Debevoise & Plimpton

Debevoise In Depth

Looking West? The Impact of the Corporate Insolvency and Governance Act on the UK Insolvency Framework

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Introduction

Improving the insolvency framework had been on the UK Government's agenda for many years and the economic crisis caused by the COVID-19 pandemic accelerated the introduction of new legislation. On 20 May 2020, the UK Government published the long-awaited draft Corporate Governance and Insolvency Bill (the "Bill"), which received Royal Assent on 25 June 2020 to become the Corporate Insolvency and Governance Act 2020 (the "Act").

Changes introduced by the Act include:

- **New Restructuring Plan –** a new, court-approved, insolvency procedure, similar to a scheme of arrangement and also drawing on the U.S. Chapter 11 procedure, with the important ability for the court to impose an approved plan on dissenting stakeholders;

- **Moratorium Process** – a period of time during which creditors may not take certain enforcement action against a company in financial difficulties. It is hoped that this protection will provide breathing space to enable rescue plans to be pursued more easily; and

- **Restriction on Termination of Supply Contracts –** suppliers will generally be prevented from using insolvency-related clauses to terminate a contract for the supply of goods or services with a company in financial difficulties.

The Act also introduces a number of temporary reliefs designed to assist businesses in difficulty due to the pandemic, including in respect of

- Wrongful Trading, which is covered in this article; and

- Winding-up Petitions and Statutory Demands.

These changes are generally welcome and it is hoped that they will bolster the ability to rescue UK businesses in difficulty. However, certain provisions of the Act (e.g., the exclusion of loans and bonds repayment from the Moratorium or the lack of a framework for debtor-in-possession financing in the Restructuring Plan) potentially reduce the practical benefits of the reforms introduced by the new law.

Restructuring Plan

One of the principal changes introduced by the Act is a new, court-sanctioned, restructuring procedure (the "Restructuring Plan"). While the Restructuring Plan and its mechanics are similar to the existing scheme of arrangement, there are key differences including:

- the ability to do a cross-class cram-down; and
- additional flexibility in respect of the Restructuring Plan's structure and potential effects.

The combined effect of both of these changes is that it will be possible for companies with a sufficient connection to the UK to be restructured without all class consent and much more comprehensively than has historically been the case in the UK. For example, the interests of non-financial creditors (e.g., suppliers, landlords, other lessors or commercial partners) may be amended through a Restructuring Plan.

The Restructuring Plan certainly shares some of its traits with the U.S. Chapter 11 procedure. However, the Restructuring Plan does not create a legal framework for debtor-in-possession financing and the creditor majority required (75% in amount per class as set out more fully below) is higher than the 2/3 in amount required under Chapter 11.

The hope is that, like the U.S. Chapter 11 procedure, the Restructuring Plan may become an important tool in cross-border restructuring. However, in Europe, that may depend on the extent to which—after the end of the Brexit transition period on 31 December 2020—the UK insolvency framework (and the Restructuring Plan) will be recognised in the European Union under the EU Insolvency Regulation.

The role of the court, and its approach to the new procedure, will be central to the development and practice of Restructuring Plans.

Restructuring Plan – Eligibility and Process

The main eligibility criteria is that a company[1] 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*".

Any of the company, the company's liquidator/administrator (if one has been appointed), or the company's creditors or shareholders may apply to the court to convene a meeting to vote on a Restructuring Plan (the "Plan Proposer"). Where more than one plan has been proposed, the first one approved by the court and the creditors would be enacted.

The process for approving a Restructuring Plan largely mirrors that for approving a scheme of arrangement. The court plays a crucial role in the process as it has absolute discretion over whether or not a Restructuring Plan is confirmed. The process is as follows:

- the Plan Proposer prepares a draft plan, setting out proposals to restructure the company and the relevant interests of creditors and/or shareholders. This plan does not need to follow a prescribed form, provided that its purpose is to "*eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties*" encountered by the company;
- the Plan Proposer applies to the court for a convening hearing;
- the convening hearing is held and the court may decide to convene a stakeholder meeting;
- notice of the stakeholder meeting and an explanatory statement is provided to all relevant stakeholders[2];
- the stakeholders' vote is held;
- the sanction hearing is held; and
- if the court sanctions the Restructuring Plan, the Restructuring Plan takes effect and the relevant notices are served.

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1 **Note:** Foreign-incorporated companies may be eligible for a Restructuring Plan if they have a "*sufficient connection*" with England and Wales as per the existing case law relating to schemes of arrangement.

2 **Note:** Relevant stakeholders will include the Board of the Pension Protection Fund if the company is, or has been, an "employer" under a defined benefit pension scheme.

Restructuring Plan – Voting Mechanics and Cross-Class Cram-Down[3]

Voting mechanics are a crucial component of the Restructuring Plan.

Eligibility to Vote

Any creditor or shareholder whose rights are affected by the proposed Restructuring Plan is eligible to vote.

The wide drafting used in the Act includes trade creditors or other categories of creditors, who are eligible to vote if their rights are affected by the proposed Restructuring Plan[4]. Ultimately, it will be for the courts to determine if someone's rights have been "*affected*" by a Restructuring Plan. In addition, an application can be made to the court to exclude a class of creditors or shareholders if the court is satisfied "*that none of the members of that class has a genuine economic interest in the company*". Again, the threshold to determine this will be set by the court.

Creditors/Shareholders Divided by Classes

As is the case with schemes of arrangements, stakeholders will be divided into separate classes to vote on the proposed Restructuring Plan and, as with schemes of arrangement, it will be critical to correctly determine class membership.

Voting Threshold

A class will be deemed to have approved the Restructuring Plan if those members of the class voting in favour hold at least 75% of the value of the credit/equity held, in aggregate, by members of that class who actually voted. There is no corresponding additional need for an absolute majority in number of that class to also vote in favour of the Restructuring Plan.

Cross-Class Cram-Down

One of the main changes brought in by the Act is that a Restructuring Plan may be confirmed by the court even if one, or more, classes eligible to vote do not approve the plan (the "Dissenting Stakeholders"). In order to confirm the Restructuring Plan in these circumstances, two conditions need to be fulfilled:

- *first*, the court needs to be satisfied that, were the Restructuring Plan confirmed, no class of Dissenting Stakeholders "*would be any worse off than they would be in the event of the relevant alternative*". The "*relevant alternative*" is defined widely as "*whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned*". We would expect that, in order

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[3] **Note:** Special rules apply where a Moratorium has been in place in the prior 12 weeks.

[4] **Note:** For example, a contractual counterparty whose legal rights under an underlying contract with the company would be affected by the Restructuring Plan.

to determine the relevant alternative, the court will need to consider various alternatives (and related valuations); and

- *second*, the Restructuring Plan needs to have received the approval of at least one class of stakeholders "*who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative*".

Interestingly, the court could approve a Restructuring Plan agreed by the junior creditors over the objections of the senior creditors (provided the above conditions are met and such plan is deemed fair and equitable by the court).

Restructuring Plan – Aviation

Under the Act, the Restructuring Plan and the scheme of arrangement give debtors the ability to compromise the interests of creditors with "aircraft-related interests".[5]

This is a departure from the Bill, which contained a provision that exempted this category of creditors from being compromised under either the Restructuring Plan or the scheme of arrangement unless they agreed with the proposal. This provision was removed during the passage of the legislation, and there is no longer any such exemption set out in the Act.

Moratorium Period – Overview

The Act introduced a new moratorium period (the "Moratorium"), which will prevent creditors from taking certain actions against the company during the Moratorium and enables the company to benefit from a payment holiday in respect of certain pre-Moratorium debts.

The purpose of the Moratorium is to provide breathing space for companies in financial difficulty, so that they can explore options for their rescue. It is not designed to protect those companies unlikely to be able to recover and trade again as going concerns. In addition, the requirement that companies continue to pay financial indebtedness, such as loans, in the Moratorium, as well as debts incurred during the Moratorium, will mean that it is not suitable for many companies.

[5] **Note:** This covered any registered interest under the Cape Town Convention.

Moratorium Period – Who is eligible and what are the requirements?

All companies[6] registered under the Companies Act 2006 are eligible for the Moratorium, other than certain excluded entities (as set out below). Overseas companies are also eligible, subject to the discretion of the court and provided that they have sufficient connection with the UK.

To ensure that the Moratorium is available for companies with a reasonable prospect of returning to financial health, the following requirements must be met:

- the company is, or is likely to become, unable to pay its debts; and
- a licensed insolvency practitioner:
  - agrees to act as monitor for the Moratorium (a "Monitor")[7]; and
  - issues a statement that the Moratorium is likely to result in the rescue of the company as a going concern.

Determining if a Moratorium is likely to rescue a company is likely to be a difficult judgement whilst the current economic crisis persists.

Entities that are excluded from the Moratorium include:

- entities that are either subject to an insolvency procedure at the time of the application or were in the 12 months prior to the application;
- certain financial institutions, including banks, insurance companies, investment banks, investment firms and payment processors (as separate reorganisation regimes apply in respect of such entities); and
- entities that are party to a capital markets arrangement.

"Capital market arrangement" is defined widely in the Act[8] with the result that businesses which have or have provided security for bond financing are not eligible for a

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[6] **Note**: "*Companies*" means: (i) companies registered under the Companies Act 2006 (the "CA"); (ii) unregistered companies capable of being wound up under Part 5 of the Insolvency Act 1986 (the "IA 1986"); (iii) "*overseas companies*" as defined in the CA if permitted by the court; and (iv) limited liability partnerships.

[7] **Note**: the Monitor and its role in the Moratorium are discussed in more detail below.

[8] **Note**: for the purposes of the Act, a "*capital market arrangement*" is any arrangement with a value over £10m involving the provision of security or guarantee in relation to a capital market investment (which includes listed, rated or traded bonds or securities).

Moratorium. This exclusion is likely to affect larger, or highly leveraged, businesses, which tend to use bond financing or PE-backed investments that use listed bonds.

Moratorium Period – How is it commenced?

In most cases, an eligible entity can start a Moratorium by filing the relevant paperwork with the court. However, court approval is required where the applicant is an overseas company or subject to a winding-up petition. The court will grant the order "if it is satisfied that a moratorium for the company would achieve a better result for the company as a whole than would be likely if the company were wound up (without first being subject to a moratorium)". As is the case with the Monitor's statement, the court's determination is likely to be influenced both by the individual position of the company and by the overall state of the wider economy.

The Monitor will need to provide notice of the Moratorium coming into force to Companies House and all known creditors of the company[9] as soon as reasonably practical after receiving notice from the company that the Moratorium is in force. These notices need to be complemented by: (i) further notices on the company's website and at its premises; (ii) a notice on every business document issued by, or on behalf of, the company during the Moratorium; and (iii) notices to be issued on any extension of the Moratorium or its termination.

Moratorium – Effect, Scope and Exclusions

Once in effect, the Moratorium is binding on all creditors (whether secured or unsecured) and most types of debt. It also creates a payment holiday for the relevant entity, in respect of all amounts falling due either before or during the Moratorium other than Excluded Debts (defined below) (the "Covered Debts"). "Excluded Debts" include:

- bank loans and overdrafts and any other debt or liability arising from a contract "for the provision of financial services consisting of lending", which includes derivative products, capital markets arrangement (including from the provision of security in respect of any such arrangement) or debts secured by a financial collateral arrangement;

- any debt or liability arising from contracts relating to the supply of goods or services to the relevant entity during the Moratorium;

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[9] **Note:** If the company is, or has been, an "employer" under a defined benefit pension scheme, notice will need to be provided to the Pensions Regulator and, potentially, the Pension Protection Fund.

- amounts payable for salary, wages or redundancy payments due, whenever arising; and
- amounts payable to cover the Monitor's expenses or remuneration (from the start of the Moratorium).

Subject to certain exclusions, the other main effects of the Moratorium are to:

- bar the relevant entity from being placed into administration;
- restrict the ability to pay, or enforce payment of, Covered Debts[10];
- prevent creditors from presenting winding-up petitions and courts from making winding-up orders; and
- unless court approval has been granted in respect of Excluded Debts only, prevent:
  - creditors from taking any steps to enforce security (except for enforcement of financial collateral, which includes security granted over shares), crystallise a floating charge or repossess goods under any hire-purchase agreement[11];
  - would-be petitioners from starting or continuing legal processes against the relevant entity[12]; and
  - landlords from exercising forfeiture.

The directors will continue to run the company throughout the Moratorium. In addition, during the Moratorium and subject to receiving the court's permission, the company may dispose of any secured property as if it was unsecured[13]. Should the court consent to such disposal, the security (and relevant contractual terms) will be disapplied. This is unusual under English law, which tends to respect the bargain struck by the relevant parties. The proceeds of any such sale need to be applied to the debt secured by the property disposed.

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[10] **Note:** This provision, which severely restricts the ability of a company to repay Covered Debts, is likely to have been inserted to maintain a level playing field between creditors affected by the Moratorium.

[11] **Note:** For the purposes of the Act, "hire-purchase agreement" also refers to conditional sale agreements, chattel leasing agreements and retention of title agreements.

[12] **Note**: The following types of proceedings are excluded employment tribunal proceedings, employee-related proceedings and legal processes that have received court approval.

[13] **Note:** This does not apply to "aircraft interests" registered under the Cape Town Convention.

Moratorium – Excluded Debts

Excluded Debts, which are not covered by the payment holiday during the Moratorium, may be paid without the court's or the Monitor's consent. Additionally, creditors may seek court approval to enforce their rights in respect of Excluded Debts.

Perhaps most significantly, Excluded Debts that are due must be paid if the Moratorium Period is to be extended (see below for a fuller explanation and applicable exceptions).

In practice, given that amounts due under bank facilities are Excluded Debts and that facilities may be accelerated if the Moratorium triggers an insolvency-related event of default, there is limited scope and utility for a company to use the Moratorium without its lenders' consent. In our view, this is likely to negatively affect the take-up of the Moratorium.

Moratorium – The Role of the Monitor

The Monitor, who is an officer of the court[14], is tasked with protecting the interests of the creditors during the Moratorium.

The Monitor has the power to sanction the commencement of a Moratorium and, in certain instances, its extension or termination. In addition, the Monitor has the following powers:

- *Consent to Specified Transactions* – The Monitor's consent is necessary before the company can effect certain transactions during a Moratorium (e.g., granting security, disposing assets or paying Covered Debts, other than *de minimis* payments[15]). The Monitor will provide its consent if it determines that such transaction would support the rescue of the company as a going concern;

- *Monitoring Powers* – The directors must provide any information that the Monitor requests to carry out its duties; and

- *Reporting Powers* – The Monitor may report any past or present director of the company to the authorities if it believes that such director has committed an offence in respect of the Moratorium.

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[14] **Note**: Monitors therefore owe a duty to both the court and the administration of justice.

[15] **Note**: Consent is needed to effect payments in respect of any Covered Debt in an amount equal to the greater of £1,000 or 1% of the value of outstanding unsecured debt of the company as at the date the Moratorium began.

Moratorium – How are creditors protected?

Creditor protection during the Moratorium includes:

- *Excluded Debt and Security* – As discussed above, the category of Excluded Debts is relatively wide and includes repayment of bank facilities as well as payment for rent, services or goods provided to the company during the Moratorium. In addition, creditors holding a financial collateral (e.g., a pledge over shares) can still enforce it even during the Moratorium;

- *Super Priority* – Unpaid Moratorium debts and "priority pre-moratorium debts"[16] that the company was required to pay during the Moratorium rank in priority if winding-up proceedings in respect of the company are started within 12 weeks of the end of the Moratorium[17];

- *Notice for Prospective Creditors* – The company will need to provide notice that the Moratorium is in force to any prospective creditor willing to provide over £500 of credit[18];

- *Limits on Extensions* – As discussed below, the Moratorium can only be extended in certain instances, most of which require meeting the Initial Conditions (as defined below) as well as securing creditor and/or court consent and meeting the other applicable conditions (as set out below);

- *Monitor's Role* – Creditors can rely on the Monitor, whose main role is to protect creditors. The Monitor's rights include the ability to veto certain transactions and terminate the Moratorium if rescuing of the business as a going concern is no longer likely;

- *Creditor Challenge* – Any creditor[19] has the right to challenge the actions of the Monitor or the directors if they believe they will cause, or have caused, "unfair harm" to it; and

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16 **Note:** This includes pre-moratorium debts payable in respect of: (i) the monitor's remuneration or expenses, (ii) goods or services supplied during the Moratorium; (iii) rent in respect of a period during the Moratorium, (iv) wages or salary arising under a contract of employment, so far as relating to a period of employment before or during the Moratorium; (v) a redundancy payment; and (vi) financial services, which fell due during the Moratorium (other than those accelerated by operation of an acceleration or early termination clause (e.g., an insolvency-related trigger activated by the Moratorium).

17 **Note:** This is significant because a debt falling in this category, even if unsecured, will rank in priority to other debts, where the company ends up in winding-up proceedings within 12 weeks of the Moratorium ending.

18 **Note:** This notice requirement also applies to trade creditors in respect of (i) a conditional sale agreement in accordance with which goods are to be sold to the company; (ii) hire-purchase agreements; and (iii) advance payments by commercial partners where the company is providing goods or services.

- *Sanctions for Directors* – The Act introduces new offences to deter directors from abusing the Moratorium. Offences include concealing information, fraudulently removing the property of the company and making false entries in any document relating to the company's affairs or property.

Moratorium – Length and Potential Extension

The initial period of a Moratorium is 20 business days[20]. Subject to certain conditions, this initial period can be extended multiple times, meaning that a Moratorium could last several years. However, as noted above, the requirement to repay all Excluded Debts (which include banking facilities) prior to an extension will mean that companies may well be *de facto* prevented from extending the Moratorium.

The table below sets out the various extensions available and their respective conditions.

	Short-term Extension by Directors	*Extension by Directors with Creditors' Consent*	*Extension by the Court Requested by Directors*	*Extension While CVA Is Pending*	*Extension by Court in the Course of Other Proceedings*
Timeline of Extension	20 business days, to start from the end of the initial period	Up to one year, to start after the initial period	No prescribed period/duration for extension	The extension will last until the CVA either takes effect or fails	The date chosen by the court
Conditions	(i) consent by the directors; (ii) directors' statement that all pre-Moratorium Excluded Debts have been paid/discharged during the Moratorium; and (iii) statement by the Monitor that Moratorium will likely result in the rescue of the company as a going concern (the "Initial	(i) the Initial Conditions; and (ii) consent[21] of pre-moratorium creditors (together with a directors' certification of the same)	(i) the Initial Conditions; (ii) directors' statement to the court either (a) confirming pre-moratorium creditors have been consulted or (b) why pre-moratorium creditors have not been consulted (iii) order from the court, which will assess whether an	None, extension is automatic if a CVA proposal is made	None The court may elect to order an extension of the Moratorium if the company has applied to convene meetings in respect of a Restructuring Plan or a scheme of arrangement

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[19] **Note:** If the company is, or has been, an "employer" under a defined benefit pension scheme and the trustees of the scheme are creditors, then the Board of the Pension Protection Fund may challenge the Monitor's actions.

[20] **Note**: The initial period will be deemed to commence on the business day following the day on which the Moratorium comes into force.

[21] **Note**: Consent needs to be provided by the majorities (in value) of both (i) secured pre-moratorium creditors and (ii) unsecured pre-moratorium creditors. However, the vote will also fail if a majority of unconnected secured creditors or unconnected unsecured creditors votes against it. It is not clear whether the majority in respect of the unconnected creditors is to be calculated by reference to value of credit held or absolute number. Similar provisions in respect of the Company Voluntary Arrangements (the "CVA") calculate the majority by reference to the value of credit held. For the purposes of the IA, connected creditors include directors or employees owed money from the company.

	Short-term Extension by Directors	Extension by Directors with Creditors' Consent	Extension by the Court Requested by Directors	Extension While CVA Is Pending	Extension by Court in the Course of Other Proceedings
	Conditions")		extension (a) is in the interest of pre-Moratorium creditors and (b) will result in the company's rescue as a going concern		
Can it be extended again with the same method?	No	Yes	Yes	No	No

Moratorium – Termination

The Moratorium will terminate:

- at the end of the relevant Moratorium period, unless it is extended;
- if a CVA takes effect or either a restructuring plan or a scheme of arrangement is sanctioned;
- once the company enters, or gives notice of its intention to enter, into administration or liquidation;
- on notice by the Monitor, where the Monitor believes one of the following:
    - the Moratorium is no longer likely to result in the rescue of the company as a going concern;
    - the rescue of the company as a going concern has been achieved;
    - it is unable to carry out its functions as Monitor; or
    - the company is unable to pay amounts due in respect of moratorium debts or any Excluded Debts.

Restrictions on Termination of Supply Contracts

The Act restricts the ability of suppliers of goods or services to a company in an insolvency procedure[22] to terminate: (i) the relevant supply contract by relying on a contractual provision with an insolvency trigger[23] (the "Relevant Clauses"); and (ii) the supply of goods or services itself by relying on a Relevant Clause.

This new protection regime is designed to help a distressed business retain its value through its continued operation.

Prior to the Act, the UK insolvency framework protected the supply of essential utilities[24] to a company in distress. However, this new protection goes much further by, in effect, disapplying the Relevant Clauses if one of the parties to the contract is subject to an insolvency procedure. This reduces the ability of the supplier to terminate the relevant contract if the customer goes into insolvency, regardless of what the parties agreed in the contract.

These new restrictions are reminiscent of the treatment of such clauses in "executory" contracts or unexpired leases under the U.S. Chapter 11 process. However, Chapter 11 gives the debtor far more protection in respect of such contracts since it applies to all commercial contracts (rather than solely to contracts for the supply of goods or services) and gives the debtor broad flexibility to accept or reject such contracts.

Restrictions on Termination of Supply Contracts – Who is eligible?

Most entities are eligible to receive the benefit of this provision. The Act sets out a list of entities that are not eligible and which include banks, insurers, investment banks and other similar regulated entities, which are subject to specific insolvency procedures.

Restrictions on Termination of Supply Contracts – What is prohibited?

The Act prohibits suppliers of goods and services to a company in an insolvency process from:

- terminating the relevant contract or supply under the contract by relying on a Relevant Clause;

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[22] **Note:** These are: (i) the Moratorium: (ii) administration; (iii) the appointment of an administrative receiver or a liquidator; (iv) a CVA; (v) liquidation; and (vi) a court order in respect of a Restructuring Plan.

[23] **Note:** An example of these provisions is a unilateral termination clause giving the non-insolvent party the right to terminate the contract if the other party becomes subject to an insolvency procedure.

[24] **Note:** These include gas, water and electricity.

- imposing payment of outstanding amounts for supplies provided prior to the insolvency event as a condition of continuing supply under the contract or do anything that would have the effect of making such payment a condition; or

- relying on contractual provisions in a contract for the supply of goods or services to the company which requires the company to do any other thing because the company becomes subject to the relevant insolvency procedure.

The scope of the last point is unclear and potentially very wide. Depending on how the courts will ultimately define "*any other thing*", a creditor may end up being prevented from claiming under a guarantee or receiving default interest if it is entitled to do so due to the company entering into the relevant insolvency procedure.

Restrictions on Termination of Supply Contracts – How are suppliers protected?

The provisions include the following protections for suppliers[25]:

- *Court Relief* – Suppliers may apply to the court to be relieved from the requirement to continue to supply goods and services if such continued supply is causing them financial hardship;

- *Right to Terminate Using Relevant Clause* – Suppliers may terminate the relevant contract by relying on the Relevant Clause with the consent of either the company or, if applicable, its administrator, administrative receiver or liquidator;

- *Right to Terminate Using Other Clauses* – Suppliers retain the right to terminate the contract using grounds other than the Relevant Clauses, provided that such ground for termination had not already arisen prior to the insolvency trigger. In practice, through this exception, suppliers may be able to terminate the contract using other grounds, including breaches of the relevant contract, breaches of financial covenants, cross-defaults, non-payment of supplies or upon notice. This may significantly reduce the practical utility of the restriction to the extent that the company is unable to meet all other obligations during the insolvency procedure.

Restrictions on Termination of Supply Contracts – Exceptions

This provision of the Act will not apply to contracts for financial services or with persons involved in financial services. As a result, this measure will not result in a lender

[25] **Note:** There is also an additional temporary carve-out to protect small suppliers during the COVID-19 pandemic.

under a revolving facility being required to fund further commitments under the relevant facility if the borrower is subject to an insolvency process.

Contracts relating to Cape Town Convention-registered interests in aircraft equipment (e.g., aircraft leases) are excluded from this provision of the Act.

Temporary Ban on Statutory Demands and Winding-Up Orders Due to COVID-19

In addition to changes to the UK insolvency framework, the Act implements a few temporary measures to help the UK economy deal with the fallout of the economic crisis caused by the COVID-19 pandemic. These measures include:

- temporarily voiding outstanding statutory demands made against companies between 1 March 2020 and 30 September 2020; and
- restricting a creditor's ability to present a winding-up petition against a debtor unless such creditor has reasonable grounds to believe that either (i) the insolvency condition would have arisen regardless of the financial effect of the pandemic on the company or (ii) the pandemic did not have a "*financial effect*"[26] on the company.

Even where a creditor is permitted to present a winding-up petition, the court may only make a winding-up order if it is satisfied that the company's relevant insolvency condition "*would have arisen even if coronavirus had not had a financial effect on the company*". How these terms would be applied in practice by the courts is an area of potential uncertainty.

Conclusion

The introduction of the Act is a landmark event for the UK insolvency community, which drastically updates the UK insolvency framework. It goes far beyond pandemic-driven measures, and constitutes a significant reform to UK insolvency law. However, its full impact will only become clear over time as companies start using (and litigating over) the new provisions.

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[26] **Note:** The pandemic will be deemed to have had a financial effect on a company "*if (and only if) the company's financial position worsens in consequence of, or for reasons relating to, coronavirus*".

Please do not hesitate to contact us with any questions.

LONDON

Geoffrey P. Burgess
gpburgess@debevoise.com

Alan J. Davies
ajdavies@debevoise.com

David Innes
dinnes@debevoise.com

Richard Lawton
rlawton@debevoise.com

Kevin Lloyd
klloyd@debevoise.com

Thomas Smith
tsmith@debevoise.com

Emily Lodge
elodge@debevoise.com

Ardil Salem
asalem@debevoise.com

Edoardo Troina
etroina@debevoise.com

NEW YORK

M. Natasha Labovitz
nlabovitz@debevoise.com

Elie J. Worenklein
eworenklein@debevoise.com

Annex

A Comparison between the Restructuring Plan and U.S. Chapter 11

	Restructuring Plan	*U.S. Chapter 11*
Eligibility	Companies that can evidence actual or likely financial difficulty may apply. Foreign companies may apply if they can evidence a sufficient connection[27] with England. However, it is important to ensure that English proceedings are recognised in that entity's home jurisdiction as there is no direct extraterritorial effect.	Debtors may apply for Chapter 11 without needing to evidence insolvency or financial difficulty. Foreign companies may apply and U.S. courts will accept jurisdiction even where the debtor only has property or a place of business in the U.S. U.S. bankruptcy court orders, including the automatic stay, generally have extraterritorial effect, which is broadly (but not universally) respected in foreign countries.
Scope	The Restructuring Plan permits companies to restructure and compromise shareholders, secured and unsecured liabilities and implement operational changes. A Restructuring Plan may result in: • sale of (all or part of) a company's assets; • restructuring of a company's capital structure (including through issuance of new debt or securities); • payment of classes of claims; and/or • changes to the corporate governance/structure of a company[28].	Debtors under Chapter 11 can do the same types of restructurings permitted by the Restructuring Plan but have the benefit of a broader framework within which to enact them, which provides greater flexibility to the debtor[29].
Process	**Who can propose the Restructuring Plan?** A Restructuring Plan may be proposed by the company, the creditors or the shareholder, though we would expect the process to be launched by the company.	**Who starts the process?** Most Chapter 11 proceedings are started by the debtor, which files a voluntary petition for relief. However, in certain circumstances, creditors may also file an involuntary petition against the debtor.

[27] **Note:** English law-governed debt or the centre of main interests being in England might prove a sufficient connection.

[28] **Note:** For example, amending the company's constitutional documents or redeeming securities.

[29] **Note:** For example, the ability to decide whether or not to reject executory contracts and unexpired leases.

<table>
<tr><th></th><th>Restructuring Plan</th><th>U.S. Chapter 11</th></tr>
<tr><td></td><td>Process
Plan proposed;
the Plan Proposer applies to the court for a convening hearing;
the convening hearing is held and the court may decide to convene a stakeholder meeting;
notice of the stakeholder meeting and an explanatory statement is provided to all relevant stakeholders;
stakeholders’ vote is held;
the sanction hearing is held; and
if the court sanctions the Restructuring Plan, the Restructuring Plan takes effect and the relevant notices are served.
Who controls the company during the Restructuring Plan?
The existing management of the business remains in control and there is no supervisory authority. Court approval is usually not necessary for major business decisions.</td><td>Process
The Chapter 11 process is court supervised and hearings are necessary to approve a number of key motions/ events. The “court-heavy” nature of Chapter 11 is one of the reasons that it is a costly process to follow.

The debtor benefits from a 120-day period during which only the debtor can propose a plan. This period may be extended to 18 months from the petition date with court approval. Should the debtor fail to propose a plan within this timeframe, any other party (including creditors) may propose an alternative plan.

Who controls the company during Chapter 11?
Generally, the existing management of the business remains in control. However, prior court approval is necessary in respect of most major decisions that are outside the ordinary course of business. In certain cases, typically where there are allegations of fraud or misconduct, the court may appoint a trustee to take over management of the company.</td></tr>
<tr><td>Approvals and Cram-Down</td><td>Who is entitled to vote?
Any creditor or shareholder whose rights are affected by the proposed Restructuring Plan is eligible to vote. Creditor is defined widely and is not limited to financial creditors.

Applications can be made to court to exclude classes of stakeholders. The court will exclude them if it is satisfied that “none of the members of that class [have] a genuine economic interest in the company”.

What majority is needed to approve a Restructuring Plan?
A class of stakeholders will be deemed to have approved the plan if stakeholders representing at least 75% in value of those voting vote in favour of the Restructuring Plan.</td><td>Who is entitled to vote?
In Chapter 11, voting rights depend on the proposed economic recovery of the class under the plan:
“Impaired” classes (i.e., creditors/equityholders receiving some, but not full, recovery) are entitled to vote;
Classes of “unimpaired” creditors (i.e., creditors recovering in full under the plan) are presumed to accept the plan and therefore not entitled to vote; and
Classes of creditors not receiving anything under the plan are presumed to reject it and likewise not entitled to vote.
Classes of priority and administrative creditors are not eligible to vote under Chapter 11.</td></tr>
</table>

	Restructuring Plan	*U.S. Chapter 11*
	Cross-Class Cram-Down The court may confirm a Restructuring Plan even if there are dissenting classes of voting stakeholders. The court may grant its approval if: • the court is satisfied that the members of the dissenting class will not be worse under the Restructuring Plan than they would be in the event of the "relevant alternative"[30]; and • at least one class of voting stakeholders, who would receive a payment or have a genuine economic interest under the relevant alternative, has voted in favour of the Restructuring Plan.	**What majority is needed to approve a Chapter 11 plan?** • **Classes of Equityholders** – At least two-thirds of voting interests voting in favour of the plan; and • **Classes of Creditors** – Creditors within that class representing (i) at least two-thirds in value of claims and (ii) over half the number of voting creditors in that class must vote in favour of the plan. **Cross-Class Cram-Down** The court may confirm a Chapter 11 plan even where there are dissenting classes of voting stakeholders. At least one class of impaired voting stakeholders (not taking into account insiders) must vote in favour of the plan. In addition, the court needs to find that the plan is "fair and equitable"[31] and does not "discriminate unfairly"[32] with respect to the dissenting classes. The court may also confirm a cross-class cram-up.
Moratorium	**Moratorium** A company could combine a Restructuring Plan with the new Moratorium. However, this is not automatic. As we noted in the body of the paper, given the wide range of Excluded Debts, Moratoriums are unlikely to be of help to large companies.	**Automatic Stay** Any debtor in Chapter 11 proceedings benefits from the automatic stay, which is triggered immediately upon a bankruptcy filing. The Chapter 11 stay, subject to some exceptions, bars creditors or other affected parties from taking any action to collect or enforce any debt which fell due prior to the bankruptcy filing, unless they have received court approval.

[30] **Note:** See the section of this update on the Restructuring Plan for more details on what would constitute a relevant alternative for the purposes of this decision.

[31] **Note:** The absolute priority rule regarding the priority scheme of bankruptcy claims will apply to determine whether or not a plan is fair and equitable. The rule mandates that, in order for the plan to be fair and equitable, either (a) each dissenting class needs to be paid in full or (b) no class junior to the dissenting class receives or retains any property under the plan on account of such junior claim or interest.

[32] **Note:** The prohibition against unfair discrimination ensures that creditors or equityholders should not, without a compelling justification, receive materially different treatment under a plan from creditors or equityholders with similar legal rights.

	Restructuring Plan	*U.S. Chapter 11*
Contracts	**Contracts** Unlike Chapter 11, the Restructuring Plan does not have a regime governing contracts (though commercial contracts can fall within the scope of the Restructuring Plan). However, the new restrictions on termination of supply contracts apply.	**Contracts** A debtor in Chapter 11 may elect, with court approval, to assume, assume and assign or reject any unfulfilled "executory contracts" and unexpired leases (subject to some exceptions). Commercial counterparties are barred from relying on insolvency-triggered clauses to terminate or amend executory contracts or unexpired leases with debtors in Chapter 11, and such contract provisions are generally unenforceable. Anti-assignment provisions are also often unenforceable, facilitating asset sales in Chapter 11.
Debtor-in-Possession Financing	The Act has no specific provision for debtor-in-possession financing. Therefore, the company must comply with the provisions of any existing debt documents when taking on new debt.	Debtor-in-possession financing possible under Chapter 11. The court may grant debtor-in-possession lenders a lien and other protections, which lien may rank in priority to pre-existing claims and liens[33].
Scrutiny	We would expect companies proposing a Restructuring Plan to be subject to enhanced scrutiny and disclosure obligations, similar to those in a scheme of arrangement.	Debtors undergoing a Chapter 11 procedure are subject to enhanced scrutiny and disclosure obligations from the court and their relevant stakeholders. This enhanced scrutiny consists of, amongst other things, an obligation to file accurate financial and legal details with the court from time to time and obtain court approval for certain transactions.

[33] **Note**: The court will grant this priority lien if either (a) existing lienholders consent or (b) debtor-in-possession financing could not be found on more favourable terms.