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Will I get paid and can I enforce?: Enforcement options for lenders

How do the Corporate Insolvency and Governance Act 2020, the Coronavirus Act 2020 and changes to the civil procedure rules impact on REF lenders' rights?

The Corporate Insolvency and Governance Act ("CIGA") received Royal Assent on 25 June 2020. The introductory text states that it is "An Act to make provision about companies and other entities in financial difficulty; and to make temporary changes to the law relating to the governance and regulation of companies and other entities". The temporary measures are in direct response to the difficulties that businesses are currently facing because of COVID-19; the permanent measures represent the culmination of government consultations over recent years to try and improve the options available for companies in financial distress.

In this note, we discuss the impact of the CIGA on REF lenders' existing loans and their enforcement options, as well as the effect of current provisions of the Coronavirus Act 2020 and relevant changes to the civil procedure rules in relation to possession proceedings.

The CIGA moratorium

The CIGA introduces a new moratorium to give companies and LLPs in financial distress time to consider a rescue plan. The new moratorium is designed to be a permanent change to the insolvency landscape, rather than one designed to last the duration of the COVID-19 pandemic.

There are a number of exceptions listed in the legislation, but it seems likely that the moratorium will be available as an option for many English companies, English LLPs and overseas companies in relation to which the English court has winding-up jurisdiction. The moratorium will initially last 20 business days (extendable to 40 business days, with further extensions available via the courts or by creditor agreement) and will be presided over by a monitor (a licensed insolvency practitioner who will be acting as an officer of the court).

The moratorium should have a less dramatic effect on financial creditors than it is likely to have on other creditors (such as trade creditors). The key reasons for this are set out below:

- **Borrowers should continue making payments of principal and interest:** A borrower in a moratorium enjoys no payment holiday for amounts due under financial contracts (whether historic or during the moratorium) and should therefore continue to make payments of interest and principal on its loans. Indeed, if the monitor thinks the company is unable to make these payments during the moratorium the monitor must bring the moratorium to an end.
- **Lenders can declare defaults and accelerate loans:** Lenders will still be able to declare events of default under their loan agreements during a moratorium. An event of default may even potentially be triggered by the act of a borrower entering into the moratorium itself. Although the CIGA introduces various prohibitions on the termination/amendment of contracts due to the occurrence of insolvency (so-called "ipso facto" provisions), these provisions seem very unlikely to apply to many REF loan agreements due to the operation of broad carve-outs for financial contracts and entities. The moratorium also does not prevent a lender from exercising a right to demand repayment following the occurrence of an event of default.

What action does the moratorium prohibit?

Even if a lender can accelerate its loan, certain consequential action which a lender could take against a borrower to recover its debt would be

curtailed while the borrower is in a moratorium. For instance, the following will be prohibited:

- Commencing insolvency proceedings.
- Enforcing security (other than security which is a financial collateral arrangement or where certain steps are taken with the permission of the court).
- Landlord's right to forfeiture without permission of the court.
- Instigation of legal proceedings, unless permitted by the court.
- Repossession of goods in the company's possession under a hire-purchase agreement.

In addition, during a moratorium the holder of a floating charge cannot give any notice to crystallise a floating charge or exercise a contractual right to serve a notice which would have the effect of restricting the disposal of property by a company. It is not uncommon for a lender to allow its borrower to continue operating its bank accounts until the occurrence of a default, following which the lender (or, in a syndicated transaction, the Security Agent) would serve notice on the account bank instructing that account bank to deal with the lender/Security Agent going forward. As it seems very likely that any security over such a bank account would be floating in nature, it seems likely that service of this type of notice would be prevented during the moratorium.

Nonetheless, it is worth noting that the monitor must bring the moratorium to an end if the monitor thinks that the company cannot satisfy its payment obligations (which will include both historic and current loan repayments). Once the moratorium ends, the lender's ability to enforce its security is reinstated.

What action can a lender take during the moratorium?

As noted above, a lender will not be prevented from declaring an event of default or accelerating a loan. In addition, despite the restrictions on enforcement of security, there is action which a lender can take to "get to cash" during a moratorium.

In common with the administration moratorium, the moratorium under the CIGA does not prohibit the exercise of contractual set-off rights. This could benefit a lender which also holds its borrower's bank accounts.

The restrictions on enforcing security also do not apply to security created under a financial collateral

arrangement (typically being security granted by a corporate over shares or cash).

REF lenders commonly take security over shares in a holding company of the SPV which owns the property being financed. This can provide a REF lender with an alternative manner of enforcement: instead of selling the property, the lender may instead be able to sell the shares in the SPV which owns the property.

If this share security qualifies as a financial collateral arrangement, the relevant regulations also allow the security holder to take advantage of a remedy called "appropriation". This remedy would entitle the security holder to take outright title to the shares without the need to obtain a court order. However, the regulations make it clear that, when exercising this right of appropriation, the lender would need to value the financial collateral in accordance with the terms of the arrangement "and in any event in a commercially reasonable manner". Many security agreements do not dictate a detailed valuation methodology and the shares in the SPV that owns the property are unlikely to be listed. Therefore, while using the remedy of appropriation available for security over a financial collateral arrangement would be attractive in principle (as it is a convenient enforcement mechanism which will fall outside the moratorium enforcement restrictions), it might prove difficult in practice for a lender to be confident about whether it has valued the shares in a commercially reasonable manner.

Disposal of property free of charge

During a moratorium the company may, with the permission of the court, dispose of property which is subject to a security interest as if it were not subject to the security interest. On the face of it, this is a concern for REF lenders as it means a dilution of their control over the property.

However, a disposal made under this provision can only be made in certain circumstances, which generally seem to align with the lender's interests.

The disposal will only be possible with the consent of the court (where presumably the court would take account of representations made by the secured creditor) and only in instances where it will support the rescue of the company as a going concern. In addition, the money received from the sale (plus a required top-up to market value) must be paid to secured creditors. So in practice, a lender is only likely to object where the sale of the property will not result in full repayment, and the lender believes the company can survive for a long enough period to

see the value of the property rise to a level which will result in a greater realisation.

Mortgagee possession proceedings

In March this year, a lender's ability to become a mortgagee in possession was reduced. The civil procedure rules were amended so that proceedings brought under CPR Part 55 (which includes mortgagee possession proceedings) as well as all enforcement proceedings by way of writ or a warrant for possession were stayed for 90 days. This stay was originally intended to end on 25 June 2020 but has recently been extended to 23 August 2020.

However, this may not have a big impact on most lenders as it is a rarely used enforcement option.

Current options for landlord borrowers to pursue unpaid rent

Under the Coronavirus Act 2020, a landlord's ability to forfeit a lease for unpaid rent and other financial obligations is currently suspended until 30 September 2020. During this period rent arrears will still accrue, however the right to forfeit the lease cannot be exercised. This means that a borrower's ability to receive rents and use them to service the loan may be impacted, without the immediate ability to use the threat of forfeiture as a recovery means.

There are also temporary provisions in the CIGA, which will make it harder for a landlord to pursue a tenant for unpaid rent. Winding-up petitions will be void if presented to the court between 27 April 2020 and 30 September 2020, unless the petitioner has reasonable grounds for believing that coronavirus has not had a financial effect on the company or caused the relevant ground for the winding-up. It seems unlikely that this exception will be applicable in most cases. Secondly, statutory demands made between 1 March 2020 and 30 September 2020 will be void, unless the same exceptions that apply to winding-up orders apply.

Nonetheless, even without the landlord's ability to forfeit and the prohibitions on winding up orders and statutory demands, lenders can require borrowers to take the following steps (if they are not already doing so already) to recover unpaid rent:

- Pursue defaulting tenants via the commercial rent arrears recovery procedure (CRAR). However, a tenant is now required to owe at least 189 days' rent rather than 7 days before action can be taken so this avenue may not be immediately available to borrowers.
- Use rent deposit monies to cover the deficit on the borrower's cash flow created by non-payment of rent by the tenant.
- Commence ordinary county court proceedings against a tenant, obtain a county court judgment and then enforce that judgment. This would however be a slower process than the usual options available to a landlord.

Authors



Archie Campbell

Partner, Finance

T: +44 20 7809 2377

E: archie.campbell@shlegal.com



Jon Smith

Associate, Finance

T: +44 20 7809 2597

E: jon.smith@shlegal.com



Charlotte Drake

Professional support lawyer

T: +44 20 7809 2583

E: charlotte.drake@shlegal.com

Contacts



James Linforth

Partner, Finance
T: +44 20 7809 2060
E: james.linforth@shlegal.com



George Vaughton

Partner, Finance
T: +44 20 7809 2523
E: george.vaughton@shlegal.com



Paul Hayward-Surry

Partner, Finance
T: +44 20 7809 2538
E: paul.hayward-surry@shlegal.com



Jayesh Patel

Partner, Finance
T: +44 20 7809 2238
E: jayesh.patel@shlegal.com



Jonathan Proctor

Partner, Finance
T: +44 20 7809 2207
E: jonathan.proctor@shlegal.com



Andrew Myers

Partner, Real estate litigation
T: +44 20 7809 2275
E: andrew.myers@shlegal.com



Sophie Schultz

Partner, Real estate litigation
T: +44 20 7809 2257
E: sophie.schultz@shlegal.com



Sue Moore

Partner, Restructuring and insolvency
T: +44 20 7809 2111
E: sue.moore@shlegal.com



Nick Axup

Senior associate, Restructuring and insolvency
T: +44 20 7809 2988
E: nick.axup@shlegal.com