

Corporate Insolvency and Governance Bill 2020: Temporary Changes



Introduction

The Government finally published the draft Corporate Insolvency and Governance Bill on 20 May 2020 after its announcements in March and April regarding temporary changes to the UK's insolvency regime to mitigate the adverse economic effects of Covid-19.

The Bill also introduces permanent changes such as a new moratorium and restructuring process which represent the most significant changes to insolvency law since the Insolvency Act 1986. My colleague Nathan Webb addresses the permanent changes in another article but here I will consider the temporary changes, namely, the suspension of liability for the offence of wrongful trading and a prohibition on the presentation of winding-up petitions and statutory demands.

1. Wrongful Trading

1.1 The Offence of Wrongful Trading

This is defined in s.214 and 246ZB Insolvency Act 1986 as follows:

'If, in the course of an insolvent winding up or insolvent administration of a company, it appears that a person who is, or was, a director of the company knew or ought to have concluded at some point before the commencement of the liquidation or administration that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration, the liquidator or administrator of the company can seek a court declaration that the director make a contribution to the company's assets.'

This is often referred to as the Reasonable Prospect Test and if a director has failed to take every step that they ought to have with a view to minimising the potential loss to the company's creditors, that director will be liable for the offence of wrongful trading and may be ordered to contribute to the company's assets for the benefit of creditors. Ordinarily, the contribution will be the amount of the reduction in the company's assets available for creditors arising after the time when the company failed the Reasonable Prospects Test and the correct

steps should have been taken by the director in question. The issue of what constitutes “every step” has come before the Courts on many occasions and is fact sensitive but in broad terms, as long as directors make reasoned decisions which are documented and follow professional advice and are carried out with the reasonable belief (taking into consideration the subjective and objective tests) that a particular action will minimise losses to creditors they are unlikely to have committed the offence of wrongful trading.

It is important to remember that the duty to take ‘every step’ to minimise losses to creditors is part of a wider suite of duties upon directors to act in best interests of creditors.

1.2 The Suspension of Liability for the Offence of Wrongful Trading

On 28 March 2020, the Business Secretary Alok Sharma MP announced that the Government would temporarily suspend the wrongful trading provisions to give company directors greater confidence to use their best endeavours to continue to trade during the pandemic, without the threat of personal liability should the company ultimately fall into insolvency.

Paragraph 10 (1) of the Bill states that *‘in determining for the purposes of section 214 or 246ZB of the Insolvency Act 1986 (liability of director for wrongful trading) the contribution (if any) to a company’s assets that it is proper for a person to make, the court is to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period.’*

Paragraph 10 (2) of the Bill confirms that the suspension will begin on 1 March 2020 and end on either 30 June 2020 or a month after the Act comes into force depending on whichever is the later.

Paragraphs 10 (3) and (4) of the Bill refer to the list of eligible companies to which the suspension applies. The most notable exclusions are insurance companies and banks.

1.3 The Effect of the Suspension

The suspension temporarily suspends liability for the offence of wrongful trading which applies retrospectively. Section 10 does not provide any clarity on the basis for the assumption and it is unclear whether there are circumstances in which the assumption could be rebutted as is possible with other offences under the Act.

As the suspension only applies to the offence of wrongful trading, directors clearly still owe the other duties to the company and its creditors. Therefore, the temporary suspension could provide enough breathing space to allow directors to draw down further liquidity to prevent a company from becoming cash flow insolvent but directors must continually assess whether a company has a reasonable prospect of avoiding insolvency as when the suspension is lifted, they will need to be able to illustrate that 'every step' is being taken with a view to minimising losses to creditors. Therefore, in practice this may be of limited use and board decisions during this period will still be somewhat constrained by the threat of personal liability for the offence after the suspension is lifted.

2. Winding-Up Petitions and Statutory Demands

2.1 The prohibition

The Government's announcement on 23 April vowed to protect high street shops and other companies from aggressive rent collection. Somewhat confusingly, in the notes to the announcement it referred to the potential for the prohibition to apply to any winding-up petition where the company's inability to pay is the result of Covid-19. However, given the aim of the prohibition as highlighted in the article, one would reasonably assume that it would relate to winding-up petitions based upon claims by landlords for arrears of rent and that they would be limited to commercial tenants as did Snowden J in paragraph 83 of his judgment in *Re St Benedict's Land Trust Limited, Re Shorts Gardens LLP* [2020] EWHC 1001 (Ch) which involved two applications to restrain the presentation of winding-up petitions in respect of historic unpaid business rates and related costs orders.

The prohibition as stated in Schedule 10 of the Bill can be summarised is as follows:

- No petition for the winding up of a company can be presented on or after 27 April 2020 on the ground that a company has failed to satisfy a statutory demand if that demand was served between 1 March and 30 June 2020 (or one month after the coming into force of the Bill, whichever is later); and
- No petition for the winding up of a company can be presented by a creditor on or after 27 April and 30 June 2020 (or one month after the coming into force of the Bill, whichever is later) unless the creditor has reasonable grounds for

believing that (1) coronavirus has not had a financial effect on the debtor or (2) the debtor would have been unable to pay its debts even if coronavirus had not had a financial effect on the debtor.



Therefore, the prohibition goes much further than suggested by the Government's announcement as the above provisions are not restricted to commercial tenants.

2.2 The impact of the prohibition

The effect of the above is that the Court "may" make a winding-up order based on a petition presented after 1 March 2020 as long as it is satisfied that the ground relied upon would apply even if coronavirus had not had a financial effect on the company.

In relation to existing winding-up orders which were made on or after 27 April 2020 but before the Bill comes into force which would not have been made if the Court applied the above principles will be considered retrospectively void. Therefore, there is no need for an application to rescind a winding-up order. However, professional advice should be sought if there is any doubt in relation to a winding-up order which has been made on or after 27 April 2020.

The Bill provides little guidance on the meaning of "financial effect" i.e. the worsening of the debtor's financial position as a result of, or for reasons relating to, coronavirus. This seems to be a very low threshold and could encourage many debtors to cite coronavirus as the reason for their inability to pay their debts. Given Snowden J's robust approach in *Re St Benedict's Land Trust Limited, Re Shorts Gardens LLP*, in my view the Court will be reluctant to apply the prohibition unless it can be shown that Covid-19 was the principal reason for a company's inability to pay in line with the Government's aim to help those most adversely affected by Covid-19.

Given the breadth of the application of the prohibition, any business which has been severely affected by coronavirus should seek advice as to whether they can apply to restrain the presentation of a winding-up petition that has been threatened against them.

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