


# Corporate Insolvency and Governance Act 2020

Impact on derivatives of the new company moratorium and the protection of supplies of goods and services: a digest

## Scenario 1



Company enters into a company moratorium under the CIGA <sup>\*1</sup>

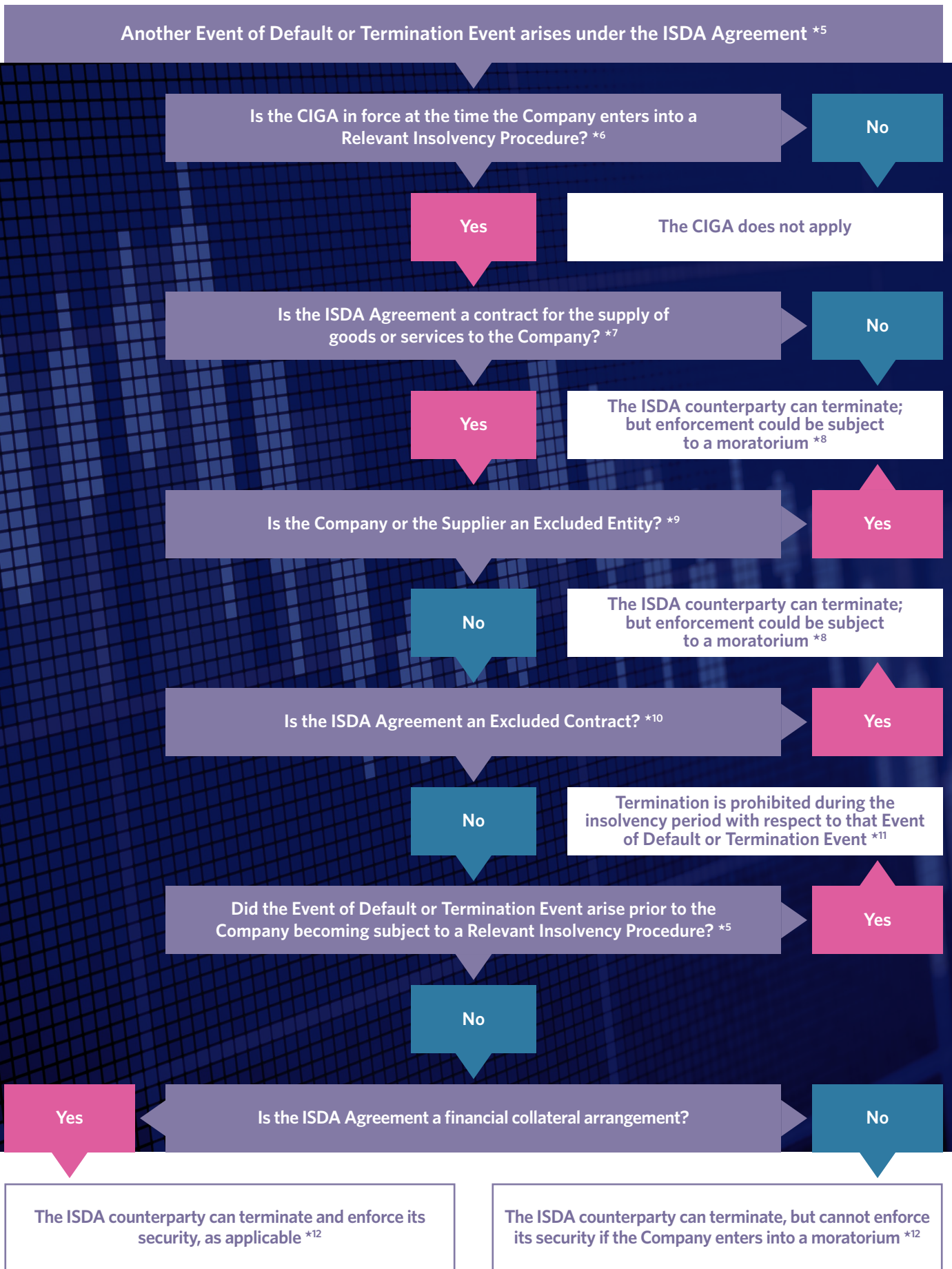
Likely to trigger an Event of Default under Section 5(a)(vii): see Scenario 2 <sup>\*2</sup>

\*Please refer to the explanatory notes

# Scenario 2



# Scenario 3



# Timings

**20 May 2020** Publication of the Bill to Parliament

**26 June 2020** Act entered into force

## Explanatory notes

1. The company moratorium is a new insolvency tool under the CIGA, allowing a Company (other than an Excluded Entity: see 9. below) to apply for a temporary moratorium from enforcement of debts by creditors, and restricting other creditor actions, with the intention that the Company can then avoid an insolvency. The moratorium is for an initial period of 20 business days, and is extendable by a further 20 business days without creditor consent, and with further extensions at the agreement of creditors or the courts. A key consequence of the moratorium is that an eligible Company would typically not have to pay any debts falling due prior to the moratorium or which become due during the moratorium under a contract entered into prior to the commencement of the moratorium (each, a "Pre-Moratorium Debt") but would have to pay debts falling due during the moratorium. Exceptions to this payment holiday with respect to Pre-Moratorium Debt include debts relating to (i) goods or services supplied during the moratorium and (ii) financial services contracts (see the "Excluded Contracts" under 10. below). However, the ISDA counterparty might still be subject to the other consequences of a moratorium (see further 8. below and Scenario 3).

Note also that during a moratorium the Company would be restricted from making consensual payments to any creditor in respect of its Pre-Moratorium Debts above the statutory maximum (generally being £5,000 or 1% of the total owed to unsecured creditors when the moratorium began) unless the monitor consented.

2. It is arguable that the onset of a moratorium would trigger an Event of Default under Section 5(a)(vii)(4) of the ISDA Master Agreement (1992 and 2002 versions). For these purposes, the moratorium could constitute "any other relief", but the question is whether the mere filing of papers in court to obtain the moratorium would constitute a "proceeding". The Practice Direction – Insolvency Proceedings - which came into force on 4 July 2018 defines "insolvency proceedings" as being any proceedings under Parts 1-11 of the Insolvency Act 1986. This will include the new moratorium. On the basis that a moratorium is an insolvency proceedings, it is therefore arguable that the filing of the relevant document which initiates this process would be a "proceeding" also.

# Explanatory notes continued

3. The CIGA further introduces a framework for agreeing a binding restructuring plan with creditors and shareholders through the UK courts.
4. It is likely that the agreeing of a binding restructuring plan with creditors and shareholders through the courts in accordance with the CIGA (and the entering into of formal UK insolvency proceedings) would trigger an Event of Default under Section 5(a)(vii) of the ISDA Master Agreement (1992 and 2002 versions). However, the CIGA looks to prohibit the operation of 'ipso facto' termination provisions where those provisions are triggered by the Company becoming subject to a relevant UK insolvency procedure (a "Relevant Insolvency Procedure"). This is defined as:
  - (a) the onset of a moratorium under the CIGA (per Scenario 1);
  - (b) the Company enters into administration;
  - (c) an administrative receiver of the Company is appointed;
  - (d) a voluntary arrangement takes effect in relation to the Company;
  - (e) the Company goes into liquidation;
  - (f) a provisional liquidator is appointed; or
  - (g) a convening order is made by the court relating to a compromise or arrangement.
5. The prohibition on termination of supply contracts also applies to other termination events that have occurred (but not been exercised) before the commencement of the relevant insolvency period (and such exercise is generally prohibited until the end of the relevant insolvency period).
6. The prohibition on termination will apply to a Company which becomes subject to a Relevant Insolvency Procedure on or after the day following Royal Assent is received (ie. 26 June 2020). Note, however, Re A Company (Injunction to Restrain Presentation of Petition) [2020] EWHC 1406 (Ch): a High Court granted an injunction restraining presentation of a winding-up petition on the basis of the Bill.
7. The prohibition on enforcement of termination clauses only applies to suppliers in goods and services supply contracts.
8. An ISDA counterparty's enforcement rights would generally be restricted by a moratorium. Limited exceptions include:
  - (i) the payment holiday with respect to Pre-Moratorium Debt would not apply to debts or other liabilities arising under a contract or other instrument involving financial services (see the "Excluded Contracts" under 10. below) and
  - (ii) the prohibition on enforcement of security would not apply to collateral security charges or financial collateral arrangements. However, the other restrictions on creditor actions under the CIGA (for example, the ability to institute legal proceedings or initiate insolvency proceedings against the Company) would still apply. It is important to remember that a moratorium would only be available to an eligible Company (see the "Excluded Entities" under 9. below). See further 12. below.
9. Excluded Entities: Certain persons involved in financial services are deemed not eligible for certain provisions of the CIGA. This list includes banks, investment banks and investment firms, payment institutions, recognised investment exchanges, securitisation companies and certain overseas companies.
10. Excluded Contracts: Exclusions apply to "any contract or other instrument involving financial services". This would include: financial contracts (loans, financial leases, guarantees and commitments, securities contracts, commodities contracts, futures and forwards contracts and swap agreements), securities financing transactions, derivatives and spot contracts and capital market investments. An Intercreditor Agreement is not specified, but it is understood that this is because it is not deemed to be a supply contract (which is relevant for the 'protection of supplies' analysis). Please further note that this list is different for the purposes of the 'moratorium' and the 'protection of supplies' exclusions. For instance, for the purposes of the latter, contracts secured by or otherwise covered by a financial collateral arrangement are not covered, albeit the 'protection of supplies' provisions are not intended to affect the operation of the Financial Collateral Arrangements (No.2) Regulations 2003.
11. It is further unlikely that the onset of a Relevant Insolvency Procedure would constitute a Potential Event of Default or Event of Default (given that the Bankruptcy Event of Default would be rendered ineffective, and there would be no Failure to Pay or Potential Failure to Pay). If a Potential Event of Default or Event of Default were to be triggered as a result of the Relevant Insolvency Procedure, query whether the ISDA counterparty would in any event be able to exercise its rights under Section 2(a)(iii): the prohibition on the operation of termination clauses in supply contracts also renders ineffective any provision that allows the supplier to the Company to do "any other thing" as a consequence of the Company becoming subject to a Relevant Insolvency Procedure. This is very broad, and so (if the effect of Section 2(a)(iii) were held to be a variation) arguably the ISDA counterparty would only be able to exercise its rights under Section 2(a)(iii) if it obtains the consent of the 'monitor' or a hardship order.
12. The onset of a moratorium would prevent the enforcement of security unless such security were created or otherwise arising under financial collateral arrangements. As such, in the case of collateralised OTC derivatives (i.e. ISDAs with CSAs), an ISDA counterparty should be able to enforce its security without restriction. Certain other moratorium restrictions would not apply to financial collateral arrangements (for example, the prohibition on crystallising a floating charge would not apply to a security financial collateral arrangement). However, in all cases, the ISDA counterparty would not be able to institute UK legal proceedings or initiate UK insolvency proceedings against the Company during any moratorium period. This should not affect the ISDA counterparty's ability to close out or terminate any outstanding transactions as well as exercising any netting and set-off rights.

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