A PROPOSAL TO REFORM ENGLISH COMPANY VOLUNTARY ARRANGEMENT MORATORIUM REGIME:
INSIGHTS FROM US AUTOMATIC STAY

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ABSTRACT

Moratoriums (most comparable to US Automatic Stay) are important mechanisms for companies in insolvency proceedings. During the moratorium period, creditors’ individual actions are normally suspended. As such, it provides insolvent companies with a breathing space to negotiate with creditors, sort out problems, and figure out potential solutions to recover from insolvency. While a moratorium is so significant for companies in restructuring proceedings, in English Company Voluntary Arrangement (CVA), the current 2000 Moratorium is of limited use by companies. Most existing literature argues that the current 2000 Moratorium is little used due to its eligibility restrictions (only available for small-sized companies). The UK Government listened to such criticism and proposed a New Pre-Insolvency Moratorium, which, if adopted in the legislature in the future, will be available to companies of all sizes. The UK Government hopes this proposed new moratorium can solve the limited use problems of the current 2000 CVA Moratorium. This article, however, argues that in the new proposal, the UK Government put focus wrongly on eligibility restrictions of current 2000 CVA Moratorium. Instead, this article argues that the main reason for the limited use of 2000 CVA Moratorium is its compliance cost and signaling problems. These two problems, however, are not solved by the new proposal. Thus, this article

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A Proposal to Reform English Company Voluntary Arrangement Moratorium Regime: Insights from US Automatic Stay

suggests that the New Pre-Insolvency Moratorium proposed by the UK Government should not be adopted to apply to CVA procedure. Instead, a special version of CVA moratorium, which targets compliance cost and signaling problems, should be adopted to replace the current 2000 CVA Moratorium. To put forward such reform suggestions, this article also discusses US Automatic Stay to see whether any insight can be drawn from it. This article also makes some justifications for adopting such a special CVA Moratorium.

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INTRODUCTION

Unlike US bankruptcy law, which provides financially distressed companies with a single, unified procedure² to restructure their debts, English insolvency law provides these companies with several choices of procedure to recover from distress.³ Among these choices, administration⁴ is a common and basic procedure used to rescue insolvent companies in England. Though administration is a suitable choice for medium- and large-sized companies, it is not a cost-effective choice for small-sized companies.⁵ Thus, alternatively, distressed companies that want to avoid the

² “US rescue system is concentrated on the Chapter 11 reorganization, whereas in England a number of insolvency possess a rescue function.” See VANESSA FINCH & DAVID MILMAN, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 234 (3rd ed. 2017).

³ Under English Insolvency law, when a company suffers from financial hardship and intends to recover from distress, three main procedures including Administration, Scheme of Arrangement or Company Voluntary Arrangement can be used to rescue this company. All of these three choices are insolvency (Under US context—Bankruptcy) proceedings that provide mechanisms for debt restructuring. See generally, Finch & Milman, supra note 2; See also Jennifer Payne, Debt Restructuring in English Law: Lessons from the US and the Need for Reform, OXFORD LEGAL STUD. RES. PAPER 89/2013 (Jan. 30, 2014), https://ssrn.com/abstract=2321615.

⁴ This paper only discusses the insolvency law of England but not that of Scotland. In English Insolvency Law, Administration is the main insolvency proceeding under English law. Unlike US Chapter 11 procedure, which allows debtor company to continue to be in charge of the company after filing for Chapter 11 (“Debtor in Possession” approach), after an administrator is appointed either by the court, creditors or directors, the administrator is in charge of managing the company. But administrators are required by Schedule B1 paragraph 3(1) Insolvency Act 1986 to try to rescue the company or the business as a going concern. In other words, rescuing financial distressed companies is the main purpose of administrators in administration procedure, and administration is often thought by scholars as a “rescue-friendly” procedure. See John Armour, The Rise of the ‘Pre-Pack’: Corporate Restructuring in the UK and Proposals for Reform, in RESTRUCTURING COMPANIES IN TROUBLED TIMES: DIRECTOR AND CREDITOR PERSP. 43, 46-49 (RP Austin & Fady JG Aoun eds., 2012); Payne, supra note 3, at 7-8; Ian F. Fletcher, UK Corporate Rescue: Recent Developments—Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements—The Insolvency Act 2000, The White Paper 2001, and the Enterprise Act 2002, 5.1 EUR BUS. ORG. L. REV. 119, 125-126 (2004). See generally, Finch & Milman, supra note 2.

⁵ The most significant cost of an administration is administrator’s fees and legal fees. Administration is a highly collective process that administrators are obliged to take the interests of all parties concerned especially all creditors into account when managing the company. This means that the amount of work of administrators is large so that the fees paid
relatively high cost of administration can choose another procedure—Company Voluntary Arrangement (Hereinafter “CVA”). CVA is a restructuring process, unique to English insolvency law, which provides opportunities for financially distressed companies to negotiate with their creditors and provides voting mechanisms for the restructuring of debts according to the wishes of majority creditors. CVA is proposed to be particularly suitable for small companies as it aims to provide a simpler, cheaper and more flexible rescue procedure for insolvent companies. In this sense, it was anticipated that CVA would be warmly welcomed by companies, especially small-sized companies suffering from difficulties but intending to restructure their debts. However, after CVA was introduced into English insolvency law during the 1985–86 insolvency law reforms, it was not a popular restructuring choice even among small-sized companies. The Insolvency Service’s General Annual Report for 1999 shows that while there were more than nine thousand Creditors’ Voluntary Liquidations (CVL) in England and Wales in 1999, the number of CVA cases in the same year was fewer than five hundred.

6 The initiative in proposing a CVA is taken by the directors of the company rather than the creditors. The existing directors/management can stay in place during CVA just like US Chapter 11 which adopts DIP approach. During the CVA procedure, creditors are able to vote for or against the CVA proposal provided by companies as a single class. Approval of the CVA requires a majority in excess of 75% by value at the creditors’ meeting. Court involvement is limited and it has no role in approving the CVA or scrutinizing the CVA proposal’s terms. Thus, after CVA is approved by creditors’ meeting, CVA proposal takes effect and binds creditors and companies. But CVA proposal cannot affect the rights of secured creditors or preferential creditors without their consent. See, e.g., RODRIGO OLIVARES-CAMINAL ET AL., DEBT RESTRUCTURING ¶¶ 3.249-56 (2nd ed. 2016).


8 Finch & Milman, supra note 2, at 419.

9 Payne, supra note 3, at 5.

10 CVL is one of the liquidation processes available to companies in English Insolvency Law.

The most common explanation identified by scholars for CVA’s limited use is the lack of a moratorium (most comparable to the US model for automatic stay, hereinafter “US Automatic Stay” 12) for companies using CVA when negotiating with their creditors. 13 A moratorium can provide financially distressed companies with a breathing space, during which they can be freed from creditors’ interference or individual actions. 14 This breathing period can be used by companies to sort out their problems, propose restructuring plans and negotiate with creditors without harassment. 15 The lack of a moratorium means that once creditors know or are informed of the financial situation of a company, they can exercise their right to seize that company’s assets, regardless of whether the company can be rescued. 16 These individual actions may significantly reduce the likelihood of successfully rescuing the company, as it may be difficult for them to continue business after the disruption of asset seizure. Accordingly, insolvent companies considering CVA must combine CVA with administration in order to obtain the important protection of a moratorium. This makes the restructuring quite expensive and complex, 17 significantly reducing its appeal for small companies.

In order to deal with this issue, the Insolvency Act of 2000 introduced a CVA moratorium (Hereinafter “2000 CVA Moratorium”), which is currently regulated in

12 The comparison between the US Automatic Stay with English Moratorium will be discussed in Part 2 and 5.

13 See LAN F. FLETCHER, LAW OF INSOLVENCY 403 (3rd ed. 2002); See also Finch & Milman, supra note 2, at 419.


15 Keay & Walton, supra note 14, at 108;

16 Finch & Milman, supra note 2, at 316-17 (discussing that certain individual actions of creditors are prohibited during moratorium).

Schedule A1 of the Insolvency Act of 1986.\textsuperscript{18} The 2000 CVA Moratorium mirrors many aspects of the moratorium provided in administration and is only available for small companies.\textsuperscript{19} Likewise, it applies only to CVA procedures and is included in no other avenue of insolvency proceedings in England. It seems at first glance that the 2000 CVA Moratorium could partly solve the problems of CVA as small companies, who are the main users of CVA procedure, can obtain protection without filing for administration. However, Insolvency Service data shows that CVA is still of limited use, and that the 2000 CVA Moratorium has also been little used by companies, appearing in only eighteen cases during 2007–08.\textsuperscript{20}

One frequently identified reason for this is that eligibility of the 2000 CVA Moratorium is so restricted that only very few companies are eligible for it.\textsuperscript{21} In response to this criticism, the UK government stated in \textit{A Review of the Corporate Insolvency Framework—A Consultation on Options For Reform} (Hereinafter “2016 Government Review”) and \textit{Insolvency and Corporate Governance: Government Response} (Hereinafter “2018 Government Response”) that it planned to introduce a new pre-insolvency moratorium (Hereinafter “2018 Pre-Insolvency Moratorium”).\textsuperscript{22}

\begin{itemize}
\item \textsuperscript{18} Payne, supra note 3, at 288.
\item \textsuperscript{19} In England, a company qualifies as small in relation to its first financial year if it meets two or more of the following requirements: 1. Not more than £10.2 million turnover; 2. Not more than £5.1 million balance sheet total; 3. Not more than 50 number of employees. See Companies Act 2006, § 382 (3) (Eng.).
\item \textsuperscript{20} Olivares-Caminal et al., supra note 6, at ¶ 3.278.
\item \textsuperscript{21} To obtain protection of this moratorium, companies have to satisfy criteria set in Companies Act, which is argued to make only few companies eligible for this moratorium. See id. at ¶ 3.279; Payne supra note 3, at 241; See also John Paul Tribe, \textit{The Extension of Small Company Voluntary Arrangements: A Response to the Conservative Party’s Corporate Restructuring Proposals}, in \textit{INSOLVENCY LAW: ISSUES, THEMES AND PERSPECTIVES} (P. Omar, ed., Forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1328478.
\end{itemize}
This moratorium is proposed to be available to all insolvency proceedings in England but the main government purpose of proposing this moratorium is to deal with the problem of limited use of 2000 CVA Moratorium. Though this 2018 Pre-Insolvency Moratorium has not yet become effective, if adopted, it will replace the current 2000 CVA Moratorium and is proposed to be available for all companies using CVA regardless of their size. The government expects that by addressing the limited eligibility problem of the 2000 CVA Moratorium, companies will be incentivized to use CVA.

Just like the 2018 Government Response, most current literature attributes the limited use of the 2000 CVA Moratorium to its eligibility restrictions but not its compliance cost and signalling problems. In addition, upon my research, there is no current literature touching on the compliance cost and signalling problems of the proposed 2018 Pre-Insolvency Moratorium. Therefore, as a first attempt, this article argues that the failure of the 2000 CVA Moratorium is not because of its eligibility restrictions but because of the compliance cost and signalling problems brought about by applying for it. The 2018 Pre-Insolvency Moratorium proposed in the 2016 Government Review and 2018 Government Response puts the focus, wrongly, on the eligibility restrictions but leaves compliance cost and signalling problems untouched.

This article will argue that, considering the special features and concerns of small companies, a more suitable moratorium (one that is particularly tailored for small companies) should be proposed to respond to the defects of both the current 2000 CVA Moratorium and the proposed 2018 Pre-Insolvency Moratorium. This article hopes that in the future, when the UK government proposes a bill based on the 2018


23 Department for Business, Energy & Industrial Strategy, supra note 22, at ¶ 5.5.
24 Id, at ¶ 5.14.
25 Id. at ¶ 5.10.
26 See supra pp. 9-10.
Government Response, it can include my proposal of a special moratorium in place of the proposed 2018 Pre-Insolvency Moratorium for CVA procedure.

To put forward reform suggestions, Part 1 of this article will first make a brief introduction of UK moratorium regimes in comparison with those of US Automatic Stay and then address the necessity of a moratorium for small companies intending to use CVA. Part 2 will introduce the special concerns and features of small companies, which can provide insights into the unsuitableness of the current 2000 CVA Moratorium and proposed 2018 Pre-Insolvency Moratorium, and provide justifications for a special moratorium for small companies. Part 3 will identify the compliance cost and signalling problems in the current 2000 CVA Moratorium and the proposed 2018 Pre-Insolvency Moratorium, especially for small companies. After identifying the problems of these two moratoriums, Part 4 will make comparisons between procedural hurdles of the US Automatic Stay and UK moratorium models to see whether there is any insight that can be gained from the US regime. Part 5 will then provide reform suggestions for a special moratorium for small companies and make justifications for these suggestions by arguing against the 2018 Pre-Insolvency Moratorium’s focus on eligibility restrictions, and appealing to the distinctive features of small companies discussed in Part 2.

1. THE NECESSITY OF MORATORIUMS FOR SMALL COMPANIES

As mentioned in the introduction, just like US Automatic Stay, an English moratorium can provide financially distressed companies a breathing space during which they can sort out problems and propose solutions, such as improving their management “either by replacement or through management training and development.” 27 To be more specific, during the period of an administration moratorium, liquidation, enforcement of any creditor’s right, re-entry by the landlord or any legal process is suspended without the permission of administrators or the leave

27 See Pandit et al, supra note 16, at 245; See also Fletcher, supra note 4, at 127-28.
Although the effect of a moratorium is not as strong as U.S Automatic Stay (which also suspends exercising set-off claims and *ipso facto* clauses), the UK moratorium is powerful enough to prevent grab-race problems that assets are seized by creditors who take actions first, as it prohibits most creditors’ individual actions.

It is, however, argued by some scholars that a moratorium is not necessary for small companies in CVAs, and thus attention should not be put on reforming moratoriums. Professor Fletcher puts forward a scenario where a moratorium is not needed in CVA procedure. In such a case, there are not many significant creditors, and all creditors are supportive of rescuing the company. Under such a scenario, “a sufficient majority of votes” can be secured to adopt the CVA proposal, and there is a very minimal possibility that CVA may be disrupted by creditors’ individual actions.

Likewise, Professor Milman points out that the reported litigation about creditors applying for court leave to exercise rights during the period of a moratorium (i.e., applying for court leave for continuing litigation) has been little. He infers that this

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29 *Ipso facto* clauses are the provisions in agreements that permits termination of these agreements due to Bankruptcy/Insolvency. With *ipso facto* clauses, the non-insolvency party normally has rights to terminate an agreement if another party files for bankruptcy or insolvency proceedings. The US Automatic Stay is drafted in the broadest terms that it is against “any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title”. See 11 U.S.C. § 362(a) (2006); ELIZABETH WARREN, REORGANIZING AMERICAN BUSINESSES (ESSENTIALS) 27-28 (3rd ed., 2008); See also Finch & Milman, *supra* note 2, at 230-31.

30 A brief introduction of grab-race problems will be provided in the subsequent paragraphs. For a comprehensive understanding of grab-race problem or common pool problem in Insolvency/Bankruptcy law, see generally, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (2001).

31 Fletcher, *supra* note 4, at 133.

32 *Id.*

33 *Id.*

is, perhaps, because an impatient creditor can often be persuaded not to exercise their rights after being informed of the potential economic benefits of a CVA.\textsuperscript{35}

Professor Tribe, following the insights mentioned above, argues that in CVA procedure, “the moratorium should be superfluous and indeed would be in a consensual CVA.”\textsuperscript{36} This is because, in Professor Tribe’s opinion, considering the burdensome compliance cost associated with gaining protection from a moratorium, it is more cost-effective for small companies to adopt a wholly consensual CVA without a moratorium.\textsuperscript{37} Such wholly consensual CVAs can be achieved if all creditors (especially secured creditors) are incentivized not to exercise their rights.\textsuperscript{38} In other words, as long as all creditors adopt the “all creditor benefit outcome”, they would not voluntarily interfere with the CVA procedure, and thus there would be no need for companies to obtain a moratorium.\textsuperscript{39} According to Professor Tribe’s argument, the focus should be on how to incentivize creditors not to exercise rights so that fully consensual CVAs can be increasingly adopted in practice.\textsuperscript{40} In this case, the necessity of obtaining a moratorium for small companies can be dispensed with, and thus it is not necessary to further reform CVA moratoriums.

In short, the main argument put forward by the above-mentioned scholars is that creditors may be incentivized or persuaded not to take individual actions to disrupt CVA procedure so that a moratorium is not necessary, at least in certain cases. This argument, however, is obviously at odds with the “common pool” or “grab-race” problem that the insolvency law aims to handle. According to the common pool theory, without the collective regime created by insolvency law, creditors are easily

\textsuperscript{35} Id.
\textsuperscript{37} Id.
\textsuperscript{38} Id. at 20.
\textsuperscript{39} Id. at 27.
\textsuperscript{40} Id. at 20.
incentivized by the grab-race problem and “their allocation of assets on the basis of first-come, first-served” to take individual actions to seize company assets. 41 Otherwise, they may “run the risk of getting nothing” back.42 In other words, according to this theory, even if creditors know that individual actions are not beneficial to creditors as a group, or to the insolvent company, they may still exercise their rights for their own benefit, in fear of assets being claimed by other creditors.43 Therefore, it is quite weak to argue that impatient creditors can be easily persuaded not to take individual actions, even if they are informed of the potential economic benefits of CVA. Therefore, a moratorium is still necessary for small companies to successfully restructure their debts in CVA procedure. Moreover, though it is true that, in some cases, creditors do agree not to take individual actions to disrupt CVA procedure, it is premature to argue that the “moratorium should be superfluous.”44 It is a better view to provide an optional moratorium, particularly tailored for small companies, so that they can choose whether to obtain its protection based on their practical needs.

Professor Tribe himself admits the above-mentioned weakness of his argument and argues that, though such argument is at odds with “common pool” problem, compared with bearing the burdensome compliance cost associated with the 2000 CVA Moratorium, it is more cost-effective that creditors “buy-in” to the insolvency process.45 In other words, the main reason he objects to the use of a moratorium in CVA for small companies is that the current 2000 CVA Moratorium involves too high a compliance cost, which is not cost-effective compared with obtaining a fully consensual CVA.46 It can thus be inferred that, though at first glance Professor Tribe seems to object to use of CVA moratorium for small companies, he does not directly negate such necessity. Therefore, the real issue is the burdensome compliance cost of

42 Id.
43 Id.
44 As argued by Professor Tribe. See id. at 4.
45 See id. at note 125.
46 Professor Tribe criticized several times of the compliance cost of current 2000 CVA Moratorium. See id. at 7, 17, 22.
the current 2000 CVA Moratorium rather than the necessity of a moratorium itself. As long as such compliance costs are addressed, it seems that Professor Tribe will be in favour of using a moratorium to deal with “common pool” problems.47

Accordingly, this article argues that a CVA moratorium is still necessary to prevent creditors’ individual actions and rescue companies. The objections to the necessity of a moratorium can be addressed if an optional version of the moratorium, particularly tailored for the needs of small companies, is introduced into the CVA regime. This is partly evidenced by the R3 Membership Survey in 2017 that showed nearly 40% respondents (117 out of 156 respondents who have experience in CVA) agree with the idea of revising the moratorium process to foster the use of CVA.48 To put forward reform suggestions of such a revised and special moratorium for small companies, this article would first discuss the special features or concerns of small companies.

2. SPECIAL FEATURES AND CONCERNS OF SMALL-SIZED COMPANIES

Small-sized companies are of significant economic importance and may offer a great number of social benefits to their country. They constitute a large portion of enterprises in UK economies and make a great contribution to the private sector.49 In the UK, small- and medium-sized companies50 play a crucial part in the private sector,

47 See id. at note 125 (admitting the existence of grab-race problems and indicating that his focus is on compliance cost of current moratorium).


49 DAVID JOHN STOREY, UNDERSTANDING THE SMALL BUSINESS SECTOR 8 (1994).

50 There is no unified definition of small companies and medium-sized companies for different countries. In UK, the definition of small companies is mentioned in note 16. See Companies Act 2006, § 382 (3) (Eng.). Medium-sized companies should meet two or more of the following requirements: 1. Turnover not more than £36 million; 2. Balance sheet total not more than £18 million; 3. Number of employees not more than 250. See Companies Act 2006, § 465 (3) (Eng.); See also, Ronald B. Davis, et al, The Modular Approach to Micro, Small, and Medium
accounting for over 99% of businesses.\textsuperscript{51} Moreover, small companies can bring several social benefits as they are a rich source of employment opportunities and have much potential to utilize new technologies.\textsuperscript{52} Empirical data shows that small and medium-sized companies can account for nearly 60% of private sector employment,\textsuperscript{53} which provides significant benefits to the whole society. While small companies are of great economic and social importance, they have quite distinct features and concerns compared with companies of a larger size.

(1) Financially vulnerable but viable. The economic situation or status of small-sized companies is quite distinguished from companies of a larger size. One difference is that small companies often have a greater tendency to fail compared with larger companies due to several combined factors, such as their limited size or scope.\textsuperscript{54} While small companies are more likely to fail, many small firms’ financial performance is inherently viable over time.\textsuperscript{55} In addition, it is common for a significant number of small companies to experience financial difficulties intermittently while their businesses remain viable.\textsuperscript{56} Thus, it can be argued that small-sized companies are worthy of being rescued, considering that they are financially vulnerable but still viable businesses.

(2) Limited & undiversified creditors. Another special feature is that small-sized companies normally rely on a limited number of creditors or specific traders compared
with companies of a larger size, which may trade or gain credit from a number of different creditors.\textsuperscript{57} In other words, they may be relatively undiversified so that losing even only one significant creditor such as an important trader has a higher impact on them.\textsuperscript{58}

(3) **Overlapped ownership and management.** Another distinct feature is that for many small-sized companies, there may not be very clear distinctions between ownership and management of the business. This is partly because for some small companies, their businesses are relatively small and may be family-run. Therefore, owners of these companies will also take charge of the daily management of the company instead of employing outsiders as directors as in publicly trading companies.\textsuperscript{59} Put another way, directors who manage small companies are often connected closely to the business, with extensive personal investment.\textsuperscript{60} In addition, in order to gain credit in daily management of these businesses, the owners of small companies are often required to “secure business loans with their personal assets or personal guarantees,” due to lack of sufficient access to credit.\textsuperscript{61} This means that there is a convergence between personal and business liabilities.\textsuperscript{62} In other words, owners or directors are more financially connected to small companies compared with larger-sized companies, who normally do not require shareholders to provide personal guarantees in lending. In sum, in a small company context, not only may ownership

\textsuperscript{57} See Davis et al., *supra* note 50, at 20 (discussing that smaller companies are often undiversified to creditors).

\textsuperscript{58} Id.


\textsuperscript{61} Davis et al., *supra* note 50, at 24.

\textsuperscript{62} Id.
overlap with management to certain extent but personal liability may also be highly associated with business liability.

(4) **Loose accounting duties.** In addition, small-sized companies also share different features regarding their accounting duties as compared with companies of a larger size. Small companies may have distinct accounting rules being applied to them, and may have fewer or more flexible duties to file accounts than large companies.\(^63\) Moreover, small companies may not fulfil these duties well, which partly results from a lack of accounting expertise.\(^64\) For example, regarding the bookkeeping duties within small companies, it is common to hire a family member or friend to “do the books,” rather than hiring a professional accountant.\(^65\) However, these family members or friends may lack accounting expertise which may result in a failure to manage accounting books satisfactorily. Information problems may thus arise, as the accounting books of small companies may fail to provide accurate and sufficient financial information during insolvency or bankruptcy proceedings. In sum, small companies may be required to obey looser accounting duties but may still not fulfil such duties sufficiently, due in part to a lack of accounting expertise, which may cause information problems.

(5) **Lack of expertise.** In addition to lacking accounting expertise, small-sized companies face a lack of expertise in several other aspects. One example is that these companies may lack in “specialist credit and risk management expertise” because they may be unable to afford hiring professionals or training their employees.\(^66\) In addition, the vast majority of small-sized companies who suffer from financial problems do not

\(^63\) *Id.* at 89-90.

\(^64\) *Id.*

\(^65\) See *The Importance of Accounting for Small Businesses*, [ACCOUNTING.COM](https://www.accounting.com/resources/accounting-basics-small-business/) (Identifying the practice of current some small businesses regarding bookkeeping, and advising how should small businesses fulfill the bookkeeping duties).

\(^66\) *Id.* at 21.
have the financial or human resources available to comply with the requirements of insolvency proceedings.67

Based on this information regarding the special features of small companies, in the next part, this article will identify problems of the current 2000 CVA moratorium and proposed 2018 Pre-Insolvency Moratorium, especially for small-sized companies.

3. PROBLEMS OF THE CURRENT 2000 CVA MORATORIUM AND PROPOSED 2018 PRE-INSOLVENCY MORATORIUM

3.1. 2000 CVA Moratorium

To obtain the protection of the 2000 CVA Moratorium, the directors of eligible companies should first choose a nominee, normally a licensed insolvency practitioner (Hereinafter “IP”), and then submit their nominee, CVA proposal68 and a statement of the company’s affairs.69 The nominee will then submit a statement to the directors indicating, in their opinion, whether the proposal has a reasonable prospect of approval and implementation, sufficient funds throughout the moratorium, and whether meetings should be called to consider the proposal.70 The moratorium begins only after the directors file the proposal, a statement of company’s affairs and statements from the nominee with the court and ends when creditors’ meetings are held.71

During the period of moratorium, the nominee has the responsibility to consistently monitor the company’s affairs and form an opinion as to whether the CVA

67 Id. at 27.
68 In CVA proceeding, in order to restructure their debts, financial distressed companies need to provide creditors with a CVA proposal which includes companies’ plans of restructuring including how creditors’ debts will be compromised and what scheme of arrangement will be adopted. See Tribe, supra note 36, at 14-15; See also Olivares-Caminal et al., supra note 6, at ¶¶ 3.250-3.251 (2nd ed. 2016).
69 Insolvency Act 1986, Sch. A1, ¶ 6(1) (Eng.).
70 Insolvency Act 1986, Sch. A1, ¶ 6(2) (Eng.).
71 Insolvency Act 1986, Sch. A1, ¶¶ 7(1), 8(2) (Eng.). See also Finch & Milman, supra note 2, at 421.
proposal still has a reasonable prospect of being approved and implemented, and whether the company still would be likely to have sufficient funds.\textsuperscript{72} If the nominee forms negative opinions of the above issues, they may withdraw their consent to act and the moratorium thus ends due to nominees’ withdrawal.\textsuperscript{73}

Based on the procedure requirements of the 2000 CVA Moratorium, this article will discuss the associated compliance cost and signalling problems.

3.1.1. Compliance Cost in a Small Company Context

It should be noted that the steps to gain the protection of this 2000 CVA Moratorium are quite onerous and may incur burdensome compliance costs. Firstly, as mentioned above, to apply for the moratorium, a statement of the company’s affairs and other necessary information must be submitted to a nominee.\textsuperscript{74} This means that far before they enter into the CVA procedure itself, the company already has to spend time and money on preparing this statement or other necessary documents in order to gain the protection of a moratorium.

In addition, the requirement that nominees need to consent to act by examining the company’s financial situation and pre-drafted CVA proposals\textsuperscript{75} means nominees have to engage in a significant amount of work before forming any opinion. Nominees have to conduct extensive consultations with the company, creditors and potential funders in order to make a responsible statement.\textsuperscript{76} This unavoidably requires a significant amount of time and incurs a great deal of cost for nominees, which is undertaken by the company in a CVA procedure.

Thus, the compliance cost associated with this requirement is not negligible for companies at all. Moreover, the time and cost the nominee spends on examining such proposals is likely to be a waste, as such CVA proposals are not final and are subject to

\textsuperscript{72} Insolvency Act 1986, Sch. A1, ¶ 24(1) (Eng.).
\textsuperscript{73} Insolvency Act 1986, Sch. A1, ¶ 25 (Eng.).
\textsuperscript{74} Insolvency Act 1986, Sch. A1, ¶ 6(1) (Eng.).
\textsuperscript{75} Insolvency Act 1986, Sch. A1, ¶ 6(2) (Eng.).
\textsuperscript{76} Finch & Milman, \textit{supra} note 2, at 426; See also Payne, \textit{supra} note 3, at 289-90.
change in subsequent processes. Additionally, this early version of the CVA proposal may be quite unsatisfactory due to signalling concerns since companies are afraid to negotiate with most creditors without the protection of a moratorium. Therefore, it is reasonable to predict that the substance of such early drafted CVA proposals may have a high possibility of being amended or even rejected at the request of creditors in subsequent processes. This means that the work and time spent by nominees on examining such early version of proposal may only have nominal value. The compliance cost associated with the requirement of nominees consenting to act is thus not only high but also wasteful.

The compliance cost associated with this moratorium is particularly onerous for small companies since they normally lack enough expertise to efficiently prepare these documents and statements. This means it is less cost-effective for small companies to do the preparation involved in obtaining the moratorium compared with large companies.

The compliance cost of nominees consenting to act is also enhanced in the small company context. The reason is that it is more difficult for nominees to know the accurate financial situation of a small company because, as mentioned in Part 2, these companies may not have a strict legal duty to produce the required accounts, and these duties are not well enforced due to their little or no expertise in account drafting. In this sense, in a small company context, nominees have to consult more intensively with creditors or request more information from the company, which may result in a higher

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77 Companies may change their proposals during the period of this moratorium and also during the period of subsequent CVA process because they have to negotiate with creditors during such periods to ensure required percentage of creditors are in favor of such proposal. See generally, Tribe, supra note 36; Olivares-Caminal et al., supra note 6, at ¶¶ 3.246-3.277.

78 Negotiating with creditors when a moratorium is not in place can signal creditors of companies’ financial problems. The creditors being signaled may thus take individual actions to seize companies’ assets in fear of grab-race. See discussion infra Part 3.1.2 on signaling problems.

79 See discussion supra Part 2(4) & (5); See also Davis et al., supra note 50, at 21, 27.

80 See discussion supra Part 2(5); See also Davis et al., supra note 50, at 89-90.
compliance cost for companies since any cost incurred by nominees’ work are undertaken by companies.

3.1.2. Signalling Problems in a Small Company Context

Attention should also be paid to the signalling problems associated with the 2000 CVA Moratorium. To obtain this moratorium, it is required that a CVA proposal should have already been drafted and submitted to a nominee at the outset.\(^{81}\) This means that the company may have to negotiate with some creditors (but possibly not all of them due to signalling concerns\(^ {82}\)) or potential funders before applying for the moratorium in order to come up with an early version of the proposal that is reasonably likely to be accepted.\(^ {83}\) Negotiation at such early stage may, however, expose the company’s financial difficulties to creditors or even the public, as the current 2000 CVA Moratorium does not offer protection during this early period.\(^ {84}\) Thus, it is reasonable to argue that the current CVA Moratorium may only provide protection after companies’ financial problems are signalled to the public or at least to some creditors.\(^ {85}\) Signalling problems may thus arise in that creditors may be informed of the company’s need for a moratorium, which may lead them to conclude the company is facing cash flow difficulties, leading them to take individual action regardless of the company’s attempts to continue business.\(^ {86}\)

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\(^{81}\) See supra notes 68-69 and accompanying text.

\(^{82}\) In such early period, companies are not protected by moratorium so that creditors may take individual actions when they are informed of potential insolvency/bankruptcy proceedings. Companies thus may have signaling concerns. See infra notes 84-86 and accompanying text.

\(^{83}\) Though this version of proposal is only an early version and is subject to change (See supra note 74 and accompany text), under current procedural requirements of 2000 CVA proposal, such version of proposal need to be reasonable that it is likely to be accepted by creditors so that it can pass the examination of nominees. See Insolvency Act 1986, Sch. A1, ¶ 6(2) (Eng.).


\(^{85}\) Id.

\(^{86}\) Olivares-Caminal et al., supra note 6, at ¶¶ 3.281-3.282.
Moreover, there is a period after the company submits their financial statements, CVA proposals and other documents to the nominee but before the moratorium takes effect when nominees have to form an opinion about the companies’ situations.  

During this period, as mentioned in part 3.1.1, to form a responsible opinion, nominees may engage in consultations with certain creditors, especially trading creditors or proposed funders. In this sense, the same signalling problems may arise during this period since such consultations will inform outsiders (e.g., creditors and potential funders) of financial difficulties within the company, and thus may incur creditors’ tactic actions.

These signalling problems are exacerbated in a small company context. Firstly, the chance of creditors being signalled of a company’s financial problems before the moratorium takes effect is relatively larger for small-sized companies compared with larger companies. For the same reasons discussed in Part 2 (lack of financial and legal expertise), small companies may spend more on negotiating with outsiders and then preparing CVA proposals before applying for the moratorium while the moratorium is not in effect. In other words, the period from the time companies begin negotiating with outsiders and preparing CVA proposals to the time the moratorium takes effect may be longer for small companies than larger ones. This means the possibility that the financial situations of the company is signalled to the public is relatively higher since the period during which the moratorium has not started is longer.

In addition, the impact of potential signalling problems is more serious for small companies. The reason for this is that, as discussed in Part 2, small companies normally rely on only a few major creditors (such as certain trade creditors), unlike

87 After companies submit required documents to nominees, nominees will spend time to examine the documents and form their opinions whether consenting to act or not. This period is not protected by moratorium since moratorium takes effect after companies submit the opinion of nominees to the court. See Insolvency Act 1986, Sch. A1, ¶ 6(1)&(2), 7(1), 8(2) (Eng.).

88 See supra note 76 and accompanying text; See supra Part 3.1.1.

89 Olivares-Caminal et al., supra note 6, at ¶¶ 3.281-3.282.

90 See Davis et al., supra note 50, at 21, 27; See supra Part 2.
large companies which trade with many different creditors at a time.\textsuperscript{91} In other words, when signalling problems arise in a small company context, most of the company’s major creditors will be informed of the financial difficulties, while in a large company context, the percentage of informed creditors is relatively low. To illustrate: suppose Small Company A only relies on three major trade creditors. When two of these major creditors are informed of the financial problems and take individual actions, Company A will be left with only one major creditor and may lose the ability to continue business and to begin restructuring. In contrast, suppose a larger-sized Company B has ten major trade creditors. When two creditors are signalled of the situation, Company B can still rely on eight other creditors to continue business and begin the restructuring process. Therefore, the impact of signalling problems is much more serious in a small company context.

3.2. Proposed 2018 Pre-Insolvency Moratorium

As discussed in our introduction, in the 2016 Government Review and 2018 Government Response, a new 2018 Pre-Insolvency Moratorium is proposed. To recall, there are two main changes in this 2018 Pre-Insolvency Moratorium. Firstly, the government proposes to make this moratorium available to all companies instead of only small-sized companies in order to repeal the eligibility restrictions of the 2000 CVA Moratorium.\textsuperscript{92} Secondly, the government also intends to reduce the cost of restructuring through “the introduction of a moratorium with a clearly defined and streamlined entry process.”\textsuperscript{93} By doing so, the government hopes that the limited use of the 2000 CVA Moratorium can be solved.\textsuperscript{94} However, the proposal provided by the government not only puts the focus wrongly on the eligibility restrictions of the 2000 CVA Moratorium but also fails to reduce the cost associated with the 2000 CVA Moratorium.

\textsuperscript{91} David et al., supra note 50, at 20; See supra Part 2(2).
\textsuperscript{92} Department for Business, Energy & Industrial Strategy, supra note 22, at ¶ 5.10.
\textsuperscript{93} Id. at ¶¶ 5.10, 5.13; The Insolvency Service, supra note 22, at ¶¶ 7.6-7.7.
\textsuperscript{94} Department for Business, Energy & Industrial Strategy, supra note 22, at ¶¶ 5.10, 5.14.
Moratorium. In addition, this proposed 2018 Pre-Insolvency Moratorium leaves the signalling problems of the 2000 CVA Moratorium untouched. Based on these problems, this article will argue that this proposal should not be adopted in the future for CVA procedure, and that a new proposal should be put forward instead.

The procedure to obtain the protection of the 2018 Pre-Insolvency Moratorium follows the current procedure for an out-of-court appointment of an administrator in administration. To apply for this moratorium, the directors will first select a supervisor and give written notice to this potential supervisor. After this supervisor has been chosen, the directors shall file a Notice of Statement and other prescribed documents with the court. The prescribed documents include a statement by the supervisor indicating “their consents to act and confirmation that they have assessed the eligibility tests and qualifying conditions and are satisfied these have been met.” The qualifying conditions include requirements that “the company must be able to show that it is likely to have sufficient funds to carry on its business during the moratorium, meeting current obligations when they fall due as well as any new obligations that are incurred,” and that “there is a reasonable prospect that a compromise or arrangement

95 See infra Part 3.2.1, Part 5(1).
96 See infra Part 3.2.2.
97 See infra Part 3.2.1-3.2.2.
98 Since the procedure in applying for this proposed New-Insolvency Moratorium assembles the out of court appointment of administrator process, it is reasonable that the provisions in Insolvency Act 1986 (Eng.) regarding administrator’s appointment can be used to describe the details of such procedure. See Department for Business, Energy & Industrial Strategy, supra note 22, at ¶ 5.19.
99 The Insolvency Service, supra note 22, at ¶ 7.14; See also Insolvency Act 1986, Sch. B1, ¶ 26 (Eng.)(The provisions of out of court appointment of an administrator).
100 See Insolvency Act 1986, Sch. B1, ¶¶ 27, 28 (Eng.)(The provisions of out of court appointment of an administrator).
101 Department for Business, Energy & Industrial Strategy, supra note 22, at ¶ 5.19; See also Insolvency Act 1986, Sch. B1, ¶ 28 (Eng.)(The provisions of out of court appointment of an administrator).
can be agreed with its creditor.\textsuperscript{102} The supervisor is expected to make the statement based on the information requested from and prepared by the directors.\textsuperscript{103} This proposed 2018 Pre-Insolvency Moratorium thus takes effect when the directors file these documents with the courts.\textsuperscript{104} It should be noted that the procedure to obtain the protection of this moratorium is very similar to the procedure for the 2000 CVA Moratorium. Both procedures require directors to select a nominee or supervisor to file their statements.\textsuperscript{105} These statements, under both procedures, require the nominees’ or supervisors’ consent to act, based on their opinion of whether an arrangement or compromise has a reasonable prospect of being agreed and whether companies are likely to have sufficient funds to carry on business.\textsuperscript{106} Both moratoriums comes into force when directors file prescribed documents with the court.\textsuperscript{107}

During the period of this pre-insolvency moratorium, the supervisor has the responsibility to ensure that the qualifying conditions mentioned above continue to be met.\textsuperscript{108} If any condition is not met during this period, the supervisor must make creditors aware of the situation and report it to court.\textsuperscript{109} By making comparison with the procedure requirements of the 2000 CVA Moratorium, the role of the supervisor under the 2018 Pre-Insolvency Moratorium is very similar to the monitoring role of the nominee in the 2000 CVA Moratorium.\textsuperscript{110}

\textsuperscript{102} The Insolvency Service, supra note 22, at ¶¶ 7.22-7.23; See also Jennifer Payne, Debt Restructuring in the UK, 15 EUR. COMPANY & FIN. L. REV. 449, 465-468(2018).
\textsuperscript{103} The Insolvency Service, supra note 22, at ¶ 7.42.
\textsuperscript{104} See Insolvency Act 1986, Sch. B1, ¶¶ 27, 28 (Eng.)(The provisions of out of court appointment of an administrator).
\textsuperscript{105} See discussions on procedures to obtain 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium. See supra pp 26-27, 35-38.
\textsuperscript{106} Id.
\textsuperscript{107} Id.
\textsuperscript{108} The Insolvency Service, supra note 22, at ¶¶ 7.40-7.43.
\textsuperscript{109} Id. at ¶ 7.43.
\textsuperscript{110} See discussions on the nominees or supervisors’ role during 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium. See supra pp 26-27, 35-38.
Moreover, during the protection period of the 2018 Pre-Insolvency Moratorium, creditors have a right to challenge the moratorium at court by raising objections based on the grounds of unfair prejudice or any qualifying condition not being met.\textsuperscript{111} In addition, creditors have the right to request information from the supervisor during moratorium in order to “make better informed decisions and assumptions” for their business, and to protect their own interests.\textsuperscript{112}

3.2.1. \textit{Compliance Cost and Signalling Problems}

The purpose in making the procedure of entry into the 2018 Pre-Insolvency Moratorium resemble the current procedure for an out of court appointment of an administrator is to avoid unnecessary costs and delays compared with a full court hearing.\textsuperscript{113} However, when we compare the procedure with that to obtain the 2000 CVA Moratorium, we can see that both procedures are actually very similar.\textsuperscript{114} This means that not only is the compliance cost of the 2000 CVA Moratorium not solved by the proposed 2018 Pre-Insolvency Moratorium but signalling problems are also untouched.

\textbf{(1) Compliance Cost.} Before the commencement of a moratorium, the supervisor is still required to provide a statement of consent to act (just like the nominee in the 2000 CVA Moratorium), based on his opinion of qualifying conditions being met.\textsuperscript{115} Such conditions include that the supervisor examine the reasonableness of the

\textsuperscript{111} The Insolvency Service, \textit{supra} note 22, at ¶¶ 7.25-7.26; Department for Business, Energy & Industrial Strategy, \textit{supra} note 22, at ¶ 5.20.

\textsuperscript{112} Before Enterprise Act 2002 (Eng.) took into effect, a full court hearing is required to appoint an administrator to enter into administration which is quite burdensome. Thus Enterprise Act 2002 added out of court appointment of administrator in order to reduce the cost of restructuring in administration. Here, the procedure of this 2018 Pre-Insolvency Moratorium resembles the out of court appointment of administrator in order to reduce the cost. See The Insolvency Service, \textit{supra} note 22, at ¶ 7.48.

\textsuperscript{113} Department for Business, Energy & Industrial Strategy, \textit{supra} note 22, at ¶¶ 5.18-5.19.

\textsuperscript{114} See \textit{supra} pp. 35-38, notes 105-107 and accompanying text.

\textsuperscript{115} See \textit{supra} notes 98-104 and accompanying text.
proposed compromise or arrangement (the proposal), and whether companies have sufficient funds.\textsuperscript{116} Therefore, similar compliance costs associated with companies preparing relevant documents and supervisors involving creditors or potential funders in consultation still exist in this 2018 Pre-Insolvency Moratorium.\textsuperscript{117} Under similar arguments discussed in Part 3.1.1, the compliance cost is more serious for small companies.\textsuperscript{118}

(2) \textbf{Signalling Problems.} Though part of the government’s intention in introducing this moratorium is to cover “initial negotiations aimed at developing a proposal,”\textsuperscript{119} it still cannot protect companies within the period from their first negotiation with major creditors to the moratorium finally taking effect. This gap within the 2018 Pre-Insolvency Moratorium is similar to that of the 2000 CVA Moratorium.\textsuperscript{120} This is because, before the commencement of this 2018 Pre-Insolvency Moratorium, just like in the 2000 CVA Moratorium, companies need to demonstrate that their proposed compromise or arrangement (i.e., the proposal) has a reasonable prospect to be agreed upon by its creditors.\textsuperscript{121} This means that before the moratorium takes effect, like in 2000 CVA Moratorium, companies still need to draft a proposal, which may involve communicating with creditors.\textsuperscript{122} Such communication with creditors may lead to their financial difficulties being signalled to the public, and thus signalling problems similar to those of the 2000 CVA Moratorium still exist in this 2018 Pre-Insolvency Moratorium.\textsuperscript{123} Under similar arguments discussed in Part 3.1.2, signalling problems are more serious for small companies.\textsuperscript{124}

\textsuperscript{116} Id.
\textsuperscript{117} See supra Part 3.1.1.
\textsuperscript{118} Id.
\textsuperscript{119} The Insolvency Service, supra note 22, at ¶ 7.7.
\textsuperscript{120} See supra notes 99-105 and accompanying text, Part 3.1.2.
\textsuperscript{121} Id.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} See supra note Part 3.1.2.
3.3. **Summary**

In summary, the proposed 2018 Pre-Insolvency Moratorium intends to solve the problem of restrictive entry criteria in the 2000 CVA Moratorium and also reduce the associated cost. However, this proposal, in substance, fails to solve the compliance cost problems and also leaves the signalling problems of the 2000 CVA Moratorium untouched, which this article argues are important factors in why small companies do not use the 2000 CVA Moratorium. This means that for small companies, even if the proposal is finally enacted into legislature, this 2018 Pre-Insolvency Moratorium is not an appropriate choice. In this sense, a special moratorium particularly tailored for the needs of small companies should be introduced to deal with the compliance cost and signalling problems of the current 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium. Before putting forward any suggestions, this article will examine US bankruptcy law to identify insights for reform of the English moratorium.


US Automatic Stay originated from the common law. At its first codification by Congress, it was only available to protect the essentials of farm operation. Any other proceedings “affecting property other than farm equipment or the household effects of the farmer’s family was excluded from protection”. To stay insolvency proceedings, non-farm related companies had to make an application to the court to restrain creditors’ actions instead of gaining automatic protection. However, with several amendments and further codification, US Automatic Stay has become a very

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126 Id.

127 Id. at 857.

128 Id. at 857, note 39.
strong mechanism under which most creditors’ individual actions are stayed automatically.\textsuperscript{129}

Current US Automatic Stay takes effect automatically the moment a company files a Chapter 11\textsuperscript{130} petition with the bankruptcy court and continues until the conclusion of the Chapter 11 procedure.\textsuperscript{131} Filing a Chapter 11 petition, however, only requires some paper work with “no court hearings and no affidavits from other people”.\textsuperscript{132} The automatic stay is then immediately in effect without any court order or notice to any parties upon filing the petition.\textsuperscript{133} In other words, the cost of obtaining the protection of US Automatic Stay is low. In addition, since there is no need for early negotiation with outsiders (creditors or potential funders) and no court hearing or notice to any party without protection of the stay,\textsuperscript{134} the signalling problems of the English moratorium also do not exist in US Automatic Stay.

There are two strong policy grounds supporting automatic stay in US bankruptcy law. One policy ground is to give debtors a fresh start,\textsuperscript{135} favoring facilitating the restructuring of financially distressed companies instead of letting impatient creditors disrupt the debtors’ restructuring effort.\textsuperscript{136} Another ground is that automatic stay


\textsuperscript{130} Chapter 11 is the only restructuring proceeding existing in US Bankruptcy Law.


\textsuperscript{132} See Warren, supra note 29, at 23-24(Discussing practically how a Chapter 11 petition is filed to the court).

\textsuperscript{133} McPherson, supra note 129, at 24.

\textsuperscript{134} There is no requirement for companies to provide restructuring proposal to file for Chapter 11 petition so that early negotiation with creditors are not required. Besides, there is no court hearing as well as no notice to creditors or the public for filing a Chapter 11 petition. Therefore, obtaining the protection of automatic stay will not notify the public of companies’ financial difficulties. See supra notes 131-133 and accompanying text.

\textsuperscript{135} Filman, supra note 131, at 252.

\textsuperscript{136} See id. at 252-53 (discussing the policy of automatic stay to provide debtors with a fresh start).
promotes the likelihood of creditor equality.\textsuperscript{137} It avoids the “common pool” problem, where stronger creditors make fast movements to collect their debts while weaker creditors are left with nothing.\textsuperscript{138}

While there are strong policy grounds underlying this debtor-friendly automatic stay in the US, US bankruptcy law still provides creditors with adequate protection through several mechanisms in order to successfully achieve the policies without harming creditors’ interests. For example, after petition, creditors are notified of the bankruptcy filing and there are first-day hearings in the court, which creditors can attend to make their objections or challenges.\textsuperscript{139} In addition, during the whole period of the automatic stay/Chapter 11 case, debtors are required to make numerous and periodic filings with the court regarding their financial situation.\textsuperscript{140} Creditors thus can rely on the information filed by the debtors with the court to protect their interests during the stay.\textsuperscript{141} Moreover, unsecured creditors may also take part in the creditors’ committee to monitor the activities of the debtors.\textsuperscript{142} Thus, US bankruptcy law ensures a debtor-friendly automatic stay while providing creditors adequate protection to balance their interests.

Though the current 2000 CVA Moratorium and proposed 2018 Pre-Insolvency Moratorium in England do not take the same debtor-friendly approach as the US,\textsuperscript{143} the policy grounds that the UK government adopts are actually very similar. In the 2018 Government Response, the government expresses their intention to facilitate the

\textsuperscript{137} Filman, \textit{supra} note 131, at 251.

\textsuperscript{138} See Id. at 251, 253 (Discussing the policy of automatic stay to enhance creditor equality).


\textsuperscript{140} Id.

\textsuperscript{141} Id.

\textsuperscript{142} See 11 U.S.C. § 1102, 1103 (2006); See also id; Warren, \textit{supra} note 29, at 66-68.

\textsuperscript{143} As discussed in the previous parts, the 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium both have compliance cost and signaling problems which are not friendly to debtors. \textit{See supra} Part 3.
financial rehabilitation of distressed companies since this is important for a modern economy.\footnote{Department for Business, Energy \& Industrial Strategy, \textit{supra} note 22, at 8, ¶ 5.9.} Moreover, the moratorium also intends to solve the common pool problem to enhance creditor equality.\footnote{\textit{Id.} at 5.5; \textit{See also supra} notes 30, 42-43 and accompanying text.} Since the policy goals of the UK are so similar to the US, it is reasonable to infer that the main reason moratoriums in England are not debtor-friendly is concern for creditor protection. Thus, as long as creditors’ interests are adequately protected (like in the US Automatic Stay), a special moratorium that borrows insights from US Automatic Stay should be provided to replace the current 2000 CVA Moratorium and proposed 2018 Pre-Insolvency Moratorium for CVA procedure.

5. \textsc{Reform Suggestions: A Special Version of English Moratorium}

Based on the discussion in previous parts, this article argues that the proposed 2018 Pre-Insolvency Moratorium should not be adopted into legislature for CVA procedure, and that the special moratorium discussed below (hereinafter “Special CVA Moratorium”) should instead be adopted to replace the current 2000 CVA Moratorium for CVA procedure.

\textbf{(1) Restricted to small-sized companies.} The first reform suggestion is that this Special CVA Moratorium only be available to small-sized companies who intend to use CVA procedure (namely, those companies who are eligible for the current 2000 CVA Moratorium).\footnote{The definition of small-sized companies: \textit{See Companies Act} 2006, § 382 (3) (Eng.); \textit{See also supra} note 19.}

This article argues that the proposed 2018 Pre-Insolvency Moratorium puts the focus wrongly on the eligibility restrictions of the 2000 CVA Moratorium. The 2016 Government Review and 2018 Government Response both argue that it is the strict eligibility restriction of the 2000 CVA Moratorium that leads to its limited use.\footnote{The Insolvency Service, \textit{supra} note 22, at ¶¶ 7.4; Department for Business, Energy \& Industrial Strategy, \textit{supra} note 22, at ¶ 5.5.}
Empirical data, however, shows that while 552 companies entered into CVAs in 2013, 514 of them were classified as small companies, representing 93.1% of all companies surveyed.\textsuperscript{148} These companies all qualify for the 2000 CVA Moratorium but still only 1.6% of eligible companies use it.\textsuperscript{149} Therefore, it can be inferred that the most important reason of 2000 CVA Moratorium’s limited use is not its restrictive eligibility but others, such as the compliance cost and signalling problems discussed in Part 3. This article thus argues that as long as this Special CVA Moratorium can deal with compliance cost and signalling problems, its restrictive eligibility will not affect its use by companies in CVA procedure.

Meanwhile, larger companies normally do not need the protection of such CVA moratoriums, and it is better that this Special CVA Moratorium is only available to small companies. One reason for this is that for companies with relatively larger sizes, a moratorium is not necessary when using CVA procedure. This is because for “large and larger mid-cap companies,” whose retail businesses heavily rely on leased properties and whose key creditors are landlords, the lack of a moratorium may not be a problem “where the landlord’s only remedy is to take repossession and the chances of re-letting the property slight.”\textsuperscript{150} For landlords of closed stores, though they may lose out due to the compromise of lease liabilities through CVA, their loss is likely to be less compared with companies that go into liquidation.\textsuperscript{151} In this sense, it is less likely that landlords will take individual actions to disturb companies’ CVA process. Thus, the lack of a moratorium is not of paramount concern for this kind of larger company, whose major creditors are landlords.

Moreover, English insolvency law is different from US bankruptcy law, which only provides a single restructuring procedure for companies—Chapter 11.\textsuperscript{152} US Automatic Stay thus applies to all companies who file for Chapter 11, regardless of

\textsuperscript{148} Walton, Umfreville, & Jacobs, supra note 48, at 15.
\textsuperscript{149} Id.
\textsuperscript{150} Olivares-Caminal, supra note 6, at ¶¶ 3.285-3.286.
\textsuperscript{151} Id. at ¶ 3.286.
\textsuperscript{152} See supra note 2 and accompanying text.
their size. Under English insolvency law, however, those larger companies who really need the protection of a moratorium can obtain it through administration\(^{153}\) (instead of through the CVA process which is more suitable for small companies). Therefore, borrowing insights from US Automatic Stay, this article suggests providing a special moratorium only for small companies, excluding larger companies.

(2) Special CVA Moratorium based on insights from US Automatic Stay. This article suggests that this Special CVA Moratorium is optional, so that debtors can choose whether to file for its protection. When debtors choose to obtain its protection, this Special CVA Moratorium takes effect immediately upon filing the application in the court (just like US Automatic Stay), and the filing requirements should only be some paper work (like filing a petition for Chapter 11 to trigger an automatic stay under US bankruptcy law\(^{154}\)), such as filing some forms regarding situations of distressed companies. There should be no requirement for companies to provide an early version of their CVA proposal before this Special CVA Moratorium is in effect.\(^{155}\) Meanwhile, this article suggests that companies need to choose an IP and also file the IP’s information to the court, along with the application for this Special CVA Moratorium. But this IP does not act as a nominee to do any substantial examination of companies’ situations, or to make statements of whether the CVA proposal may have a reasonable prospect of being approved and implemented. Instead, the function of this IP is to act as a supervisor during the period of the Special CVA Moratorium after it has already taken effect.\(^{156}\) Therefore, under this Special CVA Moratorium, based on insights from US Automatic Stay, companies do not have to negotiate with creditors in advance of their moratorium. Nominees or supervisors do not need to be involved in extensive consultation with creditors or potential funders in order to form a responsible view

\(^{153}\) In administration, not only companies may get protection of a moratorium but also they can apply for an interim moratorium protection which takes into effect upon application for administration. See Finch & Milman, supra note 3, at 316-17.

\(^{154}\) See supra Part 4.

\(^{155}\) See Jones, supra note 84, at 4 (Suggesting providing CVA proposal before moratorium takes into effect should not be required).

\(^{156}\) See infra Part 5 (3).
when consenting to act. Compliance cost is thus alleviated, and the potential disclosure of companies’ situations to the public before the moratorium takes effect is avoided.

(3) **Mechanisms to protect creditors’ interests.** While adopting this debtor-friendly Special CVA Moratorium, creditors should be granted enough protection, just like in US Automatic Stay. To safeguard creditors’ rights during this Special CVA Moratorium, this article suggests that the moratorium should only last for a short twenty-eight-day period (subject to possibilities of extension) so that creditors’ rights will not be affected for a very long time. This twenty-eight-day period is actually the same as that of the current 2000 CVA Moratorium, and also the initial period of the proposed 2018 Pre-Insolvency Moratorium. In addition, the IP should act as a supervisor during the period of the Special CVA Moratorium to monitor companies’ financial situations, just like in the 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium. The monitoring role of these supervisors will protect the interests of creditors well. Moreover, similar “challenge rights” as proposed in the 2018 Pre-Insolvency Moratorium should be granted to creditors during the period of this Special CVA Moratorium. Furthermore, creditors also have the right to request information from supervisors during the period of this Special CVA Moratorium, just like in the proposed 2018 Pre-Insolvency Moratorium. Therefore, with these mechanisms to protect creditors’ rights, this article argues that this Special CVA Moratorium can serve the policy grounds well, and solve the compliance cost and

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157 See supra Part 4.

158 See Insolvency Act 1986, Sch. A1, ¶ 8; For 2018 Pre-Insolvency Moratorium, when it was first suggested in 2016 Government Review, the proposed period is 3 month. However, this long period is criticized by the public so that in the 2018 Government Response, the period is proposed to be also 28-day. See Department for Business, Energy & Industrial Strategy, supra note 22, at ¶¶ 5.46-5.49.

159 See supra Part 3.

160 Under proposed 2018 Pre-Insolvency Moratorium, creditors can challenge to the court to argue that their interests are prejudiced or moratorium should not continue. See supra note 111 and accompanying text.

161 See supra note 112 and accompanying text.
signalling problems of previous moratorium regimes while also adequately protecting creditors’ rights.

(4) Some justifications for this Special CVA Moratorium. Though this Special CVA Moratorium provides creditors adequate protection during the moratorium period, it is true that compared with the 2000 CVA Moratorium and 2018 Pre-Insolvency Moratorium, this suggested Special CVA Moratorium abolishes the procedural requirements of obtaining it. It can be argued that such abolishment of prerequisites may lead to debtors’ abuse of this Special CVA Moratorium.\textsuperscript{162} It is true that, at first glance, it can appear that reducing the IPs’ role in obtaining this Special CVA Moratorium may cause abuse of the moratorium. This is, however, not a serious problem if we consider IPs’ lack of independence in the procedure. Regarding obtaining the moratorium, IPs are not in an unbiased position to decide whether a CVA proposal has a reasonable prospect to be approved\textsuperscript{163} because directors of distressed companies are in a position to pre—select IPs, which may result in positive opinions from IPs to be chosen and appointed by directors.\textsuperscript{164} Accordingly, IPs may not be independent enough when making statements, and their judgements may not be of a high enough quality.\textsuperscript{165} Therefore, not only may requiring nominees to provide statements at the outset of a moratorium not effectively avoid debtors’ abuse but it also may cause compliance cost and signalling problems as discussed in Part 3.\textsuperscript{166} It is thus justified to abolish the role of IPs at the outset of this Special CVA Moratorium.

A more general justification for providing this Special CVA Moratorium for small companies is considering the economic importance and economic status of small companies.\textsuperscript{167} Small-sized companies are of significant importance to the UK

\textsuperscript{162} Potential abuse of moratorium is always creditors’ main concern in supporting reform of moratorium. See Walton, Umfreville, & Jacobs, supra note 48, at 53-54.

\textsuperscript{163} Fletcher, supra note 4, at 132.

\textsuperscript{164} Id.

\textsuperscript{165} Id.

\textsuperscript{166} See supra Part 3.

\textsuperscript{167} See supra Part 2, notes 49-51 and accompanying text.
economy and private sector.\textsuperscript{168} It can thus be argued that more weight should be put on rescuing small companies by providing them with this Special CVA Moratorium. In addition, as discussed in Part 2, small companies are worthwhile to rescue because, though they may suffer from financial distress temporarily, their businesses are normally inherently viable.\textsuperscript{169} Besides, rescuing viable small companies can save a great number of employment opportunities and thus is beneficial to the whole of society.\textsuperscript{170} Accordingly, it seems appropriate to provide such a debtor-friendly Special CVA Moratorium for these viable but distressed small companies to recover from failure.

Another justification is the serious social costs involved with small companies’ failure. It is a more appropriate choice to rescue small businesses instead of liquidating them due to the potential social costs incurred by liquidation. One reason is that employees of small businesses may only have skills or knowledge specific to their businesses. This means that once these small companies are liquidated, it may be difficult for these employees to be re-employed elsewhere.

In addition, as discussed in Part 2, owners of small businesses are connected to their companies, and personal liabilities of small companies’ directors may converge with the companies’ liabilities.\textsuperscript{171} Thus, simply liquidating small companies may mean that owners or directors are also faced with personal liabilities.\textsuperscript{172} Due to such personal liabilities, these individuals may even have to file for individual bankruptcy. This means they also cannot pay back creditors out of personal pockets. The position of creditors in simply liquidating small companies is thus not much better than if they allow companies to attempt to rescue themselves since creditors may still be unable to recover from owners of small companies in the liquidation scenario. Accordingly, it

\textsuperscript{168} Id.

\textsuperscript{169} See supra Part 2 (1); See also Pandit et al., supra note 17, at 242.

\textsuperscript{170} See supra Part 2, notes 52-53 and accompanying text.

\textsuperscript{171} See supra Part 2 (3); See also Davis et al., supra note 49, at 24; Flood et al., supra note 60, at 7.

\textsuperscript{172} Id.
is better to let small companies attempt restructuring first, the result of which may be better as creditors already have nothing more to lose.

Overall, providing small companies with this debtor-friendly Special CVA Moratorium based on insights from US Automatic Stay is thus justified.

6. CONCLUSION

This article has reviewed the development of the 2000 CVA Moratorium for CVA procedure and its problem of restrictive eligibility as frequently discussed by scholars. To respond to this eligibility “problem,” a 2018 Pre-Insolvency Moratorium was suggested by the UK government for companies entering into insolvency procedures. However, as argued by this article, this 2018 Pre-Insolvency Moratorium put the reform focus, wrongly, on eligibility restrictions but repeats the compliance cost and signalling problems of the 2000 CVA Moratorium. These compliance cost and signalling problems are more important for small-sized companies. To deal with these problems, this article argues that a Special CVA Moratorium should be introduced specifically for small-sized companies. This article thus put forward reform suggestions for this Special CVA Moratorium, which gained insights from US Automatic Stay.

This article hopes that in the future, when the UK government considers proposing a bill for legislative process, the 2018 Pre-Insolvency Moratorium proposal will not be adopted for CVA procedure. Instead, my proposal of this Special CVA Moratorium should be adopted for CVA procedure to replace the 2000 CVA Moratorium so that small companies can be incentivized to use CVA procedure.