Look out for more Part A1 moratoriums

The recently reported decision of ICC Judge Greenwood in *Grove Independent School Ltd, Re* [2023] EWHC 2546 (Ch) (**Grove**) provides some clarity on the test to be applied by the court in deciding whether to exercise discretion to grant an order for a Part A1 moratorium. In this case, the company in question was also faced with a winding-up petition, presented by His Majesty's Revenue & Customs (**HMRC**).

It is fair to say that the least favoured of the new insolvency procedures/restructuring tools introduced by the Corporate Insolvency and Governance Act 2020 (**CIGA**) is the moratorium under Part A1 of the Insolvency Act 1986 or "standalone moratorium". Criticisms of the moratorium range from its protections being for too short a period, it being too expensive for the small or medium-sized enterprises (**SMEs**) it was meant to protect, and it being difficult to implement due to its overly restrictive eligibility criteria. However, the case of *Grove* may offer the moratorium a new lease of life that was anticipated under CIGA. It is difficult to argue against the potential benefits of the moratorium as a useful English law corporate rescue tool in appropriate circumstances. We consider *Grove* below and comment on how the decision may influence the use and application of the moratorium going forward.

How does the moratorium work?

The moratorium provides struggling companies a short period of protection (initially 20 business days) from creditor enforcement action, during which they can seek advice, negotiate with creditors and agree plans for their rescue as a going concern. This "breathing space" is designed to give companies a better chance of continuing as a going concern.

The case synopsis

The moratorium application was made by the directors of an English incorporated company, the Grove Independent School Limited (the **Company**). The application was supported by a witness statement from the school's principal, Ms Birkin. The independent school had 200 pupils aged from three months to 13 years old and 50 members of staff, and the judge noted that the Company "fulfils an important social function". However, the Company was another victim of the Covid pandemic and, on 18 January 2023, HMRC presented a winding-up petition for various arrears in the sum of £655,971.90. Within a week of the petition being advertised, the Company had filed an urgent application seeking a moratorium and came before ICC Judge Greenwood on 24 February 2023. The application was made because the Company needed the protection of a moratorium to allow it to trade while looking to secure a refinancing of its debts. The Company had instructed FRP Advisory Trading Ltd (**FRP**) to assist with such refinancing. Notably, the Company's only secured creditor, its bank, was supportive of the application and agreed to keep its current facilities in place during the moratorium. HMRC was notified of the application but did not appear at the hearing.

As noted by the judge, before Grove was heard, there was no reported judgment as to the test to be applied by the court on a moratorium application. It is therefore worth noting what the court decided the test should be. The initial gateway to pass is for the applicant to be an "eligible company" under Part A1. If this is established (by reference to Schedule ZA1 to the Act), the court may exercise its discretion to grant an order. In *Grove*, as the Company was subject to HMRC's winding-up petition, its application had to be made under section A4 of the Act. The judge held that, under section A4(5), the court's discretion was narrowed such that it may only make an order for a moratorium if such moratorium "would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up without first being subject to a moratorium". Crucial in assisting the court to reach this conclusion is the statement from the monitor that, in its view, the moratorium "would result in the rescue of the company as a going concern".

Focusing on the wording of section A4(5), the judge stressed that the court's discretion could only be exercised to grant a moratorium if it was satisfied that, on the balance of probabilities, the imposition

of a moratorium would result in a better outcome for creditors as a whole than would be achieved if the company entered liquidation without a prior moratorium. Notably, the judge commented on the importance of the monitor's statement, confirming that "if the view of the proposed monitor is accepted, the court is likely to accept that it has a discretion".

The judge went on to state that there is a clear distinction between the test applied on an application for an administration order and that which applies to a moratorium. The threshold of the test appears to be lower for administration and requires the court to be satisfied that achieving the purpose of administration is "reasonably likely". For the court to exercise its discretion to grant a moratorium, it must be satisfied that "the company's rescue is likely, not reasonably likely" and that a moratorium "would be more likely than not to achieve a better outcome than would be likely in a liquidation – not that it might do so or enjoys a real prospect of doing so".

By reference to the evidence, including both the witness statement of Ms Birkin and the statement of the proposed monitors from FRP, the judge was satisfied that the likely outcome of a moratorium was that the Company would be rescued as a going concern. Furthermore, the alternative to liquidation for the Company was considered "extremely damaging" for creditors, with closure of the school and "chaos" for parents and children, plus the loss of employment for the 50 members of staff. The judge was satisfied that the Company needed the breathing space afforded by the moratorium, commenting that in seeking the refinancing under the protection of the moratorium and continuing to trade (namely, keeping the school open) under the supervision of the monitors was "precisely the sort of case which these new provisions [moratoriums] were designed to meet". Consequently, the judge made the order granting the moratorium.

As a result, the test in *Grove* can be broken into three parts, namely:

- a moratorium may be granted in relation to an eligible company;
- in exercising its discretion, the court must be satisfied that a moratorium would achieve a better result for the company's creditors than would be likely if the company were wound up without first being subject to a moratorium;
- to be satisfied with this, the court must assess the scenario of the company with the imposition of a moratorium and the alternative scenario of the company entering insolvent liquidation. If, on the balance of probabilities, the outcome would be better for the company with a moratorium rather than without, the court may grant one.

The impact of *Grove* and general considerations for moratoriums

The insolvency and restructuring community will welcome the clarity brought by *Grove* in circumstances where moratoriums have not been that well regarded, nor that well used since their introduction in June 2020 by CIGA.

According to the Insolvency Service's recorded statistics published on 15 December 2023, only 47 moratoriums were obtained up to 30 November 2023. *Grove* may lead the way with more companies considering the benefits of a moratorium, particularly when faced with a winding-up petition. While use of moratoriums is not prolific, it is clear from the latest statistics that liquidations continue to rise (November 2023 recorded 359 compulsory liquidations, which is 22% higher than November last year) and, in the right circumstances, companies may seek the breathing space afforded by a moratorium to exhaust all avenues to refinance or find other ways to remain a going concern, while under the protection of a moratorium and guidance of a monitor. It is noteworthy in *Grove* that the Company's secured creditor was supportive of the application and that is one element that could be

problematic for companies if they do not have the support of their secured creditors (as financial creditors are not bound by the stay pursuant to a moratorium).

The post-implementation review of CIGA carried out by the Insolvency Service and published in late June 2023 stated that there are some areas of concern for moratoriums. For example, it notes that if a moratorium is pursued but the company is not rescued, this may have a reputational risk of acting as a monitor (not least due to potential criminal penalties for actions taken whilst acting as one). Consequently, it seems that insolvency practitioners who fed into the Insolvency Service review identified the role of monitor with some trepidation, which itself would lead to the use of moratoriums being diminished. Another key issue identified with the usefulness of moratoriums is the absence of a stay on actions by financial creditors. In circumstances where most SMEs have a single main financial creditor (usually their business bank), the success or failure of a moratorium largely rests on the support of the company's financial creditor. One encouraging aspect of the Insolvency Service's findings is that, when used, a moratorium resulted in more than half of the companies being rescued as a going concern and more than a quarter in the company entering a company voluntary arrangement. When compared to the outcomes for companies following administrations, moratoriums recorded a significantly greater proportion of positive outcomes.

Closing remarks

Since its introduction by CIGA, the Part A1 moratorium has received mixed reviews, arguably more negative than positive. In the early days, academics and practitioners lambasted its introduction, but from more recent conversations with practitioners across the spectrum there seems to be a warming towards them. However, the consistent theme is that the tool is useful only in limited and specific circumstances – this has been its main weakness, but perhaps now its real strength too. As a case such as *Grove* demonstrates, where the company is viable and requires only a short period of breathing space to get its affairs in order to continue as a going concern, the moratorium may be exactly what is needed. Another limiting factor is the type and size of company to which the moratorium is most suited (clearly aimed at the SME category). ICC Judge Greenwood also made reference to the important social function that the Company played in *Grove* (no fewer than three utterances of this in his short judgment), so it would be remiss to think that the type of business a company carries out will not also play a part when the court exercises its discretion to grant or deny a moratorium. Another key component is the support of the company's secured lender, without which a monitor would be hard pressed to continue its belief that the moratorium would in fact result in a better outcome for creditors than would be achieved without it.

Do please reach out to any of the Dentons RIB team members for further information and discussion about the Part A1 moratorium.