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The First Contested UK Moratorium Procedure

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At a Glance

The English court ruled for the first time on a contested moratorium process, clarifying a critical aspect of the procedure regarding the requirement for monitors to terminate a moratorium if they think that the company is unable to pay certain debts. The case involved the Corbin & King group which operates well-known restaurants including the Wolseley and the Delaunay.

The moratorium process has been little-used — just 15 cases since its introduction in June 2020, which contrasts sharply with the Government's "best estimate" of 1,250 cases per annum.[1] This is perhaps owing to the limited nature of the payment holiday afforded by the moratorium and various eligibility exclusions, among other matters.

This case is a notable example of a successful use of a moratorium to constrain secured creditor action. The judgment illustrates:

- the ability of a third party to advance new funding to a company within a moratorium in order to discharge critical debts and rescue the company as a going concern;
- a degree of latitude afforded to monitors' judgment as to whether to terminate the moratorium (as they are so required, if they think that the company is unable to pay certain debts to which the payment holiday under the moratorium does not apply, i.e., that are required to be paid). However, there are limits: if the company does not have the immediate prospect of receiving third party funds, or own assets capable of immediate realisation, sufficient to discharge those debts to the creditor's relevant satisfaction, then monitors must terminate the moratorium; and

- the “balance of harm” exercise that the court will conduct when considering whether to exercise its discretion to terminate a moratorium.

Background — moratorium process

The introduction of the stand-alone moratorium process was intended to introduce greater flexibility into the insolvency regime, by allowing the company in financial distress a breathing space in which to explore its rescue and restructuring options free from creditor action.

The commencement of a moratorium requires (i) a statement from the directors that, in their view, the company is, or is likely to become, unable to pay its debts and (ii) a statement from a proposed monitor that, in their view, it is likely that a moratorium would result in the rescue of the company as a going concern.

During a moratorium, a monitor must “monitor the company’s affairs for the purpose of forming a view as to whether it remains likely that a moratorium will result in the rescue of the company as a going concern”. They *must* terminate the moratorium if they think that (i) the company is unable to pay any pre-moratorium debts for which the company does not have a payment holiday during the moratorium or (ii) the moratorium is no longer likely to result in the rescue of the company as a going concern, among other grounds.

Critically, a company within a moratorium does *not* have a payment holiday for “debts or other liabilities arising under a contract … involving financial services”, which is defined to including lending. As the judge noted, the exclusion of finance debts from the “payment holiday” effects of the new moratorium process is “somewhat surprising”, but is clear from the legislation.

Background — facts

Minor Hotel Group (MHG), an associate of the Corbin & King group’s parent company (TopCo), had lent TopCo a secured loan, with secured guarantees granted by the operating companies (OpCos).

TopCo failed to repay the loan at maturity; MHG served a notice of demand 19 months later. A credit fund (the Bidder) offered to acquire interests in TopCo and the OpCos for an amount equal to the loan; this bid was rejected. The directors of the OpCos commenced the standalone moratorium procedure, appointing monitors. MHG made demands against each of the OpCos under their guarantees and appointed administrators in respect of TopCo.

The Bidder then made a further offer to TopCo's administrators to purchase the OpCos. MHG put TopCo's administrators on notice that they would pursue claims against the administrators if they were to implement this second bid. MHG also applied to the court for orders terminating the moratoria, on the basis that the monitors' failure to terminate the moratoria had unfairly harmed MHG's interests; the monitors resisted this application. MHG also made clear it wished to appoint administrators to the OpCos (but was constrained from doing so owing to the moratoria).

It was common ground that the OpCo guarantees were contracts involving financial services and therefore outside the "payment holiday" offered by the moratorium — i.e., the OpCos remained bound to pay under the guarantees when called, notwithstanding the moratoria. The OpCos could not meet the demand for payment.

The monitors did not terminate the moratoria. They gave evidence that they considered it likely that the OpCos would be rescued as a going concern and that the loan would be repaid in full in the reasonably near future.

Judgment

Standard for monitors' decision-making — "irrationality" threshold

Monitors' duty to terminate a moratorium arises once the monitor "thinks" that a particular state of affairs exists — i.e., Parliament intended a degree of latitude to be given to monitors. Accordingly, a decision will only be open to challenge if it was made in bad faith or was clearly perverse, in the sense that no reasonable monitor could have reached it. (This was common ground between the parties.)

"Commercially realistic" approach when determining inability to pay

The court held that the statutory test for monitors, in considering whether the company is unable to pay relevant debts, involves a "flexible and commercially realistic approach taking into account the circumstances as a whole", including the Bidder's offers — at least insofar as liability arising under guarantees was concerned. It was appropriate for the monitors to take into account TopCo's ability to discharge the loan and thereby relieve the OpCos of their liability under the guarantees.

Timing of debts/inability to pay

The court held that the question to be addressed by the monitor is whether the company "is unable" to pay a presently due pre-moratorium debt in respect of which it does not have a payment holiday. It distinguished this from the question of whether the company "is unable to pay its debts *as they fall due*" for the purposes of the cash-flow insolvency test[2] (in which the italicised wording introduces the element of futurity).

In light of this judgment, we suggest the following formulation when considering whether a company "is able" to pay a pre-moratorium finance debt that has fallen due:

- first, the company should be considered "able" to pay debts that are reasonably likely to be paid within five business days (which can therefore be disregarded[3]);
- then, consider whether the company can pay the debt itself out of current cash resources;
- then, consider whether the company has (i) the immediate prospect of receiving third party funds or (ii) owns assets capable of immediate realisation. What is an "immediate" receipt or realisation is a matter of commercial judgment for the monitor, as to which the monitor is allowed considerable latitude (though bearing in mind that anything over five business days requires specific assessment). Consideration should also be given to whether the debt will be discharged by co-obligors.

Monitors' decision to resist termination of moratoria

The court held that this decision "fell on the wrong side of the line" as being one which no reasonable monitor applying the correct test could have reached. It was "obvious" that the TopCo administrators could not *immediately* accept the Bidder's then-offer to purchase TopCo's interests in the OpCos but would instead be bound to conduct a marketing exercise and open sale. That process made an immediate realisation impossible.

In contrast, a later revised offer of interim funding sufficient to replace the loan *could* properly cause the monitors to "think" that the loan was able to be repaid. In fact, following the hearing, this funding was advanced and the loan repaid.

Court’s discretion to terminate moratoria

The parties agreed that the court had a discretion to terminate a moratorium, if it reached the view that the monitors ought to have done so.

Conducting a balancing exercise by reference to the facts as at the date of the hearing, the court assessed the harm suffered by MHG *as creditor* to be less significant than the harm suffered by the OpCos if MHG was able to commence insolvency proceedings against them — noting that (i) each OpCo was trading successfully and (ii) there was an immediate prospect of the loan being repaid and the OpCos’ guarantee liabilities evaporating.

Accordingly, the court had decided to allow the moratoria to continue. The loan was actually then repaid, as noted, and the OpCos rescued as going concerns.

Separately, MHG also sought an injunction to restrain repayment of the loan, arguing that accepting the Bidder's offer would breach a shareholders' agreement. However, this application was unsuccessful.

The judgment is here.

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1. Paragraph 6.11 of The Insolvency Service’s Impact Assessment in respect of the Corporate Insolvency and Governance Bill, April 2020. ↩

2. In section 123 of the Insolvency Act 1986. ↩

3. In accordance with rule 1A.24 of the Insolvency Rules 2016. ↩

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