Winding-up Proceedings Meets the COVID-19 Restrictions

Holly Samuel, Associate, Freshfields Bruckhaus Deringer LLP, London, UK

Synopsis

The recent decision in *PGH Investments Ltd v Ewing* [2021] EWHC 533 (Ch) has provided valuable further guidance on the evidence required for a distressed company to benefit from the coronavirus test (the 'COVID-19 Test') in Schedule 10 to the Corporate Insolvency and Governance Act 2020 ('CIGA 2020'). Although the case ultimately turned on contractual interpretation, the judgment provides three points of note for practitioners.

First, there can still be merit in a company applying to restrain advertisement of a winding-up petition against it during the CIGA 2020 'relevant period', where the mere fact of the petition could pose serious consequences for it. This would neither be 'premature' nor 'pointless', despite the fact that: (i) the company could await the preliminary hearing currently required; and (ii) CIGA 2020 currently prevents publication of a winding-up petition until the Court has determined whether it is likely to be able to make an order.

Second, a company cannot merely assert that its business has been affected by coronavirus. The evidential burden of the COVID-19 Test falls first to the company, who must demonstrate a *prima facie* case supported by documentary evidence rather than bare assertions. The COVID-19 Test is intended to protect otherwise viable businesses from the financial harm of the pandemic, rather than providing wholesale protection from winding-up petitions at this time.

Third, the Court can only dismiss a petition based on an undisputed debt as having been made for a collateral purpose 'sparingly'. There must be a clear case of an ulterior motive to put pressure on the Company with the petition or threat of the same and/or evidence that the petitioner is not acting in the interests of his class of creditors.

The COVID-19 Test

Given the well documented effects of the pandemic on many sectors, the modified winding-up regime under Schedule 10 of CIGA 2020 and its related practice direction (the 'CIGA PD') affords distressed companies a potential stay of execution.

The COVID-19 Test provides[1] that where:

- a creditor presents a winding-up petition during the 'relevant period' (between 26 June 2020 and, currently, 30 June 2021[2]);
- the company in question is deemed unable to pay its debts as they fall due under s.123(1) Insolvency Act 1996 ('IA 1986'); and
- the Court is persuaded that coronavirus has had a financial effect on the company before presentation of the petition,
- the Court may only make a winding-up order if satisfied that the company *would still be unable to pay its debts as they fall due, even if coronavirus had not had a financial effect on the company*.

Coronavirus has a 'financial effect' on a company only if its financial position worsens in consequence of, or for reasons relating to, coronavirus.[3]

The evidential burden of demonstrating coronavirus' 'financial effect' is first on the company, who need only demonstrate a *prima facie* case. If established, the burden shifts to the petitioner to show that, even if the financial effect of coronavirus is ignored, the company would still be unable to pay its debts as they fall due.[4]

Background – *PGH v Ewing*

Shortly following the onset of the COVID-19 pandemic in May 2020, investor Mr Ewing entered into a share purchase and loan assignment agreement (the 'Agreement') with director / shareholder Mr Neate,

Notes

1 At Schedule 10, paragraphs 5(1) and (3) of CIGA 2020.
2 Recently extended from 30 March 2021 (at the time of the judgment) per section 3(4) Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2021.
3 Schedule 10, paragraph 21(3) of CIGA 2020.
4 *Re A Company (Application to Restrain Advertisement of a Winding-Up Petition)* [2020] EWHC 1551 (Ch), at [40] and [44-45].

containing a guarantee of Neate's obligations from his company PGH Investments Ltd (the 'Company').

Amongst the terms of the Agreement:

a. Ewing was to sell, and Neate was to buy: (i) shares in two members of the Company's group (the 'Shares'); and (ii) a loan provided by Ewing to one of those group companies (the 'Loan');

b. the consideration payable by Neate was £825,000;

c. completion was set on 15 July 2020, on condition that:

   a. Ewing would not demand repayment of the Loan before completion (the 'Repayment Condition'); and

   b. Neate be able to pay the consideration on or before the completion date (the 'Solvency Condition');

d. the Agreement would automatically terminate if either condition to completion was not satisfied; and

e. the Company provided specific guarantees of Neate's obligations and an indemnity for any losses should Neate fail to complete (the 'Guarantee').

Completion did not take place, as Neate had not found an onward buyer for the Shares and so the Solvency Condition was unfulfilled. The parties corresponded after 15 July 2020 trying to agree a delayed completion. When that fell through, Ewing's solicitors issued a formal payment demand and proposed that the Agreement be amended.

When this too failed, Ewing presented a winding-up petition on 8 September (the 'Petition'). On 25 September 2020 PGH applied to dismiss the Petition or, in the alternative, for an order restraining Ewing from advertising the Petition.

The decision – *PGH v Ewing*

Application to restrain advertisement of the Petition

Deputy ICC Judge Passfield agreed that this application was not strictly necessary as:

– the Petition was presented during the 'relevant period' and so any advertisement was automatically prohibited under CIGA 2020, until such time as the Court had determined that it would likely be able to make the order on grounds that the Company could not pay its debts;[5] and

– at the preliminary hearing required under CIGA PD the Court would have to consider any alleged dispute of the petition debt, in order to determine whether it is likely to be able to make a winding-up order. The Company could have waited until that hearing rather than issuing an urgent application.

However, the judge also recognised that the well-known adverse consequences of advertising a winding-up petition (e.g. freezing of bank accounts, events of default under financing etc.) remain a real and urgent concern for certain companies. Nothing in CIGA 2020 or the CIGA PD prevented the Company's application, and it was not 'premature' or 'pointless' as alleged.

The Petition debt – liability under the Guarantee

The Guarantee was a conditional payment obligation of the Company, where Neate as buyer had failed to pay the consideration by the set completion date:

– Ewing argued that the Guarantee provision was engaged because the buyer had failed to pay the specified consideration; whereas

– the Company argued that, because the Solvency Condition to completion had not been met, Neate had not defaulted and no obligation to pay under the Guarantee arose.

The Court found in favour of the Company's arguments. No obligation under the Guarantee arose as the conditions to completion of Neate's primary obligations were not fulfilled. If not, Ewing would have made a substantial windfall, with the Company obliged to pay the consideration under the Guarantee but no corresponding duty on Ewing to transfer the Shares and Loan to Neate.

As the Company was not liable to pay under the Guarantee, the Petition was dismissed. Despite this, the judge proceeded to opine on two further matters.

Application of the COVID-19 Test

The judge made three key observations:

1. It was sufficient for a company to cite indirect 'financial effect' of coronavirus to avail itself of the COVID-19 Test protections: 'Financial impact' under CIGA 2020 is expressed broadly as both a worsening of position 'in consequence of, or for reasons relating to' the pandemic.

2. However, the Company here had not produced adequate evidence to demonstrate this indirect financial effect. Instead Neate made bare assertions about the effect on the Company's solvency and his ability to attract investment. Supporting documentary evidence is necessary to benefit from the COVID-19 Test protections.

Notes

5 See Schedule 10, paragraph 19(2) CIGA 2020.

3. If the Company's evidence had been sufficient, the burden would have passed to the Petitioner to demonstrate that the Company would be unable to pay its debts as they fall due, even if coronavirus had not had a 'financial effect'. The Court would need to consider in parallel whether it was *likely* to be able to make a winding-up order in this context (a threshold higher than 'more than fanciful' but not as high as 'more probable than not'[6]):
   a. As such, a petitioner would need to satisfy the Court that, if it allowed a petition to proceed to a final hearing, they may well be able to demonstrate that the Company would be unable to pay its debts as they fall due even if coronavirus had not had a financial effect on it.
   b. Put differently, the Petitioner would need to demonstrate that if coronavirus had not had a financial effect on the Company before the presentation of the Petition, it would still have incurred the purported debt and would still have been unable to pay it.
   c. Had it been relevant here, the judge would not have concluded that the mere fact that the Petition debt arose after the commencement of the coronavirus pandemic demonstrated this point.

Whether the Petition was made for a collateral purpose

Finally, the judge also confirmed[7] *obiter* that the court should only exercise 'sparingly' its power to dismiss a petition based on an undisputed debt as having been made for a collateral purpose. A petition in respect of a debt which was otherwise undisputed would only amount to an abuse of process in two situations:

– where the petitioner was not really seeking the winding up of the company but was using the petition or threat of the proceedings to put pressure on their subject to take some action which it was otherwise unwilling to take; or
– where the petitioner was not acting in the interests of his creditor class in that the winding up would be to the disadvantage of the body of creditors.

The judge found that, had it been relevant, neither scenario was established in respect of the Petitioner in this case.

Conclusion

Overall, the decision confirms that the Court will not extend the ambit and ease of use of the COVID-19 Test during the remainder of the 'relevant period'. This adds to the growing body of case law regarding application of the COVID-19 Test, and maintains the evidential rigour required despite the apparently 'low threshold' set in CIGA 2020.

The judgment is also a helpful example of the approach to interpreting a company guarantee for shareholder debts within an insolvency, and whether a winding-up petition has been brought for collateral purpose. Both these points will have continuing relevance beyond the pandemic.

Notes

6 By reference to *Three Rivers DC v Bank of England (No 4)* [2002] EWCA Civ 1182.
7 By reference to *Maud v Aabar Block SARL* [2015] EWHC 1626 (Ch).