The Risk in the Rescue

The Duties and Potential Liabilities of Monitors under the Corporate Insolvency and Governance Act

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The Corporate Insolvency and Governance Act has been raced through Parliament on an emergency basis in response to the COVID-19 pandemic, and came into force on 26 June 2020. It proposes to bring about not only temporary relief to businesses but permanent and substantive changes to the law of insolvency, including a new moratorium process and a new role for insolvency practitioners – that of a "monitor". Whilst the Government guidance suggests that monitors will have some immunity from compensation claims, the Act does not in fact have that effect, and insolvency practitioners acting as monitors will be taking on a range of duties and responsibilities, and with them potential risks and liabilities.

Introduction

The Corporate Insolvency and Governance Bill was introduced to Parliament on 20 May 2020.[1] It came into force as the Corporate Insolvency and Governance Act ("**CIGA**") on 26 June 2020.[2] According to the Government, its purpose is "t*o provide businesses with the flexibility and breathing space they need to continue trading*"[3] during the challenges created by the COVID-19 pandemic. But the CIGA does more than just provide support for businesses through the uncertainty of the pandemic. It includes far-reaching and permanent changes to the law on insolvency, including a new freestanding moratorium process and, within that, the creation of a new creature to the insolvency world known as a "monitor".

Insolvency practitioners will of course be accustomed to stepping into distressed companies in order to take over the management and control of their affairs. But the role of monitor is unusual: the directors retain the management and control of the company, whilst the monitor's key roles are to assent to the moratorium, to assess continually the company's financial health during its currency, and to sanction certain acts of the directors that could impact creditors.

As such, insolvency practitioners agreeing to act as monitors will be taking on a range of duties and responsibilities, giving rise to new potential risks and liabilities. There is a notable absence of detail in the CIGA as to how these duties and responsibilities are properly to be fulfilled and the extent to which monitors are entitled to rely on what they are being told by the directors. The financial consequences of the monitor's decisions (for example, a decision to terminate the moratorium) could be very serious for the company, and the company could (via subsequent administrators and liquidators) look to bring claims against its former monitor. Whilst the Government stated that it intended to give monitors immunity from certain claims for compensation, in fact no such immunity is to be found within the CIGA.

The CIGA brings about other permanent changes to the law of insolvency, including new arrangements for restructuring companies in financial distress and restrictions on contractual supplier termination clauses. There are also changes to the law on wrongful trading and in relation to winding-up proceedings: whilst these are said to be temporary, the CIGA provides powers to extend the temporary measures an indefinite number of times. Whilst each of these aspects of the CIGA warrants further consideration and scrutiny, this article focuses on the monitoring role of insolvency practitioners in the new freestanding moratorium process and its associated risks.

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[1] The Bill was introduced on an emergency basis. It was introduced to the House of Commons on 20 May 2020. It had a second reading in the Commons and all remaining stages on 3 June 2020 and was taken to the House of Lords the same day. The second reading in the House of Lords took place on 9 June, and the third reading took place on 23 June 2020. The Bill received royal assent on 25 June 2020 and the Act came into force on 26 June 2020.
[2] The CIGA will appear as a new Part A1 to the Insolvency Act 1986.
[3] Paragraph 1 of the Explanatory Notes to the Bill: https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.

The Moratorium

One of the key features of the CIGA is the introduction, as a substantive and permanent change to the law of insolvency, of a procedure for a new form of moratorium on enforcement action against a company in financial distress. The purpose of the moratorium is to allow the company time to explore rescue options instead of commencing insolvency proceedings. Its distinguishing feature is that it is freestanding: it takes place outside of an insolvency process, with the directors continuing to manage the company.

Whilst control is retained by the directors, the CIGA provides that an insolvency practitioner is appointed as a "monitor". The CIGA defines a monitor as "*the person who has the functions of a monitor in relation to the moratorium*".[4] These functions are scattered around the CIGA but the key roles of the monitor are (a) to assent to the commencement of the moratorium; (b) to monitor the financial health of the company continuously and take steps to end the moratorium in the event the monitor is of the opinion the company cannot survive as a going concern; and (c) to sanction certain acts of the directors which could have an impact on creditors such as the disposition of assets outside of the ordinary course of business or the creation of security rights.

The monitor is appointed by the directors and must consent to act in the usual way. Unless the eligible company is subject to a winding-up petition or is an overseas company, an out of court process should be used. This is intended to be a relatively simple process: the directors file "relevant documents" with the court which include statements from the proposed monitor that: (a) the company is eligible to apply for a moratorium; and (b) in the proposed monitor's view, it is likely that a moratorium will result in the rescue of the company as a going concern.

The obvious implication is that, substantially prior to the application for a moratorium, the directors must have selected an insolvency practitioner who will have consented to act as monitor, and, moreover, that the proposed monitor will already have undertaken a sufficient review of the company and its finances in order to satisfy itself that the statutory criteria for the moratorium are met. The Government has published a Guide for Monitors, which states:[5]

> "*Prior to the moratorium the prospective monitor will need to engage with the directors and seek information about the company's assets, liabilities and business so that they are able to assess the company's financial position, prospects and eligibility for a moratorium. The extent of this pre-appointment work will be for the insolvency practitioner using their professional experience and judgement to decide on and should be proportionate to the size and complexity of the company.*"

This in turn assumes that the company will have entered into a contractual arrangement with the insolvency practitioner, which will presumably need to cover issues such as remuneration and any limitations of liability (see further below). The CIGA provides no mechanism for any creditor challenge to pre-appointment remuneration.

Once the moratorium comes into force, the monitor is automatically appointed and obliged to notify Companies House that the company has the benefit of a moratorium. The monitor must also notify "*every creditor of the company of whose claim the monitor is aware*" of the fact of the moratorium as soon as reasonably practicable. Failure to do so without reasonable excuse is an offence by the monitor.[6]

The moratorium will subsist for an initial period of 20 business days beginning with the day after the day on which the moratorium comes into force.[7] It can be extended (before it has come to an end) by filing certain documents with the court. For each extension, the monitor must prepare a statement that in his or her view, it is likely that the continuation of the moratorium will result in the rescue of the company as a going concern.

[4] Section A54.
[5] Part 2, page 6.
[6] Section A8.
[7] Section A9(2).

The Monitor

Chapter 5 of the CIGA (sections A34 to A41) addresses various issues relevant to the monitor. The monitor is required to "*monitor the company's affairs for the purposes of forming a view as to whether it remains likely that the moratorium will result in the rescue of a company as a going concern.*"[8] The obligation on the monitor is absolute and continuing. It will necessitate the monitor's constant review of the financial status of the company.

Under section A35(2), the monitor is entitled, in forming the above view, to rely on information provided by the company "*unless the monitor has reason to doubt its accuracy*". Quite what this means is unclear. Can the monitor rely on conclusory statements made by the directors as to the financial circumstances of the company, or must the monitor conduct his/her own independent analysis of the company's financial information, and if so to what extent? According to the Government's guidance:[9]

> "*The monitor must support the integrity of the moratorium process and ensure creditor interests are protected. To fulfill this role the legislation therefore enables the monitor to require the directors to provide any information the monitor requires for the purpose of carrying out their functions under the moratorium (section A36). This is necessary in order that the monitor can assess the company's affairs in the short timescales available. The monitor should exercise their professional judgement to satisfy themselves of the accuracy of the information provided, and, is able to require the directors provide further information*."

That does little to provide the practical guidance that monitors are likely to require, and it is possible to envisage future claims against monitors in which they are accused of placing too much (or too little) reliance on information provided by directors.

Under section A36, "*[t]he monitor may require the directors ... to provide any information required by the monitor for the purpose of carrying out the monitor's functions*". Any failure to obtain the necessary information cannot be ignored by the monitor; the directors must comply with the monitor's request as soon as practicable and if they fail to do so and the monitor considers that he/she, as a result, is unable to carry out his/her functions, the monitor must file notice with the court terminating the moratorium.[10]

What is unclear, however, is precisely what information the monitor should be asking for, and in what circumstances. Moreover, the very existence of these powers opens the monitor up to potential criticism. It is not open to the monitor to say that it was not possible to monitor the company's financial affairs properly due to a failure by the directors to provide information (unless that failure has been sanctioned by an application to bring the moratorium to an end). Simply doing nothing will potentially leave the monitor exposed.

But how exposed is a monitor and to whom (if anyone) does a monitor owe a duty? There are two aspects of this to consider. The first is the extent to which the CIGA itself provides for challenges to the monitor's conduct. The second is the extent to which the monitor might face liability via common law/equitable claims or insolvency applications.

[8] Section A35.
[9] Guide for Monitors, part 2, page 6.
[10] Section A38.

Challenges under the CIGA

Chapter 6 of the CIGA provides a mechanism for challenging the monitor's actions. Section A42 states that specified persons may apply to the court "*on the ground that an act, omission or decision of the monitor during a moratorium has unfairly harmed the interest of the applicant*".[11] The specified persons who may apply to make such a challenge are: "(*a) a creditor, director or member of the company, or (b) any other person affected by the moratorium*".[12] The court is given wide powers to deal with any such application and may: "*(a) confirm, reverse or modify any act or decision of the monitor, (b) give the monitor directions, or (c) make such other order as it thinks fit (but may not, under this paragraph, order the monitor to pay any compensation*".[13] The CIGA specifically provides that in making an order, the court "*must have regard to the need to safeguard the interests of persons who have dealt with the company in good faith and for value*".[14]

The practical effectiveness of this mechanism is likely to depend on two main factors. The first factor is the information available to potential challengers. The problem here is that the CIGA contains no obligation on monitors (or directors) to give notification to creditors of any particular intended action. So, for example, a monitor can decide to sanction a board of directors' decision to dispose of certain assets, but since there is no obligation to give prior notice to creditors (or any other potentially interested stakeholder), creditors have no obvious way of finding out about the disposal until after it has taken place.

The second factor is the question of how quickly challenges can be put together and how quickly the court can react. Although the CIGA does not say so in terms, it seems likely that challenges to a proposed course of action by the monitor – for example, to terminate the moratorium – may need to be akin to an application for urgent injunctive relief.

Liability of monitors

Immunity?

The consultation on insolvency and corporate governance commenced in 2016 and generated views and comments during the consultation period from 93 different sources. The views and comments were considered by The Department for Business, Energy and Industrial Strategy which, on 26 August 2018, published the Government's response ("**Government Response**").[15] One of the matters raised in the consultation was the role of the monitor, including the powers to be given to the monitor. The Government Response noted that in relation to the role of monitor, "respondents felt the proposals lacked sufficient detail to allow firm conclusions to be reached".[16] As regards any potential liability of the monitor, the Government Response states:

> "*To address the risk of legal action being brought against a former monitor by a company where that monitor made an error in their assessment of the qualifying conditions, the Government intends to give monitors immunity from claims stemming from erroneous termination providing they acted in good faith. The Government believes this approach is justified in light of the importance of immediate termination if the qualifying conditions are no longer met, and it is designed to avoid monitors acting in an overly cautious manner to the detriment of creditors and suppliers. Insolvency practitioners are subject to a detailed regulatory framework which provides appropriate avenues for complaint and redress where an individual fails to comply with their legal duties as an insolvency practitioner*."[17]

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[11] Section A42(1).
[12] Section A42(2).
[13] Section A42(4).
[14] Section A42(7).
[15] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf
[16] Paragraph 5.64, Government Response.
[17] Paragraph 5.68, Government Response.

Notably, however, there is no provision in the CIGA giving the monitor immunity from claims by the company for losses caused by terminating the moratorium erroneously. As noted above, the CIGA does contain a provision preventing the court from making an order that the monitor pay compensation in relation to a challenge to the monitor's conduct. But that is not an immunity, it is just an absence of one particular remedial route that might otherwise have been provided. There is no immunity against other applications and actions for damages that might potentially be brought against the monitor by, for example, a subsequent administrator or liquidator, whether resulting from the erroneous termination of the moratorium (leading to the company's insolvency) or otherwise.

Claims by the company

The monitor will be retained directly by the company. It is likely that any agreement as to fees and the basis on which the monitor consents to act will be contained in a written contract produced by the insolvency practitioner. Any such agreement will include, if not expressly, an implied duty that the monitor will carry out his functions with reasonable skill and care.[18] Monitors will also owe a concurrent duty of care to act with reasonable skill and care as a matter of common law.

Monitors can potentially protect against claims by the company for negligence by ensuring that their retainer specifically excludes or restricts any such liability. But that is unlikely to provide absolute protection. Such limitation or exclusion clauses will only be enforceable against the company to the extent they are "reasonable".[19] There is an argument that as the relevant legislation specifically prohibits compensation being awarded for successful challenges to the monitor's conduct, any contractual terms expressly excluding any potential liability of the monitor ought to be considered reasonable. But it is difficult to make generalisations about this. The court will consider the reasonableness of the clause in all the circumstances of the particular case before it, and there is no guarantee of a consistent judicial approach. The guidance in the Government Response refers only to an intended "immunity" in the context of an erroneous termination of the moratorium, but there are many other factual scenarios that might give rise to claims (e.g. the sanctioning by the monitor of the grant of security or the disposal of assets). If a contractual exclusion of liability is found to be unreasonable it will be entirely unenforceable leaving the monitor with no protection at all. The safer course would be to cap any liability for damages in accordance with standard industry practice for professional retainers.

Further, it is not possible to exclude liability for fraud. If a monitor conducts himself in a fraudulent manner, the company will have common law claims in fraud against the monitor (for example, for deceit) and any claims for losses arising from fraud cannot be capped or excluded by contract.

It does seem that the monitor would not ordinarily be under fiduciary obligations. There is no provision in the CIGA deeming the monitor to be an agent of the company,[20] and the fact the directors retain control of the company and its property, should mean that the monitor will not be considered to be a fiduciary (save in very exceptional circumstances).

The CIGA stipulates that the monitor will be an officer of the court.[21] As such, the monitor will owe various duties to the court, including a duty not to act dishonourably and a duty to be candid, but it seems unlikely that the monitor's position as a court officer would open up additional routes of liability to the company.

[18] Section 13, Supply of Goods and Services Act 1982.
[19] As required by the Unfair Contract Terms Act 1977.
[20] Compare, for example, the position of an administrator, who is deemed to be an agent under the Insolvency Act 1986, Sch. B1, para. 69.
[21] Section A34.

Claims by creditors

It is settled law that absent any special relationship, liquidators do not owe a duty of care to individual creditors in respect of their conduct of the liquidation.[22] Whilst creditors often find this surprising, as a matter of policy the underlying reasoning appears to be sound. Unsecured creditors have no legal interest in the company's property. A liquidator is tasked with getting in and realising a company's assets for the benefit of all creditors. The purpose of a liquidation is to ensure that all unsecured creditors are on an equal footing when the realised assets are distributed so each receives a pro-rata share determined by reference to their proved claim in the liquidation. If a liquidator owed a specific duty of care to each creditor enabling each creditor to bring a claim for breach of that duty, not only would it result in a considerable amount of satellite litigation, it could also result in certain creditors receiving a greater return than others. Instead, the preferred remedy is to give individual creditors standing to bring claims against liquidators in circumstances where that liquidator has acted in breach of a duty owed to the company.[23] This gives individual creditors the ability to take action themselves against misfeasant liquidators whilst maintaining an egalitarian outcome for all creditors by directing that the proceeds of any such claim are paid to the company, not the individual creditor bringing the claim. In other words, creditors can lead the charge but only for the greater good.

A creditor will have difficulty in establishing a loss during the period of the moratorium itself because whilst the moratorium subsists, the monitor must by definition continue to be satisfied that the company can be rescued as a going concern. If the monitor is correct, the creditor will suffer no loss (irrespective of whether assets have been disposed of at an undervalue) because the company will be in a position to pay its debts.

But what if the company does not survive as a going concern and instead enters liquidation? Can a creditor then bring a claim against the monitor for any losses suffered by the creditor as a result of the fact that property was disposed of at an undervalue during the period of the moratorium such that realisations are insufficient to pay unsecured creditors in full? Whilst the CIGA provides that a creditor can challenge the conduct of the monitor after the moratorium has come to an end, a creditor will not be able to obtain compensation for any losses via an application made under that section.

Once the company is in liquidation, the unsecured creditors must look to the liquidator to examine the conduct of the monitor and take such action against him or her as the liquidator sees fit. Any such claim would be brought by the company in liquidation relying on the duty of care owed to it by the monitor as discussed above.

Claims by other third parties

Could a monitor have any liability to other third parties?

In addition to giving standing to creditors, directors and members of the company to bring an application to challenge the conduct of monitors, section A42 of the CIGA also gives standing to "*any other person affected by the moratorium*". Pending judicial determination of what "*affected by the moratorium*" means, this could encompass a very broad range of people from employees and the trustees or managers of the company's pension fund (if not already creditors) to government agencies such as the National Insurance Fund. However, all such 'persons' making an application against the monitor under this section will be subject to the same restrictions as the creditors, directors and shareholders and unable to claim compensation from the monitor.

During its progress through the House of Lords, additional provisions were added to the CIGA in relation to company pension schemes. These appear as sections 45 and 51 of the CIGA. Section 45 provides that any challenge that could be made by a trustee or manager of a pension scheme qua creditor to the conduct of a monitor, can be made by the Board of the Pension Protection Fund ("**PPF**").[24] It seems highly likely that the words 'any other person' are sufficiently wide to include government agencies such as the PPF. This section therefore appears to have been added out of an abundance of caution, no doubt prompted by the many high profile collapses which have in recent years put a considerable financial burden on the PPF.

[22] *Hague v Nam Tai Electronics* [2008] UKPC 13.

[23] Section 212, Insolvency Act 1986.

[24] Section 51 gives the Secretary of State the power by regulation to enable the Board of the Pension Protection Fund to exercise certain creditor rights under the CIGA, including challenges to the directors' actions in addition to or to the exclusion of the trustees or managers of the relevant pension scheme.

Whilst each case would need to be considered on its individual facts, it seems unlikely that 'any other person' (and/or the PPF) could establish that the monitor owed them a duty of care. Accordingly, any losses suffered would have to be claimed against the company. The company (acting by its directors or by any subsequently appointed liquidator) could then potentially claim against the monitor for breach of duty (depending on the nature of the claim brought by the third party), but absent fraud, the monitor should be able to protect himself against any such claims as already discussed.

Monitor's costs

Section A42 is silent on who should pay the costs of any challenge to the monitor's conduct, leaving that as a matter for the discretion of the court. Whilst the court would be expected to follow the usual rule that the losing party pays the costs, if that challenge is successful the monitor could find him/herself liable for significant costs as well as having to pay his or her own legal costs. Even if the monitor successfully defends a challenge, a proportion of the monitor's costs is likely to be irrecoverable from the challenging party. Whilst an indemnity could be included in the monitor's retainer with the company, directors may refuse to indemnify monitors in respect of successful challenges, potentially leaving the monitor with a significant liability.

Bonding and insurance

The existence of a general bond is a prerequisite to being qualified to hold insolvency appointments. The role of monitor has been added to section 388 of the Insolvency Act 1986, meaning that any monitor must be bonded. An insolvency practitioner acting as monitor will also need to ensure they are bonded for a specific penalty sum for each appointment in that capacity.

But, of course, the insolvency bond will only provide protection for creditors where there has been fraud or dishonesty on the part of the monitor. In other cases, affected parties must look to any protection afforded by the insolvency practitioner's general professional negligence insurance. No doubt insurers will want to consider carefully the particular risks associated with the new role of monitor and insolvency practitioners will need to make sure their policy provides adequate coverage for the risks associated with accepting monitor appointments.

Conclusion

Whilst it may have been the intention of the Government to give monitors immunity from claims arising from the erroneous termination of the moratorium, in our view the CIGA fails to provide any such immunity. In any event, the scope of a monitor's duties are much more wide-ranging and we have highlighted in this article some of the potential avenues for complaint which could give rise to claims against monitors. Monitors would be well advised to ensure the contractual terms of their appointment are properly documented and contain adequate provision to cap any such liability as may arise.

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