Winding down winding up: *the temporary restrictions*

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Introduction

As a consequence of the far-reaching economic and financial effects of Covid-19, Parliament, by way of Schedule 10 of the Corporate Insolvency and Governance Act 2020 ("CIGA") has put a number of temporary obstacles in the way of creditors wanting to wind up debtor companies. The new legislation has recieved Royal Assent, and is in force from 26 June 2020.

The courts have been making decisions on applications to restrain winding up proceedings by reference to the Government's legislative intentions notwithstanding that the provisions were not yet in force. Any creditor considering whether to serve a statutory demand or present a winding up petition needs to take into account the obstacles to winding up in the CIGA.

In summary, the key obstacles, which will be regarded as having come into force on 27 April 2020 are:

(1) No petition can be presented on the basis of a statutory demand where that demand was served in the period from 1 March 2020 ending on 30 September 2020. (This period is defined as the "relevant period" in Schedule 10. An amendment was made by the House of Lords on 24 June 2020 which changed the original date of 30 June 2020 to 30 September 2020[1].)

(2) No creditor may present a petition on the grounds that the company is unable to pay its debts pursuant to section 123(1) or (2) of the Insolvency Act 1986 ("the 1986 Act") unless the petitioner has reasonable grounds for believing that one of two conditions is met (the "coronavirus conditions"[2]).

(a) coronavirus has not had a financial effect on the company[3]; or,

(b) where the petition is presented on a ground in section 123(1)(a) to (d) of the 1986 Act[4], the facts by reference to which the relevant ground applies would have arisen even if coronavirus had not had a financial effect on the company; where the petition is presented on a ground in section 123(1)(e)[5] or (2) of the 1986 Act[6], the relevant ground would apply even if coronavirus had not had a financial effect on the company. Coronavirus is defined as having 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*[7]."

(3) Even if the petitioning creditor can overcome these obstacles, the court may only wind up the company if the court is satisfied that the facts by reference to which that ground applies would have arisen even if coronavirus had not had a financial effect on the company[8].

(4) Further, the statute gives the court powers to make such orders as appropriate to restore the position to what it would have been if:

(a) a petition was presented on or after 27 April 2020 but before the date on which Schedule 10 came into force without satisfying the coronavirus conditions[9]; and,

(b) if a winding up order was made on or after 27 April 2020 but before Schedule 10 came into force which the court would not have made had the restrictions on winding up orders been in effect at the time. (In such circumstances the court is regarded as having no power to make the order and the order is void[10].)

As explained below, even before the CIGA came into force, the impact of this legislation has already been considered in four cases; most of these obstacles were considered in the most recent case by ICC Judge Barber in *Re a Company (Application to Restrain Advertisement)* [2020] EWHC 1551 (Ch) in her judgment on 16 June 2020.

Decisions made by reference to proposed legislation

There was a failed attempt, made in late April 2020, to restrain presentation of two petitions in reliance on the impact of the Covid-19 pandemic on the financial position of the companies; see the decision of Snowden J in In *Re Saint Benedict's Land Trust Limited; Re Shorts Gardens LLP; Harper v Camden Borough Council and another; Shorts Gardens LLP v Camden London Borough Council* [2020] EWHC 1001.

This case was clearly an opportunistic attempt by a company to fend off a winding up order. After the parties had been provided with a draft judgment and shortly before the time for hand-down on 24 April 2020, further evidence was filed on behalf of the companies the gist of which was that like all companies in "*the United Kingdom and the World*" these companies "*are going to suffer from cash flow restrictions caused by the effect of the coronavirus*".

The companies raised this point at this stage by reference to the announcement on 23 April 2020 by the Ministry of Housing, Communities and Local Government and the Department for Business, Energy & Industrial Strategy that the Government intended to introduce emergency legislation relating to the use of statutory demands and the presentation of winding up petitions. The focus of the press announcement was on high street shops and other businesses under strain from aggressive rent collection. At this stage no draft legislation had been published (even if something did exist in draft form) and the judge took the view it seemed "*overwhelmingly likely*" that the legislation would be limited to companies in certain identified

1. Paragraph 1 of Schedule 10.

2. Sub-paragraphs 2(3) and (4) of Schedule 10.

3. This paragraph applies to registered companies. The restrictions in winding up petitions relating to unregistered companies are in substance the same: paragraph 3 of Schedule 10.

4. There are two grounds relevant to the law of England and Wales: the service of a statutory demand (section 123(1)(a)) and execution or other process issued on a judgment, decree or order in favour of the creditor that has not been satisfied (section 123(1)(b)).

5. If it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

6. If it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

7. Paragraph 20(3) of Schedule 10. Coronavirus "*means severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2)*".

8. Paragraph 5 of Schedule 10.

9. Paragraph 4 of Schedule 10.

10. Paragraph 7 of Schedule 10.

sectors of economic activity relating to statutory demands and petitions based on claims by landlords for arrears of rent. This would not have covered the debts in this case.

Irrespective of the scope of the protection to companies that the legislation was intending to provide, the judge also noted that there was no financial information provided and that still less "*was there any explanation of the complete volte face*" in the companies' case in circumstances where the skeleton argument on behalf of the companies had expressly stated that the companies did not contend that they faced "*liquidity or operational challenges as a result of circumstances related to COVID-19*".

It was unsurprising that the judge saw no reason to exercise any discretion in favour of the companies based on the prospect that legislative measures were to be introduced. These provisions, he concluded, were intended to assist "*more deserving companies experiencing genuine financial hardship caused by the effects of the COVID-19 pandemic.*"

Since this decision, there have been three reported cases in which the Court has granted interim injunctions restraining winding up proceedings by reference to future legislation.

At the hearing of *Travelodge Hotels Limited v Prime Aesthetic Ltd and Others* [2020] EWHC 1217 (Ch), on 6 May 2020, there was no draft legislation, but Birss J, like Snowden J, was referred to the Government's 24 April 2020 announcement. The petition in *Travelodge* was presented by a landlord, and the company was in the hospitality business. Birss J took the view that future legislation would cover this type of situation.

The judge accepted the submission made on behalf of the company that the court does not necessarily always have to make its decision only on the basis of the law as it stands but can, in a proper case, take account of imminent changes in the law. One of the cases relied on in *Travelodge* was *Sparks v Harland* [1997] 1 WLR 143 in which Sedley J stated that:

"*...there is, in my judgment, no rule of law that impending legislative change is never a material consideration in the exercise of the court's powers and discretions. Everything, it seems to me, turns on the subject matter and relevance of the pending legislation or possibility of change to the issues which the court has before it*[11]."

The decision in *Travelodge* on this point was followed by Morgan J in *Re: a Company (Injunction to Restrain Presentation of Petition)* [2020] EWHC 1406. As at the date of this hearing (1 June 2020) there was a draft of the Bill. The judge concluded from the ministerial statements that he had a high degree of confidence that Schedule 10 of the

11. In that case there was a real possibility that the law was about to be retrospectively changed to remove a limitation defence which would otherwise, had it not been changed, been a complete answer to the claim. The court refused to dismiss the claim and granted a stay. The other authority referred to on this point in *Travelodge* is *Hill v Parsons* [1972] 1 Ch 305. In that case, the Court of Appeal decided that the law was about to change and the change would remove the grounds on which the employee could be dismissed and, therefore, granted an interim injunction preventing the dismissal of the employee.

> *A statutory demand … cannot be relied on for the purpose of showing that a company is unable to pay its debts …*

Bill would be enacted in more or less its current form. He decided that when a court is considering whether to grant relief, and in particular relief which involves the court managing its own processes, that it can take account of the likelihood of a change in the law that would be relevant to its decision.

The issue as to whether the Court could take into account the provisions of the Bill, having been considered by two judges of the High Court, was not an issue at the hearing before ICC Judge Barber in *Re: a Company (Application to Restrain Advertisement)* [2020] EWHC 1551 (Ch); at that hearing it was common ground that the court should take into account the provisions of the Bill in the exercise of its discretion in relation to the Company's application in circumstances where it had not yet been enacted[12]. The position at the present time is now clear. From 26 June 2020 onwards, the CIGA is in force.

The obstacles to winding up

Obstacle 1: the restrictions on statutory demands

A statutory demand served in the relevant period[13] on a company[14] cannot be relied on for the purpose of showing that a company is unable to pay its debts pursuant to section 123(1)(a) of the 1986 Act.

If, however, a statutory demand is only one of the grounds on which the creditor contends the company is unable to pay its debts, a creditor may be permitted to amend the petition to include another definition within section 123(1) or (2) in order to allow the petition to proceed.

In *Re a Company (Application to Restrain Advertisement)* a winding up petition was presented on 1 May 2020, which is in the relevant period, in reliance on a statutory demand served on 27 March 2020, also in the relevant period. The petitioner accepted that the petition could not have proceeded on the basis that the company's inability to pay its debts was established by reason of the failure to pay the undisputed sum in the statutory demand. ICC Judge Barber, who clearly considered it important to address the other issues raised in this application, held that although the petition did not unequivocally rely on a further ground, namely section 123(1)(e) of the 1986 Act, it could be read either way, and that in any event permission to amend would be likely to be given. Similarly, Morgan J, in the application to restrain presentation, who knew that a statutory demand had been served but had not seen a copy of the petition, was prepared to assume that the petitioner may also have relied on sections 123(1)(e) and 123(2) of the 1986 Act.

As a petition can proceed on the basis that a company is deemed unable to pay its debts on additional grounds under sections 123(1) and (2) of the 1986 Act, other than section 123(1)(a) of the 1986 Act, the purpose of this restriction on statutory demands appears to be to prevent creditors using statutory demands as a means of bringing pressure on creditors, and is not a means of preventing petitions being presented. In any event, most petitions presented in the relevant period and founded on a statutory demand are likely to be capable of being amended to refer to sections 123(1)(e) or 123(2) of the 1986 Act.

Obstacle 2: the coronavirus conditions

The coronavirus conditions, set out above, are substantially the same irrespective of the grounds on which the creditor alleges the company is unable to pay its debts pursuant to sections 123(1) and (2) of the 1986 Act[15].

The burden is on the petitioner to show, at the date of the presentation of the petition, that the petitioner had reasonable grounds for the belief that either coronavirus did not have a financial effect on the company or, if it did have such an effect, the company would be unable to pay its debts even if coronavirus did not have a financial effect on the company.

The Bill was in draft form when Morgan J heard the application to restrain presentation of a winding up petition on 1 June 2020[16]. He considered that the question for the court was whether coronavirus had had a financial effect on the company before the presentation of the petition and concluded that there was a substantial body of evidence to support the conclusion that there was a strong case that this was so. The judge granted an injunction restraining presentation of the petition[17].

12. The judgment refers (at 13]) to the decision of Morgan J, where the judge expressed his "*high degree of confidence that Schedule 10 will be enacted more or less in its current form*": *Re: A Company (Injunction to Restrain Presentation of Petition)* [2020] EWHC 1406 at [17].

13. The relevant period for the purpose of Schedule 10 is defined as from 1 March 2020 to 30 September 2020 or one month after the CIGA came into force, whichever is later: paragraph 1(3). Paragraph 1 will be regarded as having come into force on 27 April 2020. The relevant period will therefore end on 30 September.

14. References to a company is to a registered company unless stated otherwise.

15. See Schedule 10, paragraphs 2(1) and (2), and 2(3) and (4). Paragraph 2 is to be regarded as having coming into force on 27 April 2020: paragraph 2(5). The same conditions also apply to unregistered companies: paragraph 3.

16. *Re: A Company (Injunction to Restrain Presentation of Petition)* [2020] EWHC 1406 (Ch).

17. The injunction was subsequently continued by undertakings.

On 8 and 9 June 2020, ICC Judge Barber heard an application to restrain advertisement of a petition[18]. The judgment notes that in this case, as in most cases, it would be difficult for a petitioner to show a reasonable belief that coronavirus had not had a financial effect on the company. The focus in this case was on whether the petitioner reasonably believed at the date of the presentation of the petition that the company would have been unable to pay its debts even if coronavirus had not had a financial effect.

The petitioner was found to have had a reasonable belief that the company would have been unable to pay its debts even if coronavirus had not had a financial effect on the company. In summary, this was because the debt had originally fallen due in January 2019, the company had failed to adhere to an agreement to pay by instalments and letters and demands from the petitioner had largely been ignored.

Obstacle 3: would the court make a winding up order on the petition

Even where a petitioner has overcome the obstacle of the coronavirus conditions, as in the case before ICC Judge Barber, it does not follow that the petition can proceed. The court will consider whether there is a real prospect of the court making a winding up order.

A court can only make a winding up order on a petition presented in the relevant period where "*it appears to the court that coronavirus had a financial effect on the company before the presentation of the petition.*[19]" Coronavirus has 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*[20]".

The company provided business and property management services. The company's evidence was that it was "*solvent for day to day operations but relies on rolling over corporate debt and fund raising by the issue of equity for its long-term financing*". The evidence also stated that in early 2020 the company had been in the process of raising funds but this had been stopped by the Covid-19 situation, which had prevented the acquisition of new finance as the international capital markets had frozen.

The company's evidence on fundraising was poor. The judgment records that the company had adduced virtually no financial documents to demonstrate its financial position either before or after Covid-19 hit. There were very few documents showing any agreements in principle for funding, and certainly there were none showing the level of funding the company said had been agreed in principle. There were no documents showing the funding to have been withdrawn.

The judge nevertheless considered the company had provided enough evidence for her to conclude that the threshold requirement of paragraph 5(1)(c) had been met. The wording suggested it was intended to be "*a low threshold*" because:

(1) All the company is required to show is "*a financial effect*"; there was no requirement to show that the pandemic was "*the or even a cause of the company's insolvency*".

(2) The question is whether it "*appears*" to the court that there has been such an effect; the court is not required to "*be satisfied*" of that matter.

On this approach, the courts are likely to take into account the impact of the Covid-19 pandemic on the company's ability to raise funds to resolve its pre-Covid-19 pandemic cash flow problems.

The issue as to whether there was a real prospect of the company being wound up was considered by ICC Judge Barber in the context of an application to restrain advertisement. The courts considering whether to restrain presentation of a petition would also be expected to take into account the prospect of a winding up order being made; Morgan J reached his decision to grant an injunction to restrain presentation, in part, on the basis of his view that it was improbable that the court would make a winding up order.

The temporary amendment to the Insolvency Rules 2016 regarding advertisements of petitions (see below) will require the issue as to whether it was likely the court would be able to make a winding up order to be determined prior to advertisement.

Obstacle 4: void winding up orders

ICC Judge Barber also made her decision by reference to her conclusion that, if a winding up order were made on the evidence as it stood at the hearing before her, the winding up order would be void. This assumed that paragraph 7 of Schedule 10 would be brought into force, which it duly was. A proposed amendment to the Bill, which would have removed this provision, was rejected.

The CIGA has a built-in protection for the official receiver, liquidators and provisional liquidators in circumstances where a winding up order is void[21]; they are not liable in any civil or criminal proceedings for anything done pursuant to the winding up order. The court may give directions to the officeholder as it thinks fit for the purpose of restoring the company to the position it would have been in immediately before the petition, on which the order was made, was presented[22].

The date of the commencement of the winding up and section 127 of the 1986 Act

For the purposes of the provisions in the CIGA the winding up is deemed to commence on the date of

18. *Re a Company (Application to Restrain Advertisement)* [2020] EWHC 1551 (Ch).

19. Paragraph 5 of Schedule 10.

20. Paragraph 21(3) of Schedule 10.

21. Paragraph 7(3) of Schedule 10.

22. Paragraph 7(4) of Schedule 10.

23. Paragraph 9 of Schedule 10.

24. Paragraph 19(1) and (2) of Schedule 10.

25. Paragraph 19(3) of Schedule 10.

the making of a winding up order and not at the time of the presentation of the petition[23].

The effect of this change means that section 127 of the 1986 Act, pursuant to which any disposition of the company's property in the period from the time of the presentation of the petition to the date of the winding up order is void, will be of no effect on petitions presented in the relevant period.

This change means that companies faced with a winding up petition presented in the relevant period do not face having their bank accounts frozen and do not need to obtain validation orders to continue to trade in the period from the date of the presentation of the petition. Where a company's business is hit financially as a consequence of coronavirus, the decision as to whether or not such an order is in the interests of the company's creditors as a whole would have been extremely difficult in these times of extraordinary financial uncertainty.

That said, this change to the legislation does remove an important provision underpinning the principle of *pari passu* distribution to creditors in circumstances where the only companies that are likely to be wound up are those that are insolvent for reasons unconnected with coronavirus.

Changes to the Insolvency Rules 2016

Restraining advertisement

ICC Judge Barber decided that it would be oppressive and unfair to allow the petition to be advertised. She took into account the fact that the company was engaged in a restructuring exercise with unsecured creditors by way of a scheme of arrangement, and that adverse publicity from the presentation of a winding up petition at this stage would be detrimental to the company. She also took into account her decision that advertisement would serve no purpose because there was no real prospect of a winding up order being made.

An injunction restraining advertisement was granted and the petitioner was given liberty to apply to lift the restraint on advertisement on the production of further evidence demonstrating that the company would have been insolvent even if coronavirus had not had a financial effect on the company.

In reaching her decision, ICC Judge Barber's decision to restrain advertisement by reference to the likelihood of a winding up order being made foreshadowed the new temporary changes to the Insolvency Rules 2016 ("the 2016 Rules") on the advertisement of winding up petitions.

The CIGA adds a new procedural requirement for petitions presented in the period between the date on which the CIGA came into force, 26 June 2020, and the end of the relevant period by way of amendment to the 2016 Rules[24].

The new temporary rules require that no petition presented in this period can be advertised until the court has determined whether it is likely the court will be able to make an order to wind up the company. The effect of this appears to be that, where such a petition has been presented, companies will no longer need to apply to restrain advertisement of the petition. Unless the issue as to whether a winding up order is likely to be made on the petition has already been determined on a company's application to restrain presentation of a petition, the creditor will need to apply to the court for such a determination before proceeding to advertise the petition.

Content of winding up petitions

The content of the winding up petition has been changed to reflect the grounds on which a petition may be brought. Rule 7.5(1) of the 2016 Rules is amended to provide that the petition is required to contain a statement that the petitioner considers the relevant coronavirus conditions are met[25].

Access to the court file

The right to inspect the court file that is accorded to the office-holders, creditors and others pursuant to rule 12.39 of the 2016 Rules are not exercisable without the permission of the court until the court has made a determination in relation to the question as to whether or not the court will make a winding up order. The purpose of this would appear to be to ensure that the restriction on advertisement, to prevent publicity before the court has decided a winding up order is likely to be made, is not circumvented by creditors gaining access to information about the proceedings on the court file.

Comment

These temporary changes to insolvency law relating to proceedings to wind up a company are plainly directed at preventing liquidation of companies whose finances have been damaged by coronavirus. There are very few companies where it will be clear that they do not fall within this category.

Statutory demands cannot be used to exert pressure to pay because they cannot be used for the purpose of winding up the company.

The majority of companies are to be expected to rely on the presence of coronavirus to defend winding up proceedings, the consequence of which is likely to be court hearings on the effect of coronavirus on the company's financial position.

Furthermore, as a consequence of the change to the rules on advertisement of petitions, the petition cannot proceed to a winding up order without a court having determined whether it is likely that the court can make an order to wind up the company, because the petition cannot be advertised prior to the determination of this question. Such a determination will require, at the very least, consideration of whether coronavirus had a financial effect on the company and, as is clear from the decision of ICC Judge Barber, the threshold for this test is very low.

Unless it is clear that the company was insolvent before the coronavirus pandemic, and probably also clear that the company was not thwarted in fundraising to address a cash flow problem, a creditor who commences winding up proceedings is likely to incur costs of court proceedings with a highly uncertain outcome for the creditor.

Creditors should, therefore, consider alternatives to winding up, and if agreement with the company cannot be reached, the obvious alternative insolvency process is administration. That in turn depends on whether any of the objectives of administration could be achieved.

In addition, directors will have the ability to obtain a moratorium to explore rescue and restructuring, and the company will also have the option of proposing a reconstruction plan, in addition to the long-established options of company voluntary arrangements and schemes of arrangement. Any creditor considering whether to embark on winding up proceedings or an administration application will, therefore, also need to consider how the directors are likely to respond to such proceedings, and the impact of this on the creditor's position. ■