KEY POINTS

- The super priority status afforded by the moratorium process creates something of an opportunity for creditors to differentiate themselves by either making sure their debts fall due or providing new financing during the moratorium.
- Super priority debts will be paid in priority to all other debts but the Act does not set out any order of priority as between moratorium debts and priority pre-moratorium debts nor any order of priority within those categories; this is likely to depend on the contractual status of the respective obligations.
- A Financial Services Contract creditor who holds a floating charge may make it a condition of its support for a moratorium that it is permitted to provide new financing.

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Rank inequality: the consequences of the creation of "super priority" debts under the Corporate Insolvency and Governance Act 2020 moratorium

In this article the authors consider the consequences of the creation of "super priority" debts under the Corporate Insolvency and Governance Act 2020 (CIGA) moratorium, including the effect on secured creditors, priority as between holders of Super Priority debt and the potential impact on floating charge holders.

CIGA MODIFICATIONS TO UK INSOLVENCY REGIME

On 25 June 2020 the UK Parliament enacted the Corporate Insolvency and Governance Act 2020 (CIGA) as part of a package of emergency measures aimed at mitigating the effects of the COVID-19 pandemic. Some measures were intended to have temporary effect, whilst others create permanent modifications to the UK insolvency regime.

Two of the new permanent measures of most consequence are:

- the introduction of a standalone moratorium; and
- the introduction of an evolved form of the pre-existing scheme of arrangement under the Companies Act 2006, known as a "Restructuring Plan".

STANDALONE MORATORIUM

The concept of a moratorium per se is already a well-established part of the UK Insolvency Act 1986 (IA86). A company in administration benefits from a moratorium preventing any person from commencing or continuing insolvency or other legal proceedings without the consent of the administrator or permission of the court.

The moratorium provides administrators with sufficient "breathing space" from creditors' claims to enable them to focus on the statutory objectives of the administration, including rescuing the company or its business. The obvious disadvantage of the moratorium is that the company has to enter a formal public insolvency process to obtain it and control passes from the directors to the administrators.

CIGA has now amended IA86 to create a standalone moratorium, allowing an eligible company in financial difficulty to obtain a moratorium through an out-of-court process for a limited period of time. During that time, the directors remain in control of the company, although there is some light touch supervision from a licenced insolvency practitioner, nominated in the office of "monitor".

ELIGIBILITY

Any company, including an overseas company, is eligible to obtain a moratorium under CIGA unless otherwise excluded under the Act. There are however a number of exclusions, broadly where:

- a company is subject to a moratorium or another insolvency proceeding or has been within the last twelve months; or
- a company's business falls into a certain category. Such categories include insurance companies, banks, e-money institutions, investment banks and firms, payment institutions and parties to capital market arrangements where a capital market arrangement incurs a debt of £10m or more.

In practice, the exclusions are likely to cover many companies in the financial services sector, for example if the company has issued a bond to the excluded value.

EFFECT OF MORATORIUM

The effect of the standalone moratorium is similar to that of a moratorium in an administration and protects the company by prohibiting:

- insolvency proceedings being commenced (other than a winding up petition by the directors themselves and including the appointment of an administrator, even by a qualifying floating charge holder); and
- enforcement and the commencement or continuation of other legal proceedings without the permission of the court.

The moratorium provides a payment holiday to certain categories of pre-moratorium debt, but notably not on some "priority pre-moratorium debts" (PPMDs), which are set out in the amended

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IA86 at new s 174A (s 174A). These include the monitor's remuneration, the cost of goods and services, rent, payroll (including redundancy) and especially debts or liabilities arising under a "Financial Services Contract" (which will include loans, securities and commodities contracts or a capital market arrangement).

The company must pay such PPMDs and debts incurred during the moratorium ("Moratorium Debts") that fall due during the course of the moratorium and, if it fails to do so, the monitor is under a duty to terminate the moratorium by filing a notice at court. There is little point therefore in a company obtaining a moratorium without the consent and co-operation of its Financial Service Contract creditors.

SUPER PRIORITY

Under s 174A if the company enters an insolvency process within twelve weeks from the day after the moratorium ends (including a scheme of arrangement or a Restructuring Plan) a new priority order of payments is established. Holders of Moratorium Debts, including any new financing that the company has obtained during the moratorium ("New Finance") and some PPMDs (together, "Super Priority Debts") will achieve priority in the order of payments from the estate of the insolvent company in an apparent exception to pari passu principles. The legislation does not prevent a connected party (eg a director or parent of the company) from creating or holding such debts.

The effect of the legislation is that where a moratorium is followed by, for example, an administration of the company, in any subsequent distribution Super Priority Debts will be paid in priority to all other debts, including preferential creditors and even the administrator's own remuneration. Super priority status only relates to the relevant Super Priority Debt. If an existing lender for example were to provide New Finance, the status of its existing debt and relative ranking except in relation to the Super Priority Debt remains unchanged.

Note that following late amendments to CIGA as part of the enactment process, under sub-para 4 of s 174A, any Financial Service Contract creditor with a PPMD that accelerated its debt during the moratorium is excluded from having super priority status. This carve out of accelerated debt is to ensure that such creditors are not motivated to "game the system" and force the company into insolvency to enjoy the benefits of super priority.

EFFECT ON SECURED CREDITORS

The most striking effect of this is that Super Priority Debts will be repaid in priority to existing debt that has not yet fallen due in a departure from well-established principles. Holders of fixed charge assets will be unaffected as those assets do not form part of the debtor's estate. However, debt secured by a floating charge will rank below any Super Priority Debt, unless that floating charge debt happens to fall due during the moratorium.

Although the company can create new security in the moratorium with the consent of the monitor there seems little point in doing so in relation to any New Finance as the Super Priority Debt will outrank both existing security and any new security that is created to the extent that it is secured against a floating asset. Priority as between security interests will continue to be determined according to the date of registration of the relevant security. The company would not in any case be able to create security over any asset over which a fixed charge already exists.

PRIORITY AS BETWEEN HOLDERS OF SUPER PRIORITY DEBT

Except for the stated priority of the Official Receiver acting in any capacity at sub-s 2(a), s 174A does not set out any order of priority as between Moratorium Debts and PPMDs and any order of priority within those categories. Sub-section 5 provides for rules to be introduced to create a ranking in cases where there are insufficient assets to pay them all, but as yet no such rules have been introduced.

Conjecturing on any future rules, by analogy with processes already governed by IA86 and the Insolvency Rules 2016, it is likely that the monitor's remuneration would be first in the order of priority as between all Super Priority Debts and it is unsurprisingly listed first at sub-s 3 amongst the sub-categories of PPMD. Debts due to Financial Service Contract creditors are listed below all other categories of PPMD and are possibly therefore considered lower in priority to the other categories of PPMD, which appear to be closer in nature to, for example, the expenses of an administration.

The priority as between Moratorium Debts and Financial Service Contract PPMDs and as between themselves is likely to depend on the contractual status of their respective obligations. For example, the provider of New Finance will likely seek to ensure to agree that the New Finance is repayable in priority to Financial Service Contract PPMDs. As discussed above where a Super Priority Debt creditor holds a floating charge, that charge's creation date will be irrelevant to determination of distributions where there is a deficiency with regard to Super Priority Debt.

POTENTIAL IMPACT ON FLOATING CHARGE HOLDERS

Potential distributions available to floating charge holders have already recently been "squeezed" due to:

- an amendment to IA86 in April 2020, increasing from £600,000 to £800,000 the "prescribed part" or portion of the company's assets that would otherwise be available to a floating charge holder that are set aside for unsecured creditors; and
- the Finance Act 2020 (entered into force on 1 December 20020), which confers secondary preferential creditor status on HMRC with respect to certain debts.

The creation of Super Priority Debt status is a third legislative threat to floating charge realisations within a year. Prospective lenders may in future "price in" the impact of these changes to the cost of lending.

In practice, a Financial Services Contract creditor who holds a floating charge may simply make it a condition of its support for a moratorium that either:

- the company agree to modify its existing arrangements to ensure that the debt to which its floating charge is subject falls

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due during the moratorium; or
- that the creditor itself is permitted to provide New Finance.

In either scenario the creditor will ensure Super Priority status for itself in some capacity.

COMBINATION OF MORATORIUM WITH RESTRUCTURING PLAN

There is obvious benefit to an existing secured creditor of providing New Finance to a company in a moratorium. As well as the potential to take greater control of the company's direction, another particular benefit may be that provision of New Finance may be a factor in forming a separate class from other senior creditors where the company subsequently seeks to implement a scheme of arrangement or Restructuring Plan.

A Restructuring Plan scenario is particularly interesting in this regard since it can, in certain circumstances, be imposed on in-the-money creditors of other classes via a "cross-class cramdown". There is likely therefore to be considerable advantage to a creditor being able to form its own class, not for the purposes of blocking a Restructuring Plan, but rather forcing it through.

CONCLUSION

The exclusions of the types of company eligible for a moratorium are likely to restrict its scope amongst larger companies, especially those with capital markets arrangements. The fact that the company must repay Financial Service Contract debts falling due during the moratorium is also likely to make the moratorium of questionable value to some debtors, notwithstanding the effect of a lender accelerating its debt.

In respect of larger companies that are eligible, the standalone moratorium will likely be seen as part of a carefully co-ordinated consensual restructuring process to facilitate a Company Voluntary Arrangement, scheme of arrangement, or Restructuring Plan. However, the super priority status afforded by the moratorium process creates something of an opportunity for creditors to differentiate themselves by providing New Finance and in some circumstances potentially gain an advantage over their peers. ■

Further Reading:

- Capital market transactions and the standalone moratorium procedure (2020) 11 JIBFL 753.
- Corporate Insolvency and Governance Act 2020: a balancing act (2020) 9 JIBFL 629.
- LexisPSL: Banking & Finance: The new Standalone Moratorium procedure under CIGA 2020.