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Client Alert Commentary

Latham & Watkins Litigation & Trial and Restructuring & Special Situations Practices

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Relief for UK Companies: Court Protects Against Winding-up of Companies Due to COVID-19

The Court based its decision on the clear policy implications of the yet-to-be-enacted Corporate Insolvency and Governance Bill.

The COVID-19 pandemic has had a debilitating impact on companies and particularly commercial tenants in the UK, especially in the retail and hospitality industries. With stores and premises closed, these businesses have suffered and continue to suffer. Many commercial tenants have sought rent and service charge deferrals and have successfully worked with their landlords and suppliers to weather the pandemic.

Some landlords, however, have not been willing to accept the COVID-19 pandemic, and the measures taken by the government in response, as a valid reason for failing to pay rent. As a result, from the beginning of the pandemic, it was clear to the government that measures were required to support the retail and hospitality sectors. The Coronavirus Act quickly passed Parliament and came into force on 25 March 2020. Specifically, Section 82 of the act prohibited forfeiture and peaceable re-entry for non-payment of rent in respect of relevant business tenancies in the period 25 March 2020 to 30 June 2020 (or longer if the government were to deem it necessary).

The Coronavirus Act did not, however, deal with alternative methods used by landlords to collect rent, such as via statutory demands and threatened winding-up petitions. This exposed a problem: whilst the majority of landlords have been supportive of commercial tenants, some landlords have pursued more challenging debt collection tactics. Such behaviour has prompted a further legislative response from the government to bar these tactics and allow companies more generally to restart their businesses (and, if required, to promote restructuring efforts in order to preserve going concern value for stakeholders and, most importantly, the jobs of employees). The government began to promote this proposed legislation in April 2020.

The Corporate Insolvency and Governance Bill

On 23 April 2020, the Business Secretary, on behalf of the government, announced a suite of measures relating to commercial landlords and tenants, including measures to protect high street shops and other companies “from aggressive rent collection”. The government announcement noted that the “majority of landlords and tenants are working well together to reach agreements on debt obligations, but some

landlords have been putting tenants under undue pressure by using aggressive debt recovery tactics". The announcement described such practices as "unfair".

On 25 April 2020, the government stated that it would "temporarily ban the use of statutory demands (made between 1 March 2020 and 30 June 2020) and winding-up petitions presented from 27 April through to 30 June, where a company cannot pay its bills due to coronavirus".

The press release accompanying the 23 and 25 April 2020 announcements included, in its "Notes for Editors", the comment that:

"Under these measures any winding-up petition which claims that the company is unable to pay its debts must first be reviewed by the court to determine why. The court will not permit petitions to be presented or winding-up orders made where the company's inability to pay is the result of COVID-19" (emphasis added).

On 20 May 2020, the government introduced the Corporate Insolvency and Governance Bill (the Bill) to Parliament. The Bill proposes a range of measures which collectively represent a significant reform to the United Kingdom's legislative framework in relation to insolvency, including putting the measures announced on 23 and 25 April 2020 on a statutory footing. The government's announcement on 20 May 2020 stated that the Bill's main purposes included:

"to temporarily suspend parts of insolvency law to support directors to continue trading through the emergency without the threat of personal liability and to protect companies from aggressive creditor action" (emphasis added).

Having had its first reading on 20 May 2020, the Bill was discussed in Parliament on 3 June 2020. The government's clear intent is that the Bill should become law as quickly as possible to provide speedy relief (including retrospective relief) to companies (including commercial tenants).

Re: A Company (Injunction to Restrain Presentation of Petition)[1]

The Court has been forced to consider the Bill in the context of a number of decisions relating to threatened winding-up petitions. It gave particularly clear guidance in this particular decision, in which Latham & Watkins represented the applicant.

This matter related to an application by a commercial tenant to restrain its landlord's presentation of a winding-up petition. The landlord had e-filed a winding-up petition in relation to the company on the basis of unpaid rent / service charges. However, the landlord had not yet paid the court fee, so the petition had not yet been presented to the company. Given that, in the absence of an injunction, the landlord could present the petition at any time, the company sought urgent relief. The Court noted that the rationale behind the non-payment was that the company was a high street retailer that had been forced to close the relevant premises in accordance with the instructions from the government in response to the COVID-19 pandemic.

As the Court explained in its decision, the grounds for the application were that: (a) a winding-up order in this case would be harmful to the interests of the creditors generally and would confer no benefit on the proposed petitioning creditor (that is, the landlord); and (b) that the petition was bound to fail, was brought for a collateral purpose, and was an abuse of the process of the court. However, the main focus of the application was the impact of the Bill.

Regarding the Bill, the judge decided that:

a) If the provisions of the Bill were enacted in their present form, then their effect would be clear, and further, that the policy behind the relevant provisions of the Bill was self-evident

b) If the Bill became law, a court would have to ask itself whether the COVID-19 pandemic had had a financial effect on the relevant company before the presentation of a winding-up petition, and if that were held to be the case, then the court could only wind up the company if the court were satisfied that the facts on which the petition was based would have arisen even if the COVID-19 pandemic had not had a financial effect on the company

c) There was a strong case in this matter that the COVID-19 pandemic had had a financial effect on the company before the presentation of the petition and, further, that the facts on which the petition would be based would not have arisen if the COVID-19 pandemic had not had a financial effect on the company

d) The presentation of a petition that would ultimately fail would nonetheless have a seriously damaging effect on the company

e) Relying on *Hill v C A Parsons*,[2] *Sparks v Holland*,[3] and *Travelodge Ltd v Prime Aesthetics Ltd*[4] (the latter of which is a recent case in which the facts were essentially the same as this one), "when the court is deciding whether to grant relief and, in particular, relief which involves the court controlling or managing its own processes, that it can take into account its assessment of the likelihood of a change in the law which would be relevant to its decision"

f) The court is not powerless to prevent its procedures being used otherwise than for the purpose of obtaining a winding-up order but for the purpose of, or at any rate with the effect of, causing serious damage to the company

g) "The grant of an injunction to restrain the presentation of the petition is powerfully supported by the clear policy objectives" of the Bill and that he would therefore grant the injunction sought

Even though the hearing was ex parte, the judge decided that he ought to give the judgment in open court, as the points which were argued in this case might arise in other cases in the near future.

We note that whilst the written judgment did not touch on this specifically, the Bill (once enacted into law) will also prevent the presentation of a winding-up petition on or after 27 April 2020 on the basis of a statutory demand served between 1 March 2020 and the later of 30 June 2020 or one month after the act is in force (without the need to satisfy the "financial effect" test).

Final remarks

This decision shows that the Court understands the pressure being faced by businesses and will protect them against some of the repercussions of COVID-19. The Court will act proactively to prevent a winding-up order (or its petition) that would cause serious damage to a company suffering from the financial effects of the pandemic or on the basis of a statutory demand served during the relevant period.

From the perspective of commercial tenants, the Coronavirus Act did not give them enough protection to weather the effects of the lockdown and the evaporation of consumer confidence and spending, putting companies at risk of liquidation and widespread permanent job losses, despite the availability of

employee, tax, and (for some businesses) bridging loan schemes. The Bill includes measures to provide urgent incremental help, and the Court has now made clear that it will use the Bill, even before it becomes an Act, to protect businesses in relevant circumstances, given that the policy represented in the Bill is clear.

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Endnotes

[1] [2020] EWHC 1406 (Ch).

[2] [1972] Ch 305.

[3] [1997] 1 WLR 143.

[4] [2020] EWHC 1217 (Ch).