees if they were unreasonable.

The monitor will be barred from accepting an appointment as an administrator or liquidator of the company for a period of 12 months. The monitor will however be able to take appointment as the supervisor of a CVA.

The monitor would also not be prohibited from advising in relation to a restructuring plan once one had been agreed by creditors.

Costs incurred during the moratorium

Costs incurred during the moratorium will be treated in the same way as an expense in administration.

Where a company exits a moratorium and subsequently enters administration or liquidation, any unpaid moratorium costs will enjoy super-priority over any costs or claims in the administration or liquidation.

Highest priority is afforded to any suppliers prevented from relying on contractual termination clauses, followed by any other costs and lastly any unpaid fees due to the monitor.

Where the OR is appointed however in a compulsory liquidation there will be an exception for OR's statutory fees which will not be affected by the super-priority of any unpaid moratorium costs.

2. **The creation of a new Restructuring vehicle.** This would include the ability to bind dissenting classes of creditors who vote against it. The current law relating to schemes of arrangement will not be changed. The restructuring plan will not be available to all companies – the type of companies currently excluded from eligibility for the small company CVA moratorium will be excluded. There will be no financial entry criteria, the company can be solvent. A restructuring plan may provide for debt write-down or debt postponement as well as other matters such as a change in the management team or selling off loss making parts of the company. The supervisor of a restructuring plan need not be a licensed IP.

Restructuring plan process

A restructuring plan proposal will be sent to creditors and shareholders and filed at court. It will be for the company to propose terms that it thinks will be agreeable to creditors.

There is no time limit to duration of the plan.

Two court hearings will be required. At the first hearing the court will examine the classes of creditors and shareholders defined by the company. Creditors and shareholders may challenge the class formation. If no challenges are brought, creditors and shareholders will vote on the proposal.

75% in value (measured by value of gross debt) of the creditors within each class (who vote) must vote in favour of a restructuring plan. In addition, the voting threshold of 75% in value is supplemented by the additional provision that more than half of the total value of unconnected creditors vote in support.

Where a cross-class cram down is to be applied, a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan.

Subject to the requisite voting thresholds being met and the rules for imposing a cross-class cram down being complied with, the court will then schedule a second hearing to consider if necessary requirements have been met and will make a decision whether or not to confirm the restructuring plan and make it binding on affected creditors and shareholders.

3. **The protection of suppliers.** 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 grounds that one of the parties to the contract has entered formal insolvency (this will also apply to entering the new moratorium or the new restructuring plan). Suppliers will retain the ability to terminate contracts on any other ground permitted by the contract. There may however be grounds for exempting some financial products and services.

Contractual licenses, such as for use of software or patents, will be covered by the 'ipso facto' provisions. Creditors affected by these provisions will be permitted to apply to court for relief where continued supply threatens its own solvency.

The provision of personal guarantees during the moratorium period will not be required.

4. **Increase in prescribed part limits.** The Government will increase the prescribed part cap from £600,000 to approximately £800,000 by linking the increase in the prescribed part cap to the impact of inflation on the current cap.

Action to improve the insolvency framework in cases of major failure

5. **Sales of distressed subsidiaries** The Government intends to take forward measures to ensure greater accountability of directors in group companies when selling subsidiaries in distress. A director of a holding company who does not give due consideration to the interests of the stakeholders of a financially distressed subsidiary when it is sold may be subject to disqualification action if that subsidiary enters insolvent liquidation or insolvent administration within a certain period after sale (12 months).

   The Government will work with industry to develop guidance on the steps that a director should take when considering the sale of an insolvent company. The measures introduced will enable directors to remain confident that a sale would not expose them to liability or sanction if they had a reasonable belief at the time of the sale that the sale would likely deliver a no worse outcome for the stakeholders of the subsidiary than placing it into formal insolvency.

   The Government will bring forward legislation to implement the measures as soon as parliamentary time permits. The measures will be clearly targeted to minimise the risk of deterring legitimate business rescue and to ensure that directors are clear as to their duties when selling a subsidiary in financial difficulties.

6. **Value extraction schemes.** The Government will legislate to enhance existing recovery powers of insolvency practitioners in relation to value extraction schemes which have been designed to remove value from a firm at the expense of its creditors when a firm is in financial distress. The Government will work with stakeholders to look at how the provision might be better framed to capture situations where other creditors are unfairly disadvantaged by credit transactions, while also having regard to the risk being taken by the person providing the credit.

   The Government will bring forward legislation as soon as parliamentary time permits.

7. **Extension of CDDA 1986 provisions to former directors of dissolved companies.**
   When legislative time allows, the Government will proceed with amendments to the Company Director Disqualification Act 1986 (the CDDA) to extend the current investigation regime to include former directors of dissolved companies. The Secretary of State will be empowered to take action against a former director of a dissolved company without the expense and delay of restoring the company to the register in cases where conduct is found to have fallen below expected standards. This includes instances of directors repeatedly dissolving companies and leaving behind debts and other liabilities – often to the detriment of small businesses and employees.

Action to further strengthen the UK's corporate governance framework

8. **Greater transparency around group structures.** Measures will be introduced to strengthen transparency requirements around group structures, including requiring groups to provide explanations of their corporate and subsidiary structures. This could include working with industry to improve guidance, or introducing a requirement for corporate groups of a significant size to provide an organogram of their corporate structures along with an explanation of how corporate governance is maintained through the group.

   The Government will also consider whether the process for dissolving redundant companies and streamlining group corporate structures could be simplified.

9. **Strengthen shareholder stewardship**. Working with the investment community, the FRC and other interested parties the Government will identify means to incorporate stewardship within the mandates given to asset managers by asset owners and establish safe channels through which institutional investors and others can escalate concerns about the management of a company by its directors, including the discharge of their duties under s172 of the Companies Act 2006.

10. **Dividend payments.** The Government will explore further with legal and accountancy bodies and with business groups the strength of the case for a comprehensive review of the UK's dividend regime to address concerns that companies could pay dividends even when in financial distress.

    The Government will legislate to require companies to disclose and explain their capital allocation decisions if investor pressure and new section 172 reporting requirements do not deliver sufficient progress.

    The Government will legislate or take other steps to ensure that, for listed companies, there is at least one shareholder vote on dividends.

    The Government will give further consideration to ways in which directors could provide stronger reassurances for shareholders and stakeholders that proposed dividends will not undermine the affordability of any deficit reduction payments agreed with pension fund trustees.

11. **Director training and guidance.** The Government will continue to work with the Financial Reporting Council to underline the importance of boards having a thorough understanding of how governance applies throughout a group and set stronger expectations that directors will keep complex group structures under review.

    The Government will bring forward further proposals to strengthen access to training and guidance for directors, tailored to different sizes of company, and will consider whether some level of training should be mandatory for directors of large companies.