

EXPLANATORY MEMORANDUM TO

**THE CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020
(CORONAVIRUS) (SUSPENSION OF LIABILITY FOR WRONGFUL TRADING
AND EXTENSION OF THE RELEVANT PERIOD) REGULATIONS 2020**

2020 No. 1349

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument makes provision to modify the effect of insolvency legislation, in order to suspend section 214 (wrongful trading) and 246ZB (wrongful trading: administration) of the Insolvency Act 1986 (c.45) (“the wrongful trading provisions”), from 26 November 2020 to 30 April 2021 (the “wrongful trading measure”).
- 2.2 This instrument also extends further – to 30th March 2021 – measures originally introduced by the Corporate Insolvency and Governance Act 2020 (c.12) (“CIG Act”) which provide temporary flexibilities to companies and other bodies as to the manner in which they are required to hold Annual General Meetings and other meetings (“the meetings measure”).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 The instrument is made using powers given in the CIG Act to make regulations which amend or modify the effect of primary legislation.
- 3.2 The wrongful trading measure is made under section 20(1)(c) of the CIG Act which enables the Secretary of State to make regulations which temporarily amend or modify the effect of insolvency legislation to change any duty of a person with corporate responsibility or the liability of such a person to any sanction. This instrument is the first occasion on which that power has been exercised and is subject to the “made affirmative” procedure.
- 3.3 In light of the scope of the power given by section 20(1)(c) there are a number of conditions which must be satisfied before that power may be exercised. In summary, it must be expedient to modify the duties of persons with corporate responsibility due to the effect of coronavirus on business or the economy of the United Kingdom, and the Secretary of State must have considered the effect of the regulations on those likely to be affected by them. The Secretary of State must also be satisfied that the need for regulations is urgent, the regulations are proportionate, and that the same result cannot be achieved either without legislation or by using a different power. Regulations must be time-limited and cease to apply after 6 months, unless that period

is extended by further regulations. The Secretary of State must also keep the need for the regulations under review and revoke or amend them if appropriate.

- 3.4 The way in which this instrument modifies the wrongful trading provisions replicates the effect of an existing provision in section 12 of the CIG Act. That section only applies in respect of events occurring between 1st March 2020 and 30th September 2020. This instrument applies the same modifications as are made by section 12 to events occurring between 26 November 2020 and 30th April 2021, thereby effectively extending the modification made by section 12 to 30th April 2021.
- 3.5 Parliament contemplated that section 12 may need to be extended and gave power to do so in section 41 of the CIG Act. Section 41 cannot however be used to make the same provisions as is made by this instrument. That is because while section 41 could be used to extend section 12, it cannot be used to revive section 12 after it has ceased to have effect. Accordingly, it is necessary to have recourse to the power given in section 20(1)(c). This is consistent with the restrictions imposed on the use of section 20(1)(c) referred to in paragraph 3.3 above; which require that the power be used as a backstop where no alternative regulation-making power is available to achieve the desired result. The reasons why it was not considered necessary to extend the period in section 12 but it is now considered expedient to revive that provision are discussed in section 7 of this explanatory memorandum.
- 3.6 The meetings measure is made using the power given in paragraph 2 of Schedule 14 to the CIG Act. The power is being used to amend primary legislation. This is the second instrument which is being made under that power. The first instrument made under that power was the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020 (SI 2020/1031).

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.7 The territorial application of this instrument includes Scotland.
- 3.8 The powers under which this instrument is made cover England, Wales and Scotland (see section 48 of the CIG Act) and the territorial application of this instrument is not limited by the Act of the instrument.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is England, Wales and Scotland.
- 4.2 The territorial application of this instrument is England, Wales and Scotland.

5. European Convention on Human Rights

- 5.1 The Minister for Climate Change and Corporate Responsibility, Lord Callanan, has made the following statement regarding Human Rights:
- 5.2 “In my view the provisions of the Corporate Insolvency and Governance Act 2020 (Coronavirus)(Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 The CIG Act makes provision about corporate insolvency as well as changes to the law relating to the governance and regulation of companies and other entities. The

provisions concerning corporate governance, and some of the provisions concerning corporate insolvency, are intended to be temporary. These temporary provisions are designed to help UK companies and other entities during the difficult time caused by coronavirus.

- 6.2 The legislative context of the wrongful trading measure is as follows. One of the temporary provisions in the CIG Act is a power, given by section 20, which enables the Secretary of State to make regulations of time-limited effect to amend or modify insolvency law to, amongst other things, change or disapply any duty of a person with corporate responsibility or the liability of such a person to any sanction.
- 6.3 The CIG Act imposes various conditions on the use of the power given by section 20. Those conditions are referred to in paragraph 3.3 above. In summary, section 21(2) provides that the power may only be used if the Secretary of State is satisfied that it is expedient to modify the duties of a person with corporate responsibility to take due account of the effects of coronavirus on business or the economy of the United Kingdom, section 22(2) stipulates that the power can only be exercised if the situation is urgent, the provision made is proportionate, and non-legislative options or other regulation-making powers are not available, and finally, section 23 requires that regulations made under section 20 must be time-limited and cannot have effect for a period of more than 6 months. Section 23(2) provides that the 6-month time limit may be extended by further regulations. Section 23(3) and (4) requires the Secretary of State to keep regulations made under section 20 under review, and to amend or revoke them if satisfied that they are no longer proportionate or should cease to have effect at an earlier date.
- 6.4 This instrument modifies the effect of sections 214 and 246ZB of the Insolvency Act 1986. Those sections provide, in summary, that a director or former director of a company may, in the course of a winding up (section 214) or administration (section 246ZB) be personally liable to make a contribution to the company's assets. That liability arises where before the commencement of winding up or administration, that person knew or ought to have known that there was no reasonable prospect of the company avoiding insolvency. This instrument modifies sections 214 and 246ZB by requiring a court considering what contribution to the company's assets it is proper for a person to make, to assume that person is not responsible for any worsening of the company's position that occurs between 26 November 2020 and 30th April 2021.
- 6.5 The legislative context of the meetings measure is as follows. Paragraph 3 of Schedule 14 to the CIG Act has the effect of relaxing certain requirements as to the manner in which the meetings of companies and other qualifying bodies must be held. Paragraph 3 is only temporary in effect – it applies to meetings held during the relevant period (see paragraph 3(1)). Paragraph 2(1)(b) of that Schedule (as amended by SI 2020/1031) provides that the relevant period ends with 30th December 2020. Paragraph 2(2) of that Schedule gives the Secretary of State power to amend paragraph 2(1)(b) to substitute a later date for the one for the time being specified. The substitute date cannot be more than three months after the one currently specified, or later than 5 April 2021. This instrument amends paragraph 2(1)(b) so that the relevant period – and the temporary relaxations in paragraph 3 which apply during that period – applies to meetings held up until 30 March 2021.

7. Policy background

What is being done and why?

- 7.1 This instrument suspends the wrongful trading provisions in the Insolvency Act 1986. Wrongful trading is an action which may be taken by an insolvency office-holder where there is evidence that creditors have incurred losses as a result of a company being allowed to trade beyond the point at which insolvency proceedings were inevitable. Where the test for wrongful trading is satisfied a court may require a director, or former director, to contribute to the assets of the company from their personal assets.
- 7.2 The possibility of directors facing personal liability is a strong deterrent to continued trading of an insolvent company and is an important protection for creditors.
- 7.3 This instrument modifies the wrongful trading provisions so that in determining what contribution to a company's assets that it is proper for a person to make, a court is required to assume that the person is not responsible for any worsening of the company's financial position that occurs during the period 26 November 2020 to 30th April 2021. This is intended to allow directors of companies which are viable but for the effect of coronavirus to make decisions as to whether to continue trading without the threat of personal liability were those companies to subsequently enter insolvency proceedings. As discussed in paragraph 3.4 this instrument revives an earlier modification to the wrongful trading provisions that was made by section 12 of the CIG Act but which ceased to apply after 30th September 2020.
- 7.4 It is considered expedient to modify the liabilities that directors may potentially face to take account of the effects of coronavirus on business and the economy of the United Kingdom until 30 April 2021. The economic effects of the various coronavirus-related restrictions are unprecedented; faced with that level of economic uncertainty directors may choose to terminate companies which would in fact have been viable, rather than face the prospect of personal liability under the wrongful trading provisions.
- 7.5 In reaching this conclusion the Government has had regard, in particular, to the fact that the level of economic uncertainty is in various respects comparable to that which applied during the period when the wrongful trading provisions were last suspended under section 12 of the CIG Act. Accordingly the Government has concluded that the same legislative response is justified, specifically:
- “Firebreak” restrictions were introduced in Wales on 23 October 2020. While they were lifted on 9 November, national restrictions continue to apply across Wales. In Scotland a 5-level system came into operation on 2 November 2020, and at present all regions of Scotland are in levels 1, 2, 3, or 4. In England national “lockdown” restrictions were reimposed on 5 November 2020.
 - The imposition of further coronavirus related restrictions on business in some form across the whole of Great Britain has coincided with the run-up to Christmas. This is an essential time of year for most businesses. The effect of these restrictions on Christmas trading in various sectors of the economy is very difficult to predict and directors are having to decide whether their companies should try to survive through that period.

- The cumulative effect for successive coronavirus related restrictions on business is likely to have had an impact upon business resilience and ability to withstand further economic uncertainty.

- 7.6 The Secretary of State has considered the impact of the suspension of the wrongful trading provisions on those likely to be affected by it. Directors will benefit because they will have the confidence to make decisions about whether companies which are viable but for the impact of coronavirus should continue to trade without the threat of personal liability. Creditors will lose a protection, but wrongful trading is part of a suite of protections which exist when companies are in a financially-distressed position, such as:
- Companies Act 2006 protections: including the switch of a director's duty of care from shareholders to creditors in an insolvency situation;
 - Fraudulent trading: a civil remedy in the Insolvency Act 1986 to recover funds from directors where fraudulent activity has occurred;
 - Misfeasance: allowing liquidators to pursue directors where they have breached their fiduciary duties;
 - Disqualification proceedings: which could be taken against a director whose actions have caused losses to creditors or whose behaviour otherwise makes them unfit to be concerned in the management of a company;
 - Compensation orders available after successful disqualification proceedings: requiring directors to contribute to the losses of creditors where it can be shown their actions have caused losses to them.
- 7.7 The suspension of the wrongful trading provisions will benefit the UK economy in assisting companies to survive the economic effects of coronavirus and continue trading, saving livelihoods and jobs. Having regard to the importance of this objective and the existence of alternative protections for those adversely affected by the suspension, it is considered that this instrument strikes an appropriate balance between the interests of those affected..
- 7.8 The need to suspend the wrongful trading provisions is urgent. Company directors will be making decisions on their company's viability and future on a daily basis; and any decision as to whether to seek to improve a company's position by trading through the Christmas period will fall to be made imminently. In making these decisions directors will have regard to the possibility of personal liability due to the wrongful trading provisions should the company enter insolvency proceedings in future. This may result in them taking action to terminate a company which would in fact have been viable.
- 7.9 The suspension of wrongful trading is proportionate. It is pursuing an important public policy objective and does not remove all legal protections for creditors, rather it selectively targets those provisions which might distort directors' decision making. The suspension does not apply in respect of all types of company, with certain financial institutions being excluded. The suspension is time limited and, as required by section 23 of the CIG Act, will be kept under review and the Secretary of State will cause it to end if it no longer necessary or proportionate. As stated in paragraph 7.5 the Government considers that the level of economic uncertainty is comparable to that which existed on the last occasion that the wrongful trading provisions were suspended and, accordingly, a similar policy response is appropriate.

- 7.10 The Government has considered whether its objectives could be achieved either without legislation or by using a different regulation-making power. The wrongful trading provisions are set out in primary legislation, and there are no means to amend those provisions, or to modify their effect other than through the use of this power.
- 7.11 This instrument also extends the period during which temporary relaxations continue to the manner in which company AGMs and other meetings must be held. In response to the coronavirus pandemic, the CIG Act allowed companies (and other qualifying bodies) to temporarily hold AGMs and other meetings in a manner which was consistent with both public health measures and their constitutional requirements. For example, they allow companies to hold meetings, and to allow votes to be cast, by electronic means. Those temporary relaxations were extended until 30 December 2020 in light of the continued need for public health measures in response to the pandemic.
- 7.12 Public health measures are highly likely to be required beyond 30 December 2020. The Government therefore considers that a further extension of these temporary measures is necessary to allow companies and other bodies to continue to hold meetings in a manner that is consistent with their constitutional arrangements and the need to limit the spread of the pandemic. The Government has received representations from across the business community requesting that the current 30 December 2020 expiry date be extended by a further three months. Based on historical data it can be inferred that between 80 and 90 FTSE All Share Index would anticipate holding AGMs in the period January to March and would be negatively impacted should public health restrictions remain in place and the extension not be granted.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

- 9.1 Not applicable.

10. Consultation outcome

- 10.1 There has been no public consultation in relation to this instrument, although the Government has engaged positively with a range of stakeholders, including business representative organisations and investor groups on these matters.

11. Guidance

- 11.1 The FRC has released guidance on best practice for holding AGMs flexibly and electronically.

12. Impact

- 12.1 The impact on business, charities, or voluntary bodies is, in respect of the wrongful trading measure, that if those entities are creditors in a company winding up or administration then they may be financially worse-off if the insolvency office-holder is unable to recover a contribution from directors, or former directors, under the wrongful trading provisions. This is because the insolvent company will have fewer

assets available for distribution to creditors. The amount that any creditor would stand to recover in any given insolvency is, however, dependent upon a range of factors, such as the number of creditors, the company's assets and liabilities, and whether a debt is secured or unsecured. The suspension of the wrongful trading provisions will therefore have a potential impact but cannot be said to have a specific quantifiable adverse impact upon any given business, charity or voluntary body. The Government has accordingly assessed that any such impact is an appropriate temporary intervention and consistent with the Government's wider interventions.

- 12.2 The impact on the public sector is, in respect of the suspension of the wrongful trading provisions, the same as that described in paragraph 12.1 in relation to business, charities, or voluntary bodies. That is to say public sector creditors in a company winding up or administration may be financially worse-off if the insolvency office-holder is unable to recover a contribution from directors, or former directors, under the wrongful trading provisions. As is the case with the impact upon business, charities or voluntary bodies however, the Government has assessed that any such impact is an appropriate temporary intervention and consistent with the Government's wider interventions.
- 12.3 This instrument is a temporary provision as part of the Government's response to coronavirus, lasting no more than 6 months. As this instrument will cease to have effect after less than 12 months, a Regulatory Impact Assessment is not required and would be disproportionate.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small business.
- 13.2 No specific action is proposed to minimise the regulatory burdens on small businesses.
- 13.3 The basis for the final decision on what action to take to assist small businesses is that the instrument is itself a temporary suspension of a liability (in the case of the wrongful trading measure), or a series of obligations (in the case of the meetings measure) that would otherwise potentially arise under legislation, and replicates in all material respects the effect of earlier suspension of that liability and obligations. In the case of the wrongful trading measure the Secretary of State is also required by legislation to keep the proportionality of the instrument under review during the period that it is in effect.

14. Monitoring & review

- 14.1 This instrument does not itself include a statutory review clause. In the case of the wrongful trading measure a review clause would be inappropriate because the Act conferring the powers under which the relevant provisions in the instrument are made itself requires the Secretary of State to keep the instrument under review. In the case of the meetings measure the Government will continue to review the need for that measure; however a statutory review clause would be unnecessary in having regard to the fact that the measure will automatically expire after 3 months.

15. Contact

- 15.1 Simon Whiting at the Insolvency Service (tel: 0303 003 1515 or email: simon.whiting@insolvency.gov.uk) can answer questions about the wrongful trading measure in these regulations. David Leitch at BEIS (tel: 0300 068 5713 or email: david.leitch@beis.gov.uk) can answer questions about the meetings measure in these regulations.
- 15.2 Angela Crossley, Director of Strategy and Change and the Insolvency Service can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Minister for Climate Change and Corporate Responsibility, Lord Callanan at the Department of Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.