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UK Corporate Insolvency and Governance Act: Temporary restrictions on winding-up petitions and statutory demands

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On 23 April 2020, the UK Government announced that the use of statutory demands and winding-up petitions would be restricted to ‘safeguard the UK high street against aggressive debt recovery actions' during the COVID-19 pandemic.

While the strapline to the measures referred to the UK high street, the provisions to implement them, which are included in the Corporate Insolvency and Governance Act 2020, are not sector specific and apply to any registered or unregistered company that can be the subject of a winding-up petition. They also apply in relation to any debt owed by a debtor company, not just rent or other commercial lease liabilities.

The measures were initially due to be in place until 30 September 2020 but were extended by The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020 to apply until 31 December 2020.

Are debtors protected from statutory demands, or other types of demand?

There is a blanket ban on statutory demands being used for presenting winding-up petitions. Statutory demands

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served between 1 March 2020 and 31 December 2020 cannot form the basis of a winding-up petition presented at any point after 27 April 2020.

Statutory demands can still be served, provided they are not used for the purposes of presenting a winding-up petition. However, service of a statutory demand without the threat of a winding-up petition would be of limited benefit.

Receipt of a statutory demand might trigger a default in a debtor's facility documentation or commercial contracts, but it is likely that where a statutory demand would trigger a cross default, an ordinary demand would also do the same. There is no restriction on issuing ordinary demands.

Does the Act remove all risk of a winding-up petition being served?

No. There isn’t a blanket ban on presenting winding-up petitions. But while the temporary provisions are effective, creditors are well advised not to present a petition unless they are satisfied that either (i) COVID-19 hasn’t had a financial effect on the debtor company; or (ii) the company would have been unable to pay its debts regardless of COVID-19. Petitioning creditors will need to include a statement to this effect in the petition.

If a winding-up petition is presented and the court determines that COVID-19 has had a financial effect, the petition will be dismissed (unless the court is satisfied that the company would be unable to pay its debts regardless of COVID-19) with the petitioner potentially being held liable for the debtor company’s legal costs and potentially damages if a petition is dismissed but the presentation of it can be proven to have caused loss or damage to the debtor.

The restrictions apply for the period from 27 April 2020 to 31 December 2020.

What does "where COVID-19 has had a financial effect" mean?

COVID-19 will be deemed to have had a “financial effect” on a company if (and only if) the company’s financial position has worsened in consequence of, or for reasons relating to, COVID-19. The bar is seemingly very low and we expect that a petitioner will find it very difficult to prove no financial effect or otherwise argue against a debtor, particularly one in the non-essential retail, hospitality and leisure sectors (where revenue has been nil or restricted as a result of the lockdown and social distancing measures).

Even if a debt pre-dates the COVID-19 pandemic, this alone may not be sufficient to justify the presentation of the petition as it would be open to the debtor company to argue that COVID-19 has had an effect on the company's ability to pay the same. That said, to the extent that a debt is significantly aged and is undisputed, it will be more likely that a petitioner could argue that the debtor is unable to pay its debts regardless of the financial effects of COVID-19. Although, as shown in the case law discussed below, the petitioner will need to supply evidence to satisfy the court on this point.

When can a winding-up order be made?

A winding-up order may only be made if the court is satisfied that the company would be unable to pay its debts even if COVID-19 had not had a financial effect on the company.

To the extent a petition is presented in the period 27 April 2020 to 31 December 2020, but it appears to the court that COVID-19 has had a financial effect on the company before presentation of the petition, the Act prohibits a winding-up order from being made (unless the court is satisfied that the company would be unable to pay its debts regardless of COVID-19). Where the petition was presented after 27 April 2020 but before 26 June 2020 (when the relevant provisions came into force), the court has power to make a remedial order to restore the position as if a petition had not been presented.

The Act also provides that if a winding-up order has been made in relation to a debtor in the period between 27 April 2020 and 25 June 2020 (the day before the relevant provisions in the Act came into force), then the order is void, if it does not meet the new requirements for the making of an order.

What have the courts said?

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There have been several reported cases where the courts considered whether to restrain the presentation or advertisement of winding-up petitions in light of the impending legislation. Two of these, Re A Company [2020] EWHC 1406 and Re A Company [2020] EWHC 1551, were handed down after the Corporate Insolvency and Governance Bill had been published but prior to it receiving Royal Assent.

Two, *Travelodge Hotels Ltd v Prime Aesthetics Ltd and others* [2020] EWHC 1217 (Ch) and *Shorts Gardens LLB v London Borough of Camden Council* [2020] EWHC 1001 (Ch), were handed down after the Government had announced that it was intending to bring forward emergency legislation relating to the presentation of winding-up petitions and the use of statutory demands but prior to the publication of the Bill.

The latest of these cases, Re A Company [2020] EWHC 1551(Ch), provides some useful insight as to how the courts will interpret the new provisions. In that case the court restrained advertisement of a petition in relation to a significantly aged debt as the petitioner had not provided sufficient evidence to satisfy the court that the company would have been unable to pay its debts regardless of the financial effects of COVID-19. Though the petitioner did have, in the court's view, reasonable grounds for believing that the company would be insolvent even without the financial effects of COVID-19.

The Judge found that: (i) the evidential burden of showing COVID-19 had a financial effect on a company is on the company and not the petitioner; (ii) whether COVID-19 has had a financial effect is a low threshold with no requirement to show that COVID-19 is the (or even a) cause of the company's insolvency; and (iii) the burden of showing that the company would be insolvent, even if COVID-19 had not had a financial effect, is on the petitioner.

In Re A Company [2020] EWHC 1406 (Ch) the court granted an interim injunction to restrain the presentation of a landlord's winding-up petition. The Judge found that there was a strong case that COVID-19 had had a financial effect on the company and that the facts on which the winding-up petition would be based would not have arisen if COVID-19 had not had a financial effect on the company.

In *Travelodge* the court also granted an injunction to restrain the presentation of winding-up petitions.

In *Shorts Gardens* (heard before the text of the Bill (as it then was) was published), the court refused to grant an order restraining the presentation of a winding-up petition on the basis of the COVID-19 pandemic. The court noted that it seemed a threshold test was envisaged under which restrictions will only apply where the reason that a company is unable to pay its debts is due to COVID-19 and that in this instance the reason the debts had not been paid had nothing to do with COVID-19.

Protections from the 'side effects' of a winding-up petition

The Act removes some of the harmful 'side effects' or implications for a debtor if a petition is presented in the relevant period (and to the extent that the court makes a winding-up order). The Act modifies existing insolvency legislation so that a petition won't prevent disposals of the debtor company's property (which, for the purposes of the Act, are voided from the date of the winding-up order, rather than the date of the petition as is the usual position, unless the court orders otherwise). Further any requirements to publish or advertise the petition do not apply until the court has determined that it is likely to be able to make a winding-up order. However, the fact of the petition may still trigger events of default and termination rights in facility agreements and supply contracts.

Only a temporary reprieve

The legislation, whilst very welcome for debtors, does not deal with the substantive problem of debt being built up and long-term balance sheet issues. It provides no solution for debtors once the restrictions expire, when they may have significant arrears of debt. The problem may be particularly acute in the non-essential retail, hospitality and leisure sectors, where businesses have seen their incomes significantly reduce but are still incurring rent liabilities.

If no further support is provided to such businesses, then we would expect to see an increase in the use of insolvency procedures such as CVAs and the new restructuring plan process (also introduced in the Act) in order to deal with the build-up of COVID-19 debts and any consequential balance sheet issues. The use of pre-pack administrations is also likely to increase.

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