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Is the Balance of Power in UK Insolvencies Shifting?

Rebecca PARRY and Stephen GWAZA

INTRODUCTION

Insolvency laws can scarcely have been more high profile than in recent years. The liquidation of Thomas Cook, the administration of the Monarch airline and those of many high street chains such as Mothercare, as well as CVAs and contractual restructurings of many other high street chains have meant that once-obscure terms of insolvency law are now gaining familiarity among the public.[1] This lexicon will inevitably be expanded if the reform proposals contained in the document published in a *Consultation Response* document during the August Bank Holiday in 2018[2] by the Department for Business, Energy and Industrial Strategy become law, since these proposals offer to managers of struggling companies the prospect of a restructuring moratorium and an improved framework for reaching an agreement with creditors.[3] This paper will have its focus the potential impact of these proposed reforms on the power dynamic in insolvencies. There is much more that a paper examining the shifting balance of power could examine[4] but reasons of space mean that the focus of this article will be on domestic arrangements and, although the attentions of the media, as well as focus of much of academic discussion has tended to be on larger

[1] For a recent discussion of relevant issues related to insolvency we recommend the BBC Radio 4 podcast, 'The Bottom Line' (24 October 2019) <https://www.bbc.co.uk/programmes/m0009km0>, accessed 25 November 2019.

[2] 'Insolvency and Corporate Governance: Government Response' (Department for Business, Energy and Industrial Strategy, 26 August 2018) (hereinafter 'Government Response').

[3] Reform proposals were also recommended in the Airline Insolvency Review report, prepared following the collapse of the Monarch airline and consequent drain on the public purse through repatriations. These proposals potentially add to the range of special insolvency regimes which already apply in areas that may have significant public impact, such as utilities, transport networks and schools, representing a sharpening of powers to maintain service provision, and such a procedure could have enabled a more orderly wind-down of the affairs of Thomas Cook. 'Airline Insolvency Review, Final Report' (March 2019).

[4] There is also the looming shadow of Brexit which stands to make cross-border restructurings more difficult in cases involving EU companies, as well as presenting the prospect of competition for high value restructurings, in the shape of new models that aim to build on the success of schemes of arrangement, prompted both as rivals to the scheme of arrangement and in response to EU initiatives to improve restructuring frameworks within the Member States.

companies,[5] particular regard will be had to smaller companies, typically owner-managed and with small numbers of employees and, in particular, from the perspective of whether the reforms will enable these persons to gain greater control in insolvency proceedings, as arguably this group has tended to be overlooked for specific attention, in spite of their economic importance.[6] This importance is emphasised by recently passed US reforms aimed at the SME sector as well as attention being paid to this area by an UNCITRAL working group,[7] which, among other things, highlighted a need for simplified and lower cost procedures.

In Part 1 this article will take an initially theoretical approach which will be used in Part 2 in an analysis of the actors involved in the balance of power, before looking at how this balance has evolved historically. As will be outlined in Part 3, the balance has tended to lie with secured creditors, rather than managers, a position which has persisted in spite of previous reforms. Part 4 will outline the proposals and evaluate the prospects for the balance to be changed.

Theoretical perspectives

Taking an initially theoretical perspective, it is notable that early normative discussions of insolvency law treated the matter as a common pool problem,[8] with the role for the law being to maximise the size of the pool through means such as staying the claims of creditors and providing transaction avoidance rules, as well as to provide rules for the distribution of assets among creditors.[9] However more recently it has been recognised that restructuring requires a different theorisation.[10] Restructuring potentially represents a nurturing process in the management of the company's assets, rather than treating the assets as a common pool to be drained for distribution to creditors, with the role for the law being to prevent opportunistic behaviour leading to unfair outcomes in the distribution of assets among creditors. Rather restructuring is properly categorised as addressing an anticommons

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[5] Of particular note is the contribution of Sarah Paterson in 'Rethinking Corporate Bankruptcy in the Twenty-First Century' (2016) 36 OJLS 697 and 'The Rise of Covenant-Lite Lending and Implications for the UK's Corporate Insolvency Toolbox' (2019) 39 OJLS 654.

[6] Scholarship on the insolvencies of small businesses is also lacking in relation to unincorporated businesses: see Rebecca Parry, 'Insolvent Partnerships' in Jennifer Gant and Paul Omar, *Elgar Corporate Restructuring Handbook* (forthcoming).

[7] Note by the Secretariat, United Nations Commission on International Trade Law, 'Insolvency of Micro, Small and Medium-Sized Enterprises, Draft Text on a Simplified Insolvency Regime' (Working Group V, Insolvency Law, 28-31 May 2019) <https://undocs.org/en/A/CN.9/WG.V/WP.166>, accessed 25 November 2019.

[8] Notably in Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986), which provided the first attempt at a normative framework for insolvency law and generated much controversy. See e.g. William W Bratton and David A Skeel, 'Bankruptcy's New and Old Frontiers' (2017-2018) 166(7) U Pa L Rev 1571 et seq.

[9] The maximisation of returns to creditors is an overriding objectives of corporate insolvency law, as identified in Kristin van Zwieten, *Goode on Principles of Corporate Insolvency Law* (5th edn, Sweet and Maxwell, 2019), 2-01

[10] See e.g. Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 EBOR 615.

problem,[11] enabling company resources to be managed more effectively on an ongoing basis for the benefit of a wider range of stakeholders. Anticommons issues arise in cases where there are several owners or entitled persons, each of whom has the potential to block the usage of others.[12] In the context of restructuring, the anticommons issue arises in cases where a workout approach to a debtor's financial distress is not possible. Workouts enable financial difficulties to be resolved without recourse to the formal insolvency laws and historically creditors have played a significant role in this regard, as instigators of remedial action.[13] It is when these individualistic contractual approaches to the company's debt problems do not work[14] that anticommons issues arise, often due to holdouts, and collective restructuring procedures are needed in cases where companies are realistically viable.

The role of collective reorganisation laws is therefore, in short, to provide a coordinating way forward in circumstances where there is an anticommons problem preventing a workout. The allocation of the power to make key decisions in these circumstances arguably can have a bearing on the outcome and this allocation therefore requires careful consideration in terms of both legitimacy and the means by which the exercise of power can be enabled and appropriately restrained.[15] Logically, if an ongoing trading approach is to be adopted it is legitimate to harness the incentives and the skills of those best placed to bring this about, which in some instances will be the existing management, subject to constraints against perverse incentives. This harnessing and the constraints to which it may be subject will be considered below, in a discussion of the players involved.

Allocation of the balance of power

This section considers how the power to determine the management of the company and the outcome of reorganisation proceedings can be allocated. Reorganisation proceedings that involve ongoing trading arguably consists of three main decision-making stages. That is, at stage one to determine whether reorganisation proceedings should be opened, at stage 2 to identify a plan providing a way forward, and at stage 3 to approve that plan. When we consider the balance of power in

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[11] A characterisation first developed by Rolef de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons' (2012) 21 Int Insolv Rev 67 and used also as an analytical framework in Michael Schillig, 'Corporate Insolvency Law in the Twenty-First Century: State Imposed or Market Based?' (2014) 14 JCLS 1.

[12] The seminal work is Michael A Heller, 'The Tragedy of the Anticommons: Property in the Transition from Marx to Markets' (1998) 111 Harvard Law Review 621.

[13] High value and financially complex cases may be conducted through a compromise by financial creditors, with smaller creditors being paid in full: Sarah Paterson, 'Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards', (2014) 14 JCLS 333. More recently, the growth of covenant-lite lending has meant that early warning mechanisms have been sacrificed. Sarah Paterson, 'The Rise of Covenant-lite Lending and Implications for the UK's Corporate Insolvency Toolbox' (2019) 39 OJLS 654.

[14] See Jennifer Payne, 'Debt Restructuring in the UK' (2018) 3 ECFR 449, 451, noting how changes in the credit market have placed strains on this approach.

[15] Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 Oxford J Legal Stud 227, 245.

insolvency proceedings there are four major players involved in the decisions regarding the management of the commons at these stages[16] and the company's future, namely: the debtor (hereinafter also referred to as the "company"); its creditors; the court and office holders who, in the UK, are licensed insolvency practitioners. These elements of control are visible in varying degrees and stages in insolvency proceedings globally and may be allocated based on factors such as incentives and skills and may be subject to safeguarding against opportunistic behaviour. In particular, the power of the party with managerial control will be enabled through means such as the protection of the moratorium, restrictions on ipso facto clauses, encouragement of further finance and frameworks for compromises with creditors but will also be subject to safeguards, such as creditor approval, supervision by an insolvency practitioner (in cases of debtor-in-possession management), or court oversight.

To give an overview of matters that will be discussed in detail later, in the first stage, regarding the opening of proceedings, initially the balance lay with the court as the ultimate arbiter of whether administration proceedings should be opened. Subsequently managers gained greater power with the ability to open proceedings out of court,[17] although even this was subject to notification requirements and the ability for a secured creditor to gain control.[18] Options for managers to formulate plans at the second stage were undermined by the lack of a debtor-in-possession option with a moratorium limiting the powers of creditors.[19] At the basic level the balance at the third stage is between the debtor and creditors as some way to resolve the anticommons problem is pursued and this could be by way of a compromise of claims or some other arrangement and in some instances the court can be given powers to resolve an impasse which, as will be explained, is a novel feature of the proposed restructuring plan procedure.

Managers

A point which should be made regarding managers is that there are variations in company sizes, managerial competences and in the circumstances that can lead to financial difficulties, so that a variety of options for the management of companies

[16] The position of shareholders of insolvent companies is not considered as their interests in insolvency proceedings tend to be limited: *West Mercia Safetywear v Dodd* (1988) 4 BCC 30, *Bilta (UK) Ltd v Nazir* [2016] AC 1, para 38. Admittedly not all shareholders are equally powerful, however, and it is noted that venture capitalists and distressed debt investors may have significant powers of persuasion, as well as mixed motives. See John Flood, 'The Vultures Fly East: The Creation and Globalisation of the Distressed Debt Market' in David Nelken (ed), *Adapting Legal Cultures* 257-278, (Hart, 2001), 257-278, and Sarah Paterson, 'The Paradox of Alignment: Agency Problems and Debt Restructuring' (2016) 17 EBOR 497. For arguments for a greater role for shareholder see Stephan Madaus, Reconsidering the Shareholder's Role in Corporate Reorganisations under Insolvency Law (2013) 22 Int Insolv Rev 106.

[17] Insolvency Act 1986, Sch B1, paras 22-34.

[18] Insolvency Act 1986, Sch B1, paras 26 and 36.

[19] The option of a CVA with a moratorium during the process of reaching agreement was inserted into the Insolvency Act 1986 as Sch A1, by the Insolvency Act 2000. However this was not a significantly successful reform, as discussed below.

during insolvency proceedings is arguably needed.[20] In some instances the management will be struggling and the intervention of an insolvency practitioner as an outside manager can be a relief for both the management and the workforce. In some instances, the management will be competent and will have a clear idea of what needs to be done to resolve the company's difficulties, which may arise due to a temporary and resolvable setback. Therefore, returning to the matter of skills and incentives, although managers will usually have strong incentives to achieve a reorganisation, there will be some instances where they have the skills to do so and some where they do not. The requirement for an outsider to take charge in administration in all cases[21] can therefore represent an inefficient expense, for reasons explored in more detail later. By placing greater powers in the hands of the existing management the 2018 proposals potentially alter the balance, enabling coordinating rules for debt restructuring to be employed by these managers to resolve the anticommons problem, as these managers are among the persons with the greatest interest in seeing the company continue trading. The potential for ongoing generation of value from the assets of the company through placing protective tools in the hands of management is therefore potentially realised in a greater way than before, although not as cheaply and easily as might have been hoped, in particular because of the significant restraints which will be outlined later. Arguably the reform proposals reflect concerns that managerial power could be abused for example by the taking of excessively risky approaches which carry a risk of further losses to creditors.[22] If power is to be vested in the company's management this must therefore be subject to some constraints on those individuals as a bulwark against opportunistic behaviour, such as providing redress in the event of wrongdoing.

Creditors

A need for collective insolvency and restructuring proceedings arises due to the anticommons difficulties of coordinating creditor claims outside of collective insolvency proceedings, in part due to the diversity of creditors and potential for holdouts. Within the context of formal insolvency laws the position of creditors, who tend to fall into different classes is nuanced. Secured creditors have historically played a central role in insolvency proceedings, although their position has changed over time, as discussed in more detail in the next part. Briefly, the dominance of secured creditors in the handling of distressed companies prior to 2002 was underpinned by incentives and skills. They had incentives to take action to recover what they were owed and the skills to identify cases where action needed to be taken,

[20] Other systems, such as in Germany and the People's Republic of China include this flexibility by offering the possibility for practitioner-in-possession proceedings to be converted into debtor-in-possession proceedings.

[21] The CVA with a moratorium, which enables managers of small companies to retain managerial control, never too off and the reasons for its failure will also be discussed later.

[22] Described as perverse investment incentives by Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.

as well as the ability to harness the skills of specialist professionals through the appointment of administrative receivers as their agents. However, it was observed that there could be perverse incentives towards liquidation in cases where the creditor was over-secured.[23] As the insolvency system gained maturity this position changed with the virtual abolition of administrative receivership under the Enterprise Act 2002. However to some extent in subsequent years prepacks have operated as quasi receiverships, in cases where the outcome is that secured creditors are repaid.[24] In addition, some of the diagnostic and intensive care roles that banks might previously have offered have declined, partly as a result of the ability to offload debt to investors who specialised in the distressed market and partly due to more lax monitoring through "covenant-lite" lending agreements.[25]

Consideration of the position of other creditors gives an insight into how anticommons problems may prevent a restructuring through a workout, as creditors have diverse interests and incentives. Other creditors include landlords who, although holding proprietary interests, have found their positions being eroded in more recent years,[26] to employees, as well as suppliers of goods and services. Tax authorities present some interesting issues, being both a voluntary creditor, who has no discretion as to whether or not to advance credit, but also a creditor with highly diversified risk, so a default by one creditor will not have as much impact as it would on a creditor with fewer debtors. A further dimension is that tax creditors are likely to be more single-minded than some other creditors, with a focus on protecting revenue and potentially less of a regard to reputational impact. There are concerns that a scheduled reintroduction of preferential status for Crown debts will impact negatively on the prospects of business rescue.[27]

In cases where a consensual compromise of creditor claims cannot be agreed, giving rise to an anticommons position, formal, collective insolvency proceedings can provide a framework to enable agreement to be reached. Creditors typically play a key role at this third stage of the proceedings, using their commercial judgment as to whether an acceptable deal has been offered, a role which has admittedly been undermined in recent years through the growth of prepacks. The reform proposals will, as will be discussed later, give the courts the power to play a greater role at this stage in giving approval to a restructuring plan which creditors have rejected, best regarded as a safeguarding role as it applies in limited circumstances.

<u>Insolvency practitioners</u>

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[23] Riz Mokal, 'Administrative Receivership and Administration – An Analysis' [2004] Current Legal Problems 355.
[24] Kayode Akintola and David Milman, 'The rise, fall and potential for a rebirth of receivership in UK corporate law' (2019 preprint) Journal of Corporate Law Studies DOI: 10.1080/14735970.2019.1631551.
[25] Sarah Paterson, 'The Rise of Covenant-lite Lending and Implications for the UK's Corporate Insolvency Toolbox' (2019) 39 OJLS 654.
[26] *Innovate Logistics Ltd (in administration) v Sunberry Properties Ltd* [2008] EWCA Civ 1321
[27] Julia Irvine, 'Javid warned over insolvency debts' <https://economia.icaew.com/news/september-2019/javid-warned-over-insolvency-debts> accessed 18 September 2019.

Hitherto the management of the company during reorganisation processes has commonly been placed in the hands of an outsider[28] acting in the interests of creditors.[29] This management arrangement is a quid pro quo of moratorium protection in administration, arguably a state of affairs which arose for historical and path dependent reasons which will be explained later in this paper. As a result, in all existing formal insolvency procedures the assistance of an insolvency practitioner is required in some capacity and therein, as noted above, lies what can in some cases be an inefficient weaknesses in the process because the insolvency practitioner, as an outsider, will need time to acquaint himself with the operations of the company first before taking any meaningful action. In a time-sensitive process such as a company rescue this may well prove to be counter-productive. Nonetheless, it should be added that the intervention of an insolvency practitioner can be welcomed in cases where the management are struggling with debt management to enable ongoing trading.

Courts

The overall power to control the parties and uphold and interpret the law is vested in the court[30] and the court can be one of the most important constraints against misuse of the insolvency procedures, through controlling access, a position that has been relaxed somewhat in recent years with the introduction of out of court appointments of administrators. However as a matter of principle judges prefer not to interfere with "commercial decisions" taken by insolvency practitioners,[31] thereby attesting to the fact that in the UK, an insolvency practitioner, who in most cases is appointed by charge holders, has many of the key decision making roles in insolvencies.

EVOLUTION OF THE BALANCE OF POWER

A brief examination of the history of UK insolvencies will show how the balance of power has been shifting; from the time when a floating charge holder, who could appoint a receiver, had absolute control of the process, to the time when Sir Kenneth

[28] The company voluntary arrangement and the scheme of arrangement being notable exceptions but neither procedure automatically brings the protection of a moratorium.

[29] Admittedly the primary objective in administration is to rescue the company as a going concern: Insolvency Act 1986, Sch B1, para 3. However, this objective is seldom realisable, not least because of the expense of a trading administration.

[30] This paper does not consider in detail the role of other state-level institutions. Generally, the preference is for the state to provide a legislative framework to enable the insolvency to be handled in market conditions with the courts providing a backstop. However, it must be added that in rare instances the state will intervene and control the proceedings, notably in cases of systemic risk, both in relation to financial institutions and even non-financial ones such as airlines and, potentially, universities. However, the preference is for a minimal state role, where possible, in order that recourse to public funds is limited. See e.g. 'Airline Insolvency Review, Final Report' (March 2019).

[31] *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) [22]; *DKLL v Her Majesty's Revenue and Customs* [2007] EWHC 2067 (Ch), [2008] 1 BCLC 112 [10]. Andrew Simmonds QC sitting as a Deputy Judge of the High Court said, "…the court places great reliance on the expertise and experience of impartial insolvency practitioners…"

Cork's report[32] led to the introduction of two new procedures namely; administration and CVAs which are mainly controlled by an insolvency practitioner.[33] The August Bank Holiday proposals will potentially shift this balance once again. In this next section the history of insolvency laws will be briefly considered, highlighting in particular how some path dependence initially shaped the development of restructuring laws, giving a balance of power that was skewed in favour of secured creditors.

1870-2002

Although formal corporate rescue procedures in the UK can be traced back as far as 1870, [34] sophisticated institutions to support formal collective procedures took longer to develop. As a result a historically significant role was played by banks, who provided the bulk of the finance to companies and therefore had incentives to monitor the affairs of companies, as well as to participate in consensual restructurings according to market norms under the London Approach.[35] These were collective approaches based on contract rather than on formal insolvency procedures. A predominant feature of contractual approaches is receivership, which enables a secured creditor to protect their interests by appointing a receiver to collect, protect or receive the property that is the subject of the security. An important variation for the protection of the rights of creditors was administrative receivership, which dominated insolvency proceedings particularly in the period leading up to the coming into force of the reforms of the Enterprise Act 2002. As previously noted, at that time the allocation of power was logical as floating charge holders were possessed with incentives as they had a sufficient interest in the company's property, as well as information and skilled judgement as to whether to initiate proceedings and devise a way forward.[36] However their incentives were not always geared towards ongoing trading. Administrative receivership was merely a vehicle for the enforcement of the entitlements of the floating charge holder and the prospects of rescue for the company would be dependent on whether this coincided with the interests of the secured creditor.[37] Administrative receivership was a poor response to an anticommons problem such as an insolvency and more collective approaches were developed, although path dependency factors meant that there was initially little disturbance to the balance of power.

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[32] Cork Committee, *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982).
[33] Insolvency Act 1986, Sch B1, para 14 and Insolvency Act 1986, Sch A1, para 6.
[34] The scheme of arrangement procedure was introduced in England under the Joint Stock Companies Arrangement Act 1870 for implementation in relation to companies in winding up. Subsequently the law was amended to enable such schemes to be used in relation to solvent companies and, indeed, that is the most common usage in the modern context.
[35] John Armour and Simon Deakin, 'Norms in Private Insolvency: the "London Approach" to the Resolution of Financial Distress' (2001) JCLS 42.
[36] John Armour and Sandra Frisby, 'Rethinking Receivership' (2001) 21 OJLS 73It should be added that the dominance of receivership is evident historically in countries with advanced insolvency laws and also in countries which have yet to develop effective insolvency laws and institutions.
[37] Mokal (n 23).

The modern age of formal insolvency laws began with the reforms which led to the Insolvency Act 1986, which marked a significant modernisation of the insolvency system. In this process the recommendations of the Cork Committee were highly influential. This Committee reported in 1982, [38] having been appointed following the economic turmoil of the 1970s. The Committee's report advised the provision of "means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country",[39] and it was the recommendations of this Committee which led to the enactment of the legislation relating to the company voluntary arrangement and the administration order. Both procedures were somewhat limited. The company voluntary arrangement provided a simple framework for a company to reach a compromise or arrangement with its creditors and to do so while under the control of its existing management but it did not initially provide a moratorium. Administration did enable the company to obtain the temporary protection of a moratorium but only while under the control of an administrator. Path dependency arose because administration built upon the successes that administrative receivership was having in preserving struggling companies. [40] Accordingly it was initially designed to address a power vacuum so that an insolvency practitioner could take charge of the company in cases where there was no floating charge holder able to appoint an administrative receiver. Effectively a floating charge holder could block the appointment of an administrator and they would routinely do so.[41] These reforms did not therefore end the dominance of secured creditors in the balance of power and they did not lead to significant numbers of companies being rescued, partly due to weaknesses in the procedures, including the lack of a moratorium in relation to the company voluntary arrangement[42] and the expense and time-consuming nature of administration.

2002-2019

In the UK there was a notable realignment of the insolvency system following the virtual abolition of administrative receivership under the Enterprise Act 2002, together with the modifications to administration under that Act, which reduced the influence of secured creditors and emphasised the collective interests of creditors, as

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[38] Cork Committee (n 32).

[39] Ibid. 55, para 198(j)

[40] Mention should also be made of the usage, in large and complex cases involving multiple lenders of the London Approach, a coordinated and (largely) consensual. strategy adopted by lenders See John A Flood, Robert Abbey, Eleni Skordaki and Paul Aber, *The Professional Restructuring of Corporate Rescue: Company Voluntary Arrangements and the London Approach* (ACCA, 1995); Alice Belcher, *Corporate Rescue* (Sweet and Maxwell, 1997) 117-122; John Armour and Simon. Deakin, 'Norms in Private Insolvency: the 'London Approach' to the Resolution of Financial Distress' (2001) 1 JCLS 21.

[41] Insolvency Act 1986, s 9 (as originally enacted). A preference for the appointment of an administrative receiver rather than an administrator was noted in Hamish Anderson, 'Seismic Change in the UK' (2002) 21 International Financial Law Review 41.

[42] This changed under the IA 2000 with the introduction of a CVA with moratorium. However, this procedure remained fairly under-used, perhaps because informal restructuring has been successful in enabling debtors to reach agreement with their creditors but also perhaps because insolvency practitioners may favour administration and prepacks in view of the greater role that they have in these procedures.

well as making improvements to administration in effort to boost the rescue culture. The phenomenon of a rescue culture, although first legislatively addressed under the Insolvency Act 1986, had been slow to establish and was not fully realised under the 1986 Act, as first enacted, largely due to the dominance of administrative receiverships. It was considered that greater success in saving companies was evident in the US, which had reformed its bankruptcy laws in 1978, which marked a significant shifting of the balance of power, although there has been further shifting since. The US Chapter 11 developed as a model based on debtor-in-possession control, supported by specialist courts, in contrast to the practitioner-in-possession model of administration. A couple of points must be noted however. Chapter 11 represents only a small proportion of insolvency cases in the US, although large companies will tend to restructure using this procedure and recent reforms will introduce a streamlined variation for the benefit of small businesses.[43] It is also notable that the way in which Chapter 11 cases often proceed has changed. Creditors have been able to gain the upper hand through the attachment of conditions to post-commencement finance[44] and section 363 sales are often used to achieve a quick business sale, rather than the period of trading envisaged in Chapter 11.[45] The balance of power has therefore swung back in the direction of creditors.

The lack in the UK of a vehicle for continued trading by existing management while under the protection of a moratorium led to a variation of administration which had not been anticipated in the legislation, namely the prepack,[46] which in part developed in response to the expense of the sort of trading administration envisaged under the 1986 Act, a trend that has also been evident in the rise in s 363 sales in the US.[47] As a result, a different sort of rescue culture, that of business rescue, dominated, rather than culture of corporate rescue, leading to creditor dissatisfaction. This trend has been discussed in detail in the literature[48] and is not the main focus of this paper. However, it gives rise to a key question, which is whether the proposed reforms will facilitate ongoing trading in a way that the rise of prepacks indicates that administration has failed to do.

2018 REFORM PROPOSALS

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[43] Small Business Reorganization Act of 2019 inserting into Chapter 11 a new Subchapter V on small business debtor reorganisations.

[44] David A Skeel, 'Creditors' Ball: The New New Corporate Governance in Chapter 11' (2003) 152 U Pa L Rev 917.

[45] Douglas G Baird and Robert K Rasmussen, 'The End of Bankruptcy' (2002) 55 Stan L Rev 751.

[46] John Armour, Audrey Hsu & Adrian Walters, 'The costs and benefits of secured creditor control in bankruptcy: evidence from the UK' (2012) 8 Review of Law & Economics 101.

[47] Baird and Rasmussen (n 45).

[48] Teresa Graham, 'Graham Review into Pre-pack Administration' <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>, accessed 25 November 2019; Kristin van Zwieten, *Goode on Principles of Corporate Insolvency Law* 5th edn (Sweet and Maxwell, 2019), 11-38; Vanessa Finch and David Milman, *Corporate Insolvency Law Perspectives and Principles* (3rd edn, Cambridge University Press, 2017), Ch 10.

A culture of business rescue rather than corporate rescue was therefore the environment in which the August Bank Holiday reforms were announced.[49] As noted in the introduction, the August 2018 reform proposals stand to alter the balance, with firstly the introduction of a self-standing moratorium framed on similar lines to the administration moratorium[50] but importantly this will be a debtor-in-possession pre-insolvency process under the supervision of an insolvency practitioner referred to as a monitor.[51] Secondly, the proposed reforms will enable anticommons debt problems to be addressed through a restructuring plan, which offers some advantages over the scheme of arrangement, and thirdly, restrictions will be introduced to prohibit the use of ipso facto clauses, which are clauses that allow for contractual termination in the event of one party entering formal insolvency. These reforms potentially offer the prospect of a revived rescue culture, with greater powers for company managers, although these powers are inevitably tempered by constraints. As a result there is a danger that the form in which these procedures are presented may make them unsuitable for small businesses. This paper now turns to examine the proposed reforms to the UK insolvency framework and how they reflect a shifting of the balance of power at the three stages of restructuring, opening, formulating and agreeing, so as to encourage more company rescues.

Moratorium

Since the advent of the Insolvency Act 1986 the moratorium has been an important mechanism in UK insolvency framework because it has the effect of imposing a freeze on the enforcement of actions against a debtor to enable a way forward to be devised and implemented but, as noted, it was only initially available in administration and this entailed the appointment of an external manager. Later, small companies were offered the option to apply for a moratorium in connection with a company voluntary arrangement process.[52] However this moratorium was extremely under-utilised since its inception. An R3 commissioned report revealed that in 2013 of 514 small or micro companies entering CVA only 8 or 1.6 percent used a moratorium[53] while a recent government analysis of Companies House records established that no more than 10 percent of small companies proposing a

[49] Government Response (n 2) is quite a wide-ranging document in terms of the efforts that it made to address some of the underlying corporate governance deficiencies which were exposed in the infamous collapses of BhS and Carillion. The document also proposes specific measures which the government intends to further consider in relation to tackling transparency and accountability of those dealing with complex groups of companies and the payment of dividends by companies facing financial hardships. In relation to governance more generally there were efforts to strengthen shareholder stewardship and to improve boardroom effectiveness.

[50] Insolvency Act 1986, Sch B1, paras 42 and 43.

[51] Government Response (n 2) paras 5.65 and 5.59.

[52] Insolvency Act 1986, Sch A1.

[53] Peter Walton, Chris Umfreville & Lezelle Jacobs, 'Company Voluntary Arrangements: Evaluating Success and Failure' (R3 May 2018), Executive summary < https://www.icaew.com/-/media/corporate/archive/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx> accessed on 12 September 2019.

CVA utilised a moratorium.[54] The responses to the government *Consultation*[55] revealed that the very low uptake of this moratorium could be attributed to the onerous demands and risks of personal liability it imposes on insolvency practitioners and also the restriction of usage to small companies.[56] Therefore a strong case for the introduction of a simpler, more accessible moratorium capable of providing the much needed "breathing space" to financially distressed, yet viable, smaller businesses where managers have the skills and incentives to achieve the rescue of the company as a going concern. The proposed short-term standalone moratorium holds the prospect of empowering company directors and managers in this way, offering simplified means to enable them to consider their options and also facilitating pre-insolvency negotiations with creditors to achieve a debt restructuring and it may therefore enable anticommons problems to be addressed. However, although this procedure is likely to be cheaper and simpler for companies than administration, enabling the skills an incentives of managers to be harnessed, arguably the safeguards which have been attached to this procedure will make it unsuitable for SMEs.

Since this is a facilitative procedure without any indicative outcome the first two stages, of opening and formulating, will be discussed below. It is anticipated that the moratorium may be used as a vehicle for the agreement of a restructuring plan and that procedure therefore would provide the framework for agreement, although this is not the only outcome that could be pursued during the moratorium.

Opening

Since the moratorium will impact significantly on the entitlements of creditors to enforce their claims against the company it is unsurprising that there are safeguards attached to the use of this procedure. These include conditions for eligibility for obtaining a moratorium. From the perspective of small and medium enterprises these *ex ante* conditions are potentially prohibitively expensive, in particular when it is borne in mind that significant *ex post* sanctions are available in cases of abuse and the moratorium will operate for a relatively short period of time.[57]

a) Solvency

Unlike in an administration or CVA moratorium, it is a condition of eligibility for this proposed free standing moratorium that a debtor must be solvent.[58] Although this restriction will provide a safeguard for creditors in cases where companies have

[54] Government Response (n 2) para 5.14 and footnote.
[55] The Insolvency Service, 'A Review of the Corporate Insolvency Framework: A Consultation on the Options for Reform' (May 2016).
[56] Government Response (n 2) para 5.10.
[57] Where the conditions of eligibility are satisfied, this moratorium will be commenced by filing the necessary papers at court in a process resembling the out of court appointment of an administrator in accordance with paragraph 22 of Sch. B1 of the Insolvency Act 1986. Ibid. para 5.19.
[58] Ibid. para 5.28.

passed the point of no return, hindering the mis-use of this protection by directors of insolvent debtors seeking "to kick the can down the road" while also compounding creditor losses in the process,[59] it arguably reveals an approach with some distrust of struggling companies and it may deny protection to companies that are facing cash flow difficulties but still viable.

The availability of the proposed moratorium is thereby restricted to companies who are facing "relatively minor short-term cash flow issues." This requirement also guards against strategic use of the moratorium by healthy companies and the government therefore proposes that the test for eligibility shall involve an enquiry into whether the solvent company seeking the moratorium will become insolvent if action is not taken.[60] The *Government Response* calls this the "prospective insolvency" test.[61] The delicate onus of determining the proper cut-off point between prospective insolvency and actual insolvency falls on the company directors. This seems like a clarion call for company directors and managers to take early corrective measures which may prevent unnecessary company collapses and safeguard employment. Clearly the government will be hoping that the courts will be able to resolve the tension that seems to exist between the requirement that a company must be solvent at the time of filing for this moratorium and the fact that a debtor already embroiled in winding-up proceedings can still be eligible for this protection. However, it must also be noted that the inclusion of this requirement can potentially put the availability of moratorium protection beyond the reach of many small and medium enterprises. A contrast may be made with the United States Chapter 11, which contains no requirement to prove the solvency,[62] or indeed insolvency, of a company which is applying for protection, and instead provides a safeguard that the filing can be challenged in cases where there is cause to do so, such as if the filing is not made in good faith.[63] In contrast, an enquiry as to a company's solvency will add to the "time, effort and funds"[64] required if a moratorium is to be made and it arguably would have been preferable if other safeguards, discussed below, had been considered sufficient.

b) Prospects of rescue

Another condition of eligibility is that a company must show that there are prospects of rescue. Clearly, the nature and extent of the rescue envisaged here will need to be clarified when these proposals reach draft legislation otherwise this requirement is

[59] Ibid. para 5.28.
[60] Ibid. para 5.29.
[61] Ibid. para 5.29.
[62] A position that has been explained by reference to the inability to restructure debts otherwise than consensually outside the context of insolvency proceedings: Madaus, (n 10), 628.
[63] 11 USC, s 1112(b).
[64] Samuel Bufford 'The New Chinese Bankruptcy Law: Text and Limited Comparative Analysis' (2007) 16 Norton Journal of Bankruptcy Law and Practice 697, part II(B). The learned former judge was criticising a requirement for a debtor to prove insolvency, rather than solvency, however arguably the same issues arise.

likely to generate controversy.[65] During the *Consultation* it was considered that the test to be applied to assess the prospect of rescue might be whether or not there were "reasonable prospects" of agreeing a compromise or arrangement with creditors if the moratorium was triggered.[66] However, the government has resolved to set the bar higher. It proposes that the test will be whether on "the balance of probabilities", rescue will be more likely than not.[67] As a concession the government has rejected stakeholder suggestions that a debtor should seek the consent of creditors first before commencing the moratorium. The government believes that pre-filing engagements between the debtor and the creditors will suffice.[68] However concerns may again be presented as to the possible time and expense that this condition will add to the application process.

It is also a condition of entry that the company seeking a moratorium must have sufficient funds to operate its business, meeting all its current obligations as well as those falling due during subsistence of the protection.[69] This requirement clearly operates as a tool for measuring a debtor's potential to recover from its difficulties and provides a safeguard for both existing and new creditors. However, it is again a matter that the company will need to prove and this may present an obstacle for SMEs.

c) Ineligibity

A company[70] shall be ineligible to engage this moratorium if it has entered into another moratorium, administration or CVA in the last 12 months.[71] Clearly, the rationale here is to deter companies from unnecessarily trying to postpone an inevitable insolvency by abusing this protection. However, a company subject to a winding-up petition in the last 12 months which did not result in a winding-up order shall not be ineligible; nor shall a company subject to a pending winding-up petition.[72] In the latter scenario the company will have to seek the court's permission to access the moratorium.[73]

d) Monitor

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[65] Sandra Frisby (2019): 'Of rights and rescue: a curious confluence?' (2019, forthcoming) JCLS, DOI: 10.1080/14735970.2019.1615165. p 1 <https://www.tandfonline.com/loi/rcls20> accessed on 12 September 2019.
[66] Government Response (n 2) para 5.31.
[67] Ibid. para 5.31.
[68] Ibid. para 5.31.
[69] Ibid. para 5.33.
[70] Companies of all sizes will be eligible except those listed in paragraphs 4A to 4J of Insolvency Act 1986, Schedule A1 (those engaged in Capital Markets, Public-Private Partnership projects and those in Financial Collateral Arrangements).
[71] Government Response (n 2) para 5.21.
[72] Ibid. para 5.22.
[73] Ibid. para 5.23.

The supervisory role of the monitor is required right at the onset. Following the government *Consultation*[74] it has been agreed that initially the monitor will have to be a licenced insolvency practitioner although there is a possibility of a wider range of professionals being eligible to hold office in the future.[75] The monitor, who will have undertaken an assessment of the company beforehand, will have to file their consent to act and a confirmation that the eligibility tests and qualifying conditions are met.[76] To further assuage the concerns of creditors generally it is proposed that a monitor will have to send notices to all known creditors and to register the company's entry into the moratorium at Companies House.[77]

Formulating

This moratorium should last for an initial 28-day period from the day that the necessary papers which include the monitor's consent to act and confirmation of eligibility and qualification for entry are filed with the court.[78] This moratorium is comparatively far shorter than the initial 120 days protection which the US Chapter 11 moratorium where these reforms derive their inspiration. Only pre-packs, which the *Consultation* clearly did not contemplate as the desired outcome,[79] are likely to thrive when a debtor has limited time within which to resolve their difficulties, in that instance through a sale of the company's underlying business. Perhaps unsurprisingly therefore, provision for an extension of a further 28 days, which is predicated on the monitor's confirmation of the company's continuing qualification for the protection, is proposed.[80] An extension beyond the 56 days would require the approval of 50 percent of the secured creditors by value, and more than 50 percent of unsecured creditors by value but where this approval is impracticable the company may apply for an extension through the court like in administration.[81]

A monitor will have the responsibility of sanctioning any asset disposal outside of the normal business operations of the company and the granting of new security.[82] Most notably, in a clear sign of a shift in the balance of power, a monitor will not be permitted to consent to actions that undermine the effect of the moratorium without the consent of the company like in an administration where an administrator may act as they "think" and neither will a creditor be able to do likewise without a court's approval.[83] In very unambiguous language the *Government Response* declares that

[74] The Insolvency Service (n 55).
[75] Government Response (n 2) para 5.63
[76] Government Response (n 2) para 5.19
[77] Ibid. para 5.19
[78] Ibid. para 5.49.
[79] The Insolvency Service (n 55) para 7.21. "…to ensure that a company applying for a moratorium has the prospect of exiting the moratorium or other insolvency procedure as a going concern..."
[80] Government Response (n 2) para 5.52.
[81] Ibid. para 5.55.
[82] Ibid. para 5.65.
[83] Ibid. para 5.40.; Insolvency Act 1986, Sch B1 para 43

this: "reflects that the moratorium is a debtor-in-possession process and that the monitor is not running the company."[84]

The government proposes that any credit advanced during this moratorium will enjoy "super-priority" status over any costs or claims in administration or liquidation, including the expenses of such procedures in the event that the rescue fails.[85] Interestingly, the *Government Response* contemplates that within this class of "super-priority" creditors the "highest priority" will be afforded to suppliers who will have been prohibited from triggering termination clauses, as will be discussed below.[86] While acknowledging the difficulties that this proposal will create especially in relation to secured creditors and the future appointments of administrators, whose fees will rank lower, the government believes that creating an enabling environment for company rescue is well worth the trouble.[87] This enabling environment indicates a shifting balance of power for those companies which are able to make use of the moratorium, as those elements which traditionally occupy a strong position in administration proceedings, give way to the enhanced position of a debtor is the quest to create a better rescue culture.

Apart from being responsible for assessing the eligibility and qualification of a company at commencement of the moratorium, as discussed above, the monitor will also be expected to terminate the moratorium immediately, where the qualifying conditions cease to be met during its tenure.[88] While it is an important safeguard for creditors, the proposal to terminate a moratorium based on information to be provided by directors in a debtor-controlled rescue operation may prove quite challenging.[89] When a monitor terminates the moratorium by notifying the court, the company and creditors, the creditors will be free once again to enforce their rights but the monitor will be immune from claims emanating from erroneous termination provided they acted in good faith.[90] However, a monitor is prohibited from taking a subsequent appointment in an administration or liquidation involving the same company within 12 months will be imposed on a monitor to obviate conflicts of interest[91] but they will be permitted to act as a supervisor in a CVA.[92]

<u>Ex ante scrutiny</u>

It is envisioned that creditors will be able to challenge this moratorium at any stage during its lifespan on the grounds that the company is ineligible for the protection;

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[84] Ibid. para 5.40.
[85] Ibid. para 5.79.
[86] Ibid. para 5.79.
[87] Ibid. para 5.81.
[88] Ibid. para 5.65.
[89] Chris Umfreville, 'A revised moratorium to help business rescue: a review of the latest reform proposals' (2018) 411 Co LN 1, 5.
[90] Ibid. para 5.68.
[91] Ibid. para 5.76.
[92] Ibid. para 5.76.

or that the qualifying conditions are not being met; or that there is unfair prejudice to creditors.[93] To facilitate these challenges the government proposes to take a similar legislative approach to that enabling a creditor to obtain the permission of the court to take action that would otherwise be restricted by the administration moratorium. However, the first two grounds of these challenges may prove unsustainable for an ordinary creditor who may not have access to the company's financial information in the relatively short duration of the moratorium. Likewise, without a clearer definition of the meaning of "unfair prejudice" this ground could also present difficulties to the creditor.[94]

There is also the possibility that a director can be made liable for wrongful trading[95] in cases where the company which obtains the moratorium has past the point of no return during the tenure of this moratorium.[96] Furthermore as a deterrent against the abuse of this moratorium by "dishonest or reckless directors" the government will consider imposing similar sanctions to those applicable to the CVA[97] moratorium.[98]

Ex post scrutiny offers safeguards for creditors as well as potential deterrents against abuse of the moratorium procedure. Since the monitor provides both an *ex post* and an *ex ante* safeguard, it might be wondered whether the *ex ante* conditions of solvency and prospects of rescue were also necessary, given the extra burdens that it has previously been noted that these requirements will entail and which may put the moratorium procedure beyond the reach of some companies, in particular SMEs, so that the shifting of the balance of power that the moratorium potentially brings for managers will only lie in limited directions.

Restructuring plan

Building on the success of the scheme of arrangement, which is technically not an insolvency procedure but which has been used to effect successful restructurings of large companies, the Government proposes to introduce a new flexible procedure into the insolvency framework which will enable a debtor's restructuring plan to be binding against all creditors even those who will have voted against it, through the use of a cross-class cram down provision.[99] This proposal would significantly strengthen the ability of the court to support the restructuring efforts of the company in situations where creditor holdouts have given rise to an anticommons problem preventing a contractual workout outside insolvency law. However, to prevent the creditors from having an unfair deal foisted upon them the proposed cram down would only be imposed upon dissentient class of creditors if they will not be worse off than in liquidation as a result of the plan. Cramdown powers are therefore

[93] Ibid. para 5.39.
[94] Sandra Frisby (n 65).
[95] Insolvency Act 1986, s 214.
[96] Government Response (n 2) paras 5.41 and 5.42.
[97] Insolvency Act 1986, Sch A1, para 16.
[98] Government Response (n 2) para 5.44.
[99] Ibid. para 5.114.

effectively restricted to cases where there is a financially unreasonable aspect to the refusal.

Opening

After extensive deliberations the *Government Response* proposes that this restructuring plan should be a standalone procedure available to companies of all sizes with the exception of those involved in specific financial markets and similar undertakings,[100] like those excluded from the moratorium discussed above.[101] Both solvent and insolvent companies will have access to this procedure and this procedure may therefore be regarded as a type of pre-insolvency proceedings. Enabling solvent companies with emerging financial difficulties to restructure using this procedure is intended to "reduce the stigma and encourage earlier action on the part of directors, thereby avoiding value-destructive action and leading to better outcomes on the whole for creditors and other stakeholders in a company."[102] It may also be noted that companies will not face the evidential task of proving solvency as a condition of restructuring, which will help to limit the costs of this procedure, although as previously noted that will be a requirement if a moratorium is first obtained. Companies already engaged in an insolvency procedure will also be able to propose a restructuring plan in line with existing provisions in the framework, through the office holder, since there is no financial entry criterion.[103] Just like the scheme of arrangement, which it is intended to resemble, the implementation of a restructuring plan takes place in stages.

Agreeing

The first stage involves the presentation of the restructuring plan to creditors and shareholders and filing the same at court.[104] That plan must specify the division of the creditors and shareholders into their classes. At the first court hearing a court will consider the class composition and any challenges by creditors or shareholders before confirming that a vote on the proposal may be conducted on a specific date (electronic voting will be encouraged) ahead of a second hearing. In this regard the restructuring plan framework will build upon the vast jurisprudence built over many years to deal with the issue of class formation for voting purposes.[105] If no challenges or counter proposals are allowed by the court the creditors and shareholders will vote on the plan. The approval threshold has been set at 75 percent in value of the creditors in each class which must be supported by a majority in number of unconnected creditors. Confirmation of the restructuring plan will be done at the second court hearing if the voting threshold is achieved but if not the rules applicable

[100] Insolvency Act 1986, Sch A1, paras 4A-4J.
[101] Government Response (n 2) para 5.130
[102] Ibid. para 5.131
[103] Ibid. para 5.132.
[104] Ibid. para 5.135
[105] Ibid. para 5.151.

to the proposed cross-class cram down of dissenting classes of creditors must be complied with first.[106]

The proposed introduction of a cross-class cram down into this restructuring plan is a significant move towards alignment with the US Chapter 11 features. The government is very clear that the addition of this tool to the restructuring plan, subject to safeguards, is very important for business rescue and that it will ensure that the UK can maintain its position as a "leading global restructuring hub."[107] It is hoped that cross-class cram down will resolve the problems caused by ransom or hold-out creditors giving rise to the anticommons problem discussed above.[108] These can be creditors who sabotage the progress of the restructuring plan by demanding better treatment at the expense of other creditors, usually resulting in the collapse of the negotiations. The government also hopes that the existence of this tool may well incentivise creditors to seek more consensual restructurings because a cross-class cram down empowers a court to confirm a plan despite opposition by a particular class.[109] In the US the safeguard for a cross-class cram down is found in the "absolute priority rule" (APR) which provides that the claims of a class of creditors must be paid in full before those of a junior class unless the senior class consents to a departure from this rule.[110] However the UK government proposes to apply a different approach.

The court will be permitted to confirm a non-compliant plan if; (a) it is necessary to achieve the aims of the restructuring and, (b) it is just and equitable in the circumstances. The *Government Response* suggests that this is a much higher threshold where the APR will be applied at the same time allowing enabling the court to exercise its absolute discretion to sanction a "workable restructuring plan."[111] This residual power is potentially of great benefit to debtors who might otherwise be at the mercy of holdout creditors who wield what is effectively a deciding vote in their class. Under this two stage test creditors will also have an additional safeguard in that at least one class of impaired creditors will be required to have voted in favour of the plan for a court to confirm the cross-class cram down.

The *Government Response*, rather inconclusively, examines the issue of the how to value the company's estate for restructuring purposes after noting the controversy surrounding the issue both the US and UK. It is proposed that valuation would be based on what the government terms "the next best alternative" for creditors if a plan is not agreed.[112] The rationale is that the valuation must be based on the insolvency proceedings into which the company may end up in, if rescue fails; either

[106] Ibid. para 5.149.
[107] Ibid. para 5.148.
[108] Ibid. para 5.145.
[109] Ibid. para 5.148.
[110] Ibid. para 5.157.
[111] Ibid. paras 5.164 and 165.
[112] Ibid. para 5.174.

administration or liquidation,[113] effectively the approach which has been applied in relation to schemes of arrangement. However there is also optimism that this usually contentious issue need not be the subject of dispute and that any impasse can be resolved through "dialogue and negotiation."[114]

However, supposing the issue of valuation has been resolved and the proposed two stage test for a non-compliant plan has been applied and at least one class of impaired creditors has voted in favour of the restructuring plan a court can confirm the cross-class cram down. The effect of confirmation by a court in this case, just like in a restructuring plan where the requisite voting thresholds have been reached, as discussed above, is that the plan will be binding on all affected parties including any dissenters and all previous rights against the company will be extinguished and replaced by those contained in the plan.[115] Even if the plan was to subsequently fail the creditors' rights would governed under the plan. The restructuring plan has no time limits, just like a scheme of arrangement.

Unlike in the moratorium where supervision is required, company directors will be able exercise unfettered rights as a debtor-in possession throughout the tenure of the restructuring plan. For the first time within the UK, the insolvency framework enables company directors of a debtor company to instigate a restructuring plan on their own volition at any time,[116] to causing the extinguishment of the pre-existing rights of any class of creditors without their consent,[117] trigger a cross-class cram down of dissenting classes of creditors[118]and to determine the valuation of their own company estate.[119] This procedure therefore offers the prospects of greater powers for struggling companies to reach an agreement with their creditors. This procedure potentially addresses the anticommons problem in a way that represents empowerment of managers, with the support of the courts, to implement plans for the survival of their companies at relatively low cost. The lack of a "built-in" moratorium is a potential weakness but the procedure can be combined with the new moratorium process that was previously outlined. As noted, that procedure brings costs that may put it beyond the budget of many SMEs.

Termination clauses (Ipso facto clauses)

A further reform proposal in the *Government Response* relates to what has been termed, "helping businesses keep trading through the restructuring process."[120] The proposal is aimed at tackling the practice by suppliers of triggering termination clauses (ipso facto clauses) when a customer enters an insolvency procedure, even

[113] Ibid. para 5.175.
[114] Ibid. para 5.176.
[115] Ibid. para 5.143.
[116] Ibid. para 5.131.
[117] Ibid. para 5.143.
[118] Ibid. para 5.165.
[119] Ibid. para 5.176.
[120] Ibid. para 5.88.

when invoices are being settled on time. The now defunct Woolworths fell victim to this practice when upon its entry into administration the record company of the popular musical band Take That halted all van deliveries of the group's latest album to its stores.[121] Ransom payments, which are instances when suppliers of products or services that are necessary for the survival of a debtor demand higher payments to continue supplies during the insolvency procedure, are also targeted by the reform.[122] Currently suppliers of "essential supplies" such as IT and utilities are already required to maintain supplies by law. The *Consultation* considered whether a company or insolvency practitioner should be empowered to designate the services to be considered essential to the business but instead the government resolved to impose a broader and more far-reaching solution which will: "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 ground that one of the parties to the contract has entered formal insolvency."[123]

Clearly, this proposal has the potential of being the most controversial of the three main reforms proposed in August 2018 because it has the effect of undermining commercial contracts and by so doing forcing suppliers of certain goods and services to resort to cash sales which would impact adversely on small businesses.[124] However, such an assault on a creditor's contractual rights is arguably not without precedence in the UK insolvency framework. In *Innovate Logistics Ltd (in administration) v Sunberry Properties Ltd*[125] Mummery J upheld the continued occupation of a building in the course of an administration in violation of a landlord's rights and stated that it may be, "necessary for administrators to repudiate contracts and breach obligations" to achieve the objectives of administration.[126]

An aggrieved supplier can challenge this prohibition. They would need to seek the permission of the court to terminate supplies on the grounds of "undue financial hardship."[127] The standard to be applied by the court in determining "undue financial hardship" is whether the supplier would be more likely than not to enter an insolvency procedure as a consequence of continuing to supply the debtor.[128] How a supplier is practically expected to establish that its own operations will be imperilled by this prohibition, when the government proposes that all suppliers within a restructuring plan will enjoy "high priority" under the rules, remains to be seen. The

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[121] 'Band on the run: Take That album caught up in collapse', *The Guardian* (London, 29 Nov 2008) https://www.theguardian.com/business/2008/nov/29/woolworths-take-that-album> accessed on 16 September 2019.
[122] Government Response (n 2) para 5.90.
[123] Ibid. para 5.97.
[124] The government, however, proposes to exempt contracts pertaining to certain financial services from this prohibition: Government Response (n 2) para 5.102. Likewise, licences issued by public authorities may be exempted as well where there are legitimate public policy grounds for their revocation: Ibid. para 5.104.
[125] [2008] EWCA Civ 1321, [2009] BCC 164.
[126] *Innovate Logistics Ltd (in administration) v Sunberry Properties Ltd* [2008] EWCA Civ 1321, [32].
[127] Ibid. para 5.107.
[128] Ibid. para.5.108.

government admits that it intends to set the bar for challenging the prohibition relatively high so as to discourage "frivolous petitions" by suppliers. This proposed reform therefore strengthens the position of companies that are dependent on continued supplies but suppliers may feel that the balance of power has swung too far against them and suppliers who are SMEs may particularly feel the pinch.

CONCLUSION

A feature of UK insolvency law has been the building of reforms based on what has gone before. The 2018 proposals stand to add to the toolkit of options for struggling companies in potentially significant ways, some of which increase the powers of company managers to steer their companies out of difficulties. A concern when offering options which alter the balance of power, as these reforms potentially do, is whether it is a good fit for the skills of the legal institutions and practitioners which have developed. Some changes in role are notable, with the courts playing a greater role at the agreement stage and practitioners occupying a safeguarding, rather than managerial role. Significant distrust of company managers has perhaps been evident in the rescue laws to date, with the emphasis in administration on insolvency practitioner control and it is still arguably evident in the way in which some of the proposed reforms have been shaped, with safeguards designed to prevent the procedures being used for abusive purposes making the procedures more costly and more difficult to implement than might have been desired of a true alternative to administration. In particular the moratorium is still likely to be on the expensive side for SMEs given the number of things that have to be proved by companies seeking a moratorium, as well as the cost of the monitor, and arguably this reform does not meet the recommendations of the UNCITRAL working group that SMEs should be able to benefit from low cost procedures.[129] The government should be commended for intending to take the bold decision to introduce a debtor-in-possession moratorium for the first time, as soon as parliamentary time permits, offering a potential recalibration of the balance of power in an attempt to invigorate the rescue culture.

[129] Nonetheless, the reforms do meet the UNCITRAL recommendations that early access should be encouraged. Secretariat, United Nations Commission on International Trade Law (n 7).