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The Rt. Hon. the Baroness Taylor of Bolton
Constitution Committee
House of Commons
London
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19th June 2020

Dear Baroness Taylor,

I am writing to respond to the Select Committee on the Constitution (the "Committee") in relation to its report on the Corporate Insolvency and Governance Bill 2020 (the "Bill") published on 12 June.

I am grateful to the Committee for its detailed consideration of the Bill, particularly given its accelerated passage through Parliament.

I have carefully considered the views of the Committee, and of the many noble Lords who have contributed to the debate as the Bill has proceeded through Second Reading and Committee, and I hope that my response will be able to resolve the Committee's concerns.

**Fast-tracking, permanent provision and sunset clauses**

*Committee's Recommendation*

We recommend the permanent provisions in the Bill are subject to a sunset clause in line with the amended procedure for the temporary measures that we propose below.

*Government response*

All of the permanent provisions contained in the Bill, including the moratorium, have not just been developed in the short time since COVID-19 first appeared, but have been the subject of a considerable period of consultation and engagement dating back to 2015. This process included the then Government's public consultation on its 'Review of the Corporate Insolvency Framework' in 2016, and an extensive period of engagement since then with a wide range of stakeholders.

In summary, the measures have been developed and refined over several years. There has also been widespread pressure to introduce them as early as possible, to ensure the UK keeps pace with the restructuring reforms introduced in other important jurisdictions (such as Singapore and a number of EU countries) and remains one of the top restructuring hubs in the world.

I agree that prior consultation does not itself justify fast-tracking measures. However, permanent introduction of these measures will provide much-needed certainty for business around the tools available to support them through the pandemic emergency, bearing in mind that the restructuring process in more complex cases can last many months. We will monitor information and feedback from stakeholders and the industry on the effectiveness of the new insolvency procedures. Delegated powers included in the Bill will allow us to make adjustments where necessary to ensure the measures are effective.

*Committee's Recommendation*

The Delegated Powers and Regulatory Reform Committee recommended that the clause 39 power be limited such that the temporary provisions of the Bill can be extended only if Secretary of State is satisfied that the immediate effects of the COVID-19 pandemic require it. We agree.

*Government response*

I have considered the recommendation from this Committee and from the Delegated Powers and Regulatory Reform Committee relating to the Bill's clause 39 power, and I agree. The power allows for changes to the duration of the Bill's temporary provisions. We will add the condition recommended so that the power can only be exercised where an extension is required to deal with the effects of COVID-19.

*Committee's Recommendation*

We also recommend the power in clause 39 to extend the temporary measures in the Bill is subject to a sunset provision or limited in the number of times it may be used.

*Government response*

In accordance with the Committee's previous recommendation, the clause 39 power will be limited so that it can only be used to deal with the effects of COVID-19. We currently have no clear understanding of how long the effects of COVID-19 might last, but the amendment already accepted will have the effect of providing an appropriate sunset for the power.

**Retrospective Provision**

*Committee's Recommendation*

We recommend that the Bill be amended such that the retrospective effect of clause 10 does not completely protect the actions of company directors taken between 1 March 2020 and when the Act comes into force. Creditors should not be precluded from taking legal action against directors for wrongful trading during that period if they can discharge any burden of proving that the instance of wrongful trading has no connection to financial distress induced by the pandemic.

We consider that it would be open to the Government to provide for a retrospective presumption in favour of company directors during the pandemic. However, it should

be rebuttable where it can be shown that the facts alleged in the wrongful trading claim would have arisen even if the coronavirus had not had a financial effect on the company.

*Government response*

The policy aim behind the suspension of personal liability is to remove wrongful trading as a barrier to the continuation of trading of companies during the period of economic downturn due to the COVID-19 crisis. The measure seeks to avoid a situation where the directors choose to shut down companies that would in fact have been viable rather than face the risk of subsequently being subject to legal proceedings for alleged wrongful trading. A retrospective presumption in favour of company directors in the course of proceedings for winding-up would not cure the problem this measure seeks to address. It would result in directors still facing the possibility of complex legal proceedings and the risk of personal liability if those proceedings were not resolved in their favour. Faced with that risk many directors may still adopt a precautionary approach and choose to close the company. If that was replicated across the economy it would result in significant additional loss of employment and damage to the economy as a whole.

The Committee has rightly noted that retrospective legislation should only be enacted as an exception. We agree. We consider however that this is an exceptional case. Liability for wrongful trading arises where a director ought to have known that there was no reasonable prospect that a company would avoid going into insolvent liquidation. In the ordinary course of events it would be reasonable to expect a director to assess whether a company was rescuable. There is however no precedent a director could rely upon to assess a company's future prospects in circumstances such as the present where entire sectors of the economy have been shut down, by force of law, for what was initially an indeterminate period.

Businesses suffering difficulties due to the crisis are likely to have started to suffer such impacts long before the legislation commences. Indeed, many companies may already have reached the stage at which their directors need to consider whether to cease to trade, in order to avoid personal liability. When an application is made to court for a declaration against a director, a point in time is pinpointed as being the time at which trading should have ceased and any liability imposed on the director will be based on losses incurred from that date. Given that there is a possibility that the outcomes which this legislation seeks to prevent are already occurring, retrospective effect is necessary in order that this legislation achieves its publicly-stated policy objective. Had this measure not been made retrospective to a date which corresponded broadly to the start of the COVID-19 crisis, directors would instead have been left with the possibility of future provision removing the liability for wrongful trading. An assurance that directors would not at some future point face liability in respect of future conduct would, however, have provided no comfort to those directors who were concerned that they may, as a result of the crisis, already have been exposed to liability.

In response to these urgent concerns, the Government announced its intention to legislate to suspend personal liability for wrongful trading on 28 March, with effect from 1 March.

The temporary suspension of personal liability will not mean that directors will be able to avoid other protections afforded to creditors and the wider business community. Directors must continue to comply with their normal duties as clearly set out in the Companies Act, and various other remedies remain available where directors do not meet acceptable standards of behaviour. For example, fraudulent trading provisions provide both a civil recovery remedy as well as a criminal element where trading is continued with intent to defraud creditors. We believe that the provisions as drafted strike the right balance in responding to this extraordinary crisis.

*Committee's Recommendation*

We recommend the Government set out its justification for the retrospective application of provisions in the Bill, including an assessment of their compliance with the rule of law.

*Government response*

There are five sets of provisions in the Bill with retrospective application: wrongful trading, statutory demands, winding-up petitions, AGMs and other meetings, and filing requirements.

As set out above, the temporary suspension of liability for wrongful trading is required to mitigate the effects of the COVID-19 emergency, and is a proportionate measure. There are safeguards against abuse in the form of other, unchanged elements of Company and Insolvency law. As I have also set out above, given the inevitable delay in drawing up legislation, it was essential to give public assurance that these provisions would have retrospective effect in order for them to be able to have their intended effect on directors' confidence in continuing to keep their companies going.

The policy aim behind the statutory demand and winding-up petition measures is to prevent creditors, who may themselves be under financial pressure, from jumping to the use of what are intended to be mechanisms of last-resort when many of the debts due for payment will be impossible to settle because of the effects of the pandemic. The Government is very concerned to encourage creditors to show forbearance in this extraordinary situation and to seek to reach a practical agreement with the debtor which allows both to survive. However, we are aware that there are cases where creditors have been acting precipitately against otherwise viable companies, and it has been necessary to take steps to prevent that and avoid unnecessary damage to the economy. The measure therefore seeks to achieve this while allowing debt recovery processes to proceed where the pandemic is not a factor. It has been necessary to provide for the measures to become operational from the date of announcement, since otherwise some creditors would have been incentivised to rush in statutory demands and present winding-up petitions to pre-empt the announced change in the law. The outcome would have been to encourage the very behaviour these measures seek to prevent and it would therefore have undermined the intended effect of the policy.

The Government therefore announced its intention to change the law with retrospective effect on 25 April 2020. The legislation has been made retrospective from the start of 27 April, which was the start of the next working day. We expect that

the majority of creditors will have acted responsibly and not placed any winding-up petitions after that point if the company's difficulties have been caused by the pandemic.

It is possible that a small number of creditors may not have acted responsibly, and may have sought to take advantage of the inevitable delay between the policy being announced and Parliament being able to consider and enact the legislation needed to give effect to that policy. In those cases, it is right that the affected company's position is restored and, if a creditor has acted irresponsibly, that they should in certain cases be required to contribute to the costs of undoing the inappropriate action they have taken.

Clause 36 of the Bill and Schedule 14 to it are two other related provisions of the Bill that have retrospective effect. Their effect relates to actions that a company may or may not have taken since 26 March this year in respect of the holding of AGMs and accounts meetings. They consider both the timing of those meetings and other practical arrangements for holding them in the context of the coronavirus regulations passed in the four nations of the United Kingdom.

The proposed legislation would in effect treat as valid meetings held by a company and resolutions passed at such meetings during the emergency period, and therefore before the new provisions come into force. It would also treat as valid a decision by the company to postpone a meeting beyond the deadline that would otherwise apply. If the meeting was held, this would have the effect of conferring validity to the meeting and the resolutions passed at that meeting, even though at the time they were held, and resolutions passed, they may not fully have complied with the legal requirements in the Companies Act 2006 and their constitutional documents, because they could not do so while complying with the temporary legal requirements on social distancing.

Retrospection is necessary to resolve the conflict between the two sets of legislation. Namely the restrictions in the Coronavirus Regulations with attendant criminal sanctions for non-compliance, and the requirement to hold an AGM and an accounts meeting by the applicable deadlines in the Companies Act 2006, which also contains attendant criminal sanctions for non-compliance. In practice these two meetings are often combined and precede the filing of accounts by the company. The accounts meeting deadline is also the accounts filing deadline and the Government wishes to continue to support the practices of combining the meetings and filing accounts after the accounts meeting.

Given the inevitable delay in drawing up legislation, it was essential to give public assurance that these provisions would have retrospective effect in order for them to be able to have their intended effect in enabling companies to deal with important matters which require valid resolutions to be passed; and to consider the accounts of the company with shareholders before they are filed.

The Government's stated aim is to do everything within its power to assist business in this challenging environment. The BEIS Secretary of State announced as part of that commitment that he would bring forward flexibilities to allow companies to overcome the tension between the Companies Act and coronavirus regulations. These flexibilities apply only in the time-limited window established by the revised statutory deadline for holding the AGM and for filing the accounts and therefore for

holding an accounts meeting. Until such time as the measures become law an ever-growing number of companies will be forced to postpone AGMs and accounts meetings to a point that breaches the Companies Act and risks the good governance of the company, or to deploy work-arounds within the existing legal framework which risk jeopardising the health and well-being of staff, shareholders and others by pushing the boundaries of conduct that is permissible under the Coronavirus Regulations.

*Committee's Recommendation*

We recommend that the Government considers measures to make the imposition of retrospective legislation strictly proportionate to the Bill's aims, rather than a form of punishment for those who exercised rights which were valid at the time. One option is to remove paragraph 7 of schedule 10. Another is to introduce powers enabling payment of compensation to those who suffered retrospectively imposed loss as a result of the Bill.

*Government response*

We do not consider that creditors who have been required to contribute to restoring a company to the position it was in prior to the presentation of the petition can be properly characterised as having suffered as a result of the retrospective application this measure. This aspect of the measure is concerned with a small number of creditors who (despite having other debt-enforcement mechanisms available to them) have nevertheless taken certain action specifically in order to "beat" the coming into effect of this measure in anticipation that the adverse consequence of a winding-up petition for the debtor will have crystallised prior to this Bill being enacted in a manner which cannot readily be undone. It is right that creditors who have knowingly sought to defeat Parliament's legislative intention in that manner (and noting in particular the significant adverse effects a winding-up petition produces for the debtor company) should potentially be required to contribute to remedying the adverse consequences of their actions. We would note in addition that the amount of any contribution required under paragraph 7 of Schedule 10 will be at the court's discretion and, for those purposes, the court will be able to ensure that it is proportionate in the circumstances.

**Delegated powers**

*Committee's Recommendation*

We agree with the Delegated Powers and Regulatory Reform Committee that the clause 18 power should be restricted. The Secretary of State should be able to lay instruments under the made affirmative procedure only if satisfied that the situation is urgent, and that Parliament would be unable to meet to consider the regulations before they needed to take effect.

*Government response*

I have listened to the recommendations of both Committees, and, having considered their concerns, as well as points raised by many noble Lords, I agree that restrictions should be put in place to limit the clause 18 power that enables the Secretary of State to temporarily amend corporate insolvency and governance legislation. We are

therefore adding a condition to this power, that the Secretary of State must be satisfied of the urgency of the situation before it is exercised.

*Committee's Recommendation*

We recommend clause 21 specifies how often the Secretary of State must review regulations made under clause 18 and that a report must be laid before Parliament on each occasion.

*Government response*

I have considered this recommendation, along with the views of other noble Lords, and it is right that Parliament should have oversight and scrutiny of new measures. All changes will be presented to both Houses, and will apply for a temporary period of a maximum of 6 months. As the Committee has noted, the Secretary of State has a duty to continually review temporary legislation made under clause 18 and to revoke measures if they are no longer needed, or amend them as appropriate.

*Committee's Recommendation*

We therefore recommend that clause 22 be amended such that the power in clause 18, which expires on 30 April 2021, is renewable only once, for up to a year.

*Government response*

I am grateful for this recommendation from the Committee and have considered it carefully. I am keen to ensure this power fulfils its purpose in enabling Government to support business through the unknown length of this emergency, while also being appropriately limited. We will add a limitation to clause 22 so that the expiry date cannot be extended beyond 2 years after Royal Assent.

I would like to thank the Committee again for their thorough scrutiny, and reassure them that we are doing all we can to ensure the powers in the Bill comply with constitutional principles and are proportionate and necessary to support UK businesses through this COVID-19 emergency.

**LORD CALLANAN**
Parliamentary Under Secretary of State for Business, Energy & Industrial Strategy