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Select Committee on the Constitution

7th Report of Session 2019–21

Corporate Insolvency and Governance Bill

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Select Committee on the Constitution

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Corporate Insolvency and Governance Bill

Introduction

1. The Corporate Insolvency and Governance Bill was introduced to the House of Commons on 20 May 2020. It had second reading in the Commons and all remaining stages on 3 June and was brought to the House of Lords the same day. Second reading in the House of Lords took place on 9 June and committee stage is scheduled for 16 June.
2. The Bill has 47 clauses and 14 schedules. It is 233 pages long. The Government states that the Bill aims to “to provide businesses with the flexibility and breathing space they need to continue trading” during the challenges created by the COVID-19 pandemic. “The measures are designed to help UK companies and other similar entities by easing the burden on businesses and helping them avoid insolvency during this period of economic uncertainty.”¹
3. During times of crisis and emergency it is all the more important to be vigilant about constitutional principles, such as the rule of law and parliamentary accountability. The need for an urgent response to COVID-19 does not justify Parliament neglecting its duty to consider the constitutional implications of the legislation presented to it.
4. We accept fully the need for the temporary emergency arrangements proposed in this Bill to protect business and the economy from the effects of the COVID-19 pandemic. None of the recommendations we make in this report interfere with those essential urgent measures. However, the Bill does more than just provide for supporting businesses through the uncertain period of the pandemic: it includes far-reaching permanent changes to the law on insolvency, and it provides powers to extend the temporary measures an indefinite number of times. We consider these and a number of other constitutional issues in this report.

Fast-tracking, permanent provisions and sunset clauses

5. The Bill is being fast-tracked through both Houses. We have previously examined the issues with fast-tracking legislation and found that it constrains parliamentary scrutiny, limits the opportunities for parliamentarians to table and debate amendments, restricts input from stakeholders and the public, and potentially leads to poor legislation.² While the fast-tracking of bills has become concerningly commonplace in recent years,³ they usually have been short measures with only a handful of clauses. It is unusual for a bill of this size and significance to be fast-tracked. The Coronavirus Bill is the only recent precedent for such a substantial measure being expedited.⁴ It was and

1 Corporate Insolvency and Governance Bill, [Explanatory Notes](#) [HL Bill 58—EN (2019–21)], para 1

2 Constitution Committee, [Fast-track Legislation: Constitutional Implications and Safeguards](#) (15th Report, Session 2008–09, HL Paper 116)

3 See, for example, Constitution Committee, [Northern Ireland \(Executive Formation and Exercise of Functions\) Bill](#) (15th Report, Session 2017–19, HL Paper 211); [Northern Ireland \(Executive Formation\) Bill](#) (26th Report, Session 2017–19, HL Paper 404); [European Union \(Withdrawal\) \(No. 5\) Bill](#) (19th Report, Session 2017–19, HL Paper 339)

4 Constitution Committee, [Coronavirus Bill](#) (4th Report, Session 2019–21, HL Paper 44)

remains our view that the measures in that significant bill were reasonably tailored to the exigencies of a quick response to the COVID-19 pandemic.

6. In our report *Fast-track Legislation: Constitutional Implications and Safeguards* we concluded that fast-tracking should “only occur where strictly necessary”.⁵ We recommended that the Explanatory Notes to a bill should explain the justification for fast tracking, and this has been done for this Bill.⁶ We also considered the issue of including non-urgent measures in a fast-tracked Bill for reasons of convenience.⁷
7. This Bill contains both temporary measures to respond to COVID-19 and permanent changes to insolvency law. However, the justification for all the measures in the Bill—and its fast-tracking through Parliament—is the implications of the pandemic.⁸
8. The permanent measures are significant. They include:
 - A procedure for a new moratorium on enforcement action against companies that are in financial distress and wish to explore rescue options instead of commencing insolvency proceedings;
 - New arrangements for restructuring companies in financial distress—in particular a procedure for overruling dissenting classes of creditors with a new “cross-class cram down” procedure,⁹ and
 - Restrictions on contractual supplier termination clauses. These provisions would impose restrictions on the use of contractual clauses that ordinarily enable suppliers to discontinue contractual services on account of pre-insolvency default (typically non-payment) on supply contract arrangements.
9. The Government consulted on the permanent measures in the Bill in 2016 and 2018. It published a response to those consultations on 26 August 2018, indicating a plan to take forward the measures in a bill.¹⁰ While the Bill includes a sunset clause for some of the temporary provisions, the Explanatory Notes state that “the permanent measures will be reviewed as and when appropriate.”¹¹ Even the more temporary measures in the Bill can be extended, as we consider below.
10. **Prior consultation with the public and stakeholders is not a substitute for the normal processes of legislative scrutiny and does not itself justify fast-tracking measures. There is a significant difference**

5 Constitution Committee, *Fast-track Legislation: Constitutional Implications and Safeguards* (15th Report, Session 2008–09, HL Paper 116), para 152

6 Explanatory Notes, paras 78–96

7 Constitution Committee, *Fast-track Legislation: Constitutional Implications and Safeguards* (15th Report, Session 2008–09, HL Paper 116), paras 52–54

8 Explanatory Notes, paras 78–96

9 The cross class cram-down procedure will allow a company to obtain a restructuring if it can prove to the court that the arrangement would (a) benefit and is supported by 75% of one class of creditors, and (b) that none of the members of a dissenting class of creditors would be worse off financially under the restructuring plan than they would otherwise have been. The procedure derives its name from the fact that one class of creditors can prevail over the dissenting votes of another other at the relevant meeting.

10 Department for Business, Energy and Industrial Strategy, *Insolvency and Corporate Governance: Government Response*, 26 August 2018: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736207/ICG - Government response doc - 24 Aug clean version with Minister s photo and signature AC final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736207/ICG_-_Government_response_doc_-_24_Aug_clean_version_with_Minister_s_photo_and_signature_AC_final.pdf) [accessed 8 June 2020]

11 Explanatory Notes, para 94

between seeing proposals outlined in a consultation document and considering the legislative provisions to give effect to such policies.

11. **While temporary measures to respond to the COVID-19 pandemic may meet the threshold of urgency and exceptional circumstances to warrant fast-tracking, long-planned and permanent changes to the law do not. It is inappropriate for such permanent changes to be fast-tracked through Parliament and so subject to less debate and scrutiny.**
12. **We recommend the permanent provisions in the Bill are subject to a sunset clause in line with the amended procedure for the temporary measures that we propose below.**
13. While the temporary measures in the Bill are subject to sunset clauses, the Secretary of State is given a power in clause 39 to extend (or curtail) their effect. The temporary measures can be extended by a statutory instrument subject to the affirmative procedure for up to six months. There is no limit on the number of times an extension can be made and there is no sunset provision on the power to make such instruments. As the Delegated Powers and Regulatory Reform Committee noted, “there is nothing in clause 39 that explicitly limits the exercise of the powers” to the effects of the COVID-19 pandemic.¹²
14. **The Delegated Powers and Regulatory Reform Committee recommended that the clause 39 power be limited such that the temporary provisions of the Bill can be extended only if Secretary of State is satisfied that the immediate effects of the COVID-19 pandemic require it.¹³ We agree.**
15. **We also recommend the power in clause 39 to extend the temporary measures in the Bill is subject to a sunset provision or limited in the number of times it may be used.**

Retrospective provision

16. Retrospective legislation is generally regarded as inconsistent with the rule of law. Changing the law so that a legal right that could be relied on is erased—such that a person who enjoyed that right is subsequently liable to suffer loss as a result of it—goes against the principle that the law should be intelligible, clear and predictable.
17. We have examined the relationship between the rule of law and retrospective legislation in previous reports on bills. We have concluded that such provisions are “inherently constitutionally suspect”¹⁴ and should be avoided.¹⁵ Where used, they should be based on necessity rather desirability,¹⁶ there must be a

12 Delegated Powers and Regulatory Reform Committee, *Corporate Insolvency and Governance Bill* (14th Report, Session 2019–21, HL Paper 74), para 24

13 *Ibid.*

14 Constitution Committee, *Energy Bill* (4th Report, Session 2015–16, HL Paper 27), para 7

15 Constitution Committee, *Final Progress Report 2005–06* (16th Report, Session 2005–06, HL Paper 255), para 4

16 Constitution Committee, *Banking Bill* (3rd Report, Session 2008–09, HL Paper 19), para 7; Constitution Committee, *Energy Bill* (4th Report, Session 2015–16, HL Paper 27), para 9; Constitution Committee, *Banking Act 2009: Supplementary report on retrospective legislation* (11th Report, Session 2008–09, HL Paper 97), para 10

compelling reason for them,¹⁷ they should be drawn as narrowly as possible¹⁸ and should not deprive individuals of the benefit of a judgment already obtained.¹⁹

18. Two key provisions in the Bill have retrospective effect. These are clause 10, on the suspension of wrongful trading legislation, and schedule 10 (inserted by clause 8), which introduces restrictions on winding-up petitions.

Suspension of wrongful trading legislation (clause 10)

19. Under the Insolvency Act 1986 a court may hold personally liable directors of a company who allow it to continue trading when insolvency looks inevitable. The aim is to deter trading prior to impending insolvency.
20. Clause 10 of the Bill disables those provisions temporarily, providing that a court “is to assume” that a director is not responsible for any worsening of the company’s financial position during the “relevant period”. There is no requirement to show that the worsening of the position is related to the pandemic. The “relevant period” begins on 1 March 2020 and ends one month after the Act comes into force.
21. This provision has retrospective effect. It will affect the ability of creditors to obtain relief for wrongful trading between 1 March 2020 and when the Act comes into force. Under clause 10 it is assumed that the director is not responsible for any worsening of the financial position of the company or its creditors during the relevant period, unless that time period is extended under clause 39.
22. It is not clear in the Bill if behaviour by company directors during this period could be challenged in court proceedings. The rule of law concerns this provision raises would be ameliorated if such a challenge were possible. However, if this was the case, directors could still be exposed to wrongful trading liability for their decisions during the relevant period. Therefore, the assumption is that such behaviour could not be subject to such a challenge.
23. The policy objective of suspending wrongful trading provisions appears to be to remove the “deterrent to continuing to trade during that period”.²⁰ However, the “deterrent-effect” rationale cannot apply to decisions already taken—it is too late to affect decisions taken by company directors in the period between 1 March 2020 and (at the earliest) the publication of this Bill. This raises the question of the value of providing such blanket immunity. The rights of creditors and other interested parties to challenge potentially wrongful trading decisions taken by company directors during this period must also be considered.
24. **We recommend that the Bill be amended such that the retrospective effect of clause 10 does not completely protect the actions of company directors taken between 1 March 2020 and when the Act comes into force. Creditors should not be precluded from taking legal action against directors for wrongful trading during that period if they can**

17 Constitution Committee, *Banking Bill* (3rd Report, Session 2008–09, HL Paper 19), para 7

18 *Ibid.*

19 Constitution Committee, *Nationality, Immigration and Asylum Bill Further Report* (7th Report, Session 2001–02, HL Paper 129), para 10

20 Explanatory Notes, para 28

discharge any burden of proving that the instance of wrongful trading has no connection to financial distress induced by the pandemic.

25. **We consider that it would be open to the Government to provide for a retrospective presumption in favour of company directors during the pandemic. However, it should be rebuttable where it can be shown that the facts alleged in the wrongful trading claim would have arisen even if the coronavirus had not had a financial effect on the company.**

Restrictions on winding-up proceedings (clause 8 and schedule 10)

26. Paragraph 1 of schedule 10 prohibits a petition for winding-up a company on the basis of a statutory demand served during the relevant period. The “relevant period” in this instance is between 1 March 2020 and 30 June 2020 or one month after schedule 10 comes into force, whichever is later. However, paragraph 1 of schedule 10 is to be regarded as having come into force on 27 April 2020. Therefore, it would apply to any proceedings commenced on or after that date, but taken in respect of arrears that accumulated at any time after 1 March 2020. The Explanatory Notes state that the reason for the 27 April 2020 date is that “the policy was announced on 25 April 2020 as taking effect from 27 April 2020”.²¹
27. Paragraphs 2 and 3 of schedule 10 introduce restrictions on winding-up petitions. Their principal effect is to prohibit creditors from making winding-up petitions during the “relevant period” unless the creditor has reasonable grounds to believe that the coronavirus has not had a financial effect on the company, or that the facts grounding the petition would have arisen even if the coronavirus had not had a financial effect. For winding up petitions taken under these paragraphs, there is a burden on the creditor to show that the demand has no connection to coronavirus-induced financial distress.
28. The Explanatory Notes state that paragraph 4 of schedule 10 “allows the court to undo any negative effects of winding-up provisions that are brought under the pre-existing law, and may lead to the petitioner becoming liable for the cost of doing so.”²² Paragraph 7 of schedule 10 goes further, rendering void court orders winding-up a company where such orders were made between 27 April and the date on which schedule 10 comes into force.
29. This retrospective imposition of loss for the exercise of statutory rights, and the attendant negation of court orders made under valid law at the time, are *prima facie* incompatible with the rule of law.
30. **We recognise that the COVID-19 pandemic presents companies with considerable challenges and that the Government is rightly seeking to protect businesses and the economy as a whole. We also recognise that the Government is seeking to introduce measures to deal with what it and others perceived as unfair business practices taken during the health emergency. However, measures with retrospective effect are exceptional and undesirable in principle, requiring the strongest possible justification. We do not think the Government has yet made the case for them in this Bill.**

²¹ Explanatory Notes, para 213

²² Explanatory Notes, para 214

31. **We recommend the Government set out its justification for the retrospective application of provisions in the Bill, including an assessment of their compliance with the rule of law.**
32. **We recommend that the Government considers measures to make the imposition of retrospective legislation strictly proportionate to the Bill's aims, rather than a form of punishment for those who exercised rights which were valid at the time. One option is to remove paragraph 7 of schedule 10. Another is to introduce powers enabling payment of compensation to those who suffered retrospectively imposed loss as a result of the Bill.**

Delegated powers

33. Clause 18 creates a Henry VIII power to modify all “corporate insolvency or governance legislation” by regulations subject to a made affirmative procedure. We have concluded previously:

“Henry VIII clauses are ‘a departure from constitutional principle. Departures from constitutional principle should be contemplated only where a full and clear explanation and justification is provided’. Such justification should set out the specific purpose that the Henry VIII power is designed to serve and how the power will be used. Widely drawn delegations of legislative authority cannot be justified solely by the need for speed and flexibility.”²³

34. The Government does not advance a specific intention for the use of this Henry VIII power. Its justification for the clause 18 power is that it

“needs to be able to react with speed to changing developments in order to be able to deal with the economic consequences of the crisis. These powers will enable temporary legislative changes to be made quickly to the insolvency and business rescue regime in order that it can cope with significant and potentially unexpected future challenges caused by the impact of the Covid-19 emergency. There are no specific plans to use the power to make temporary changes at present, but it is likely that its use will be considered where representations have been made by industry or where discussions with key stakeholders have identified areas where urgent legislation could help save otherwise viable businesses or mitigate the impact of the pandemic otherwise.”²⁴

35. Regulations under clause 18 must be laid before Parliament “as soon as reasonably practical” after being made (i.e. taking effect) and must be approved within 40 sitting days. The use of the made affirmative procedure is one aspect of the use and parliamentary scrutiny of emergency powers that we are considering in our inquiry into the constitutional implications of COVID-19.²⁵
36. Clause 19 states that the Secretary of State can make such regulations only “if satisfied” that they respond to the effects of coronavirus on business. Clause 20 requires that he or she make such regulations only if satisfied that

23 Constitution Committee, *The Legislative Process: The Delegation of Powers* (16th Report, Session 2017–19, HL Paper 225), para 67

24 Corporate Insolvency and Governance Bill, *Delegated Powers Memorandum*, page 33

25 Constitution Committee, *Constitutional implications of COVID-19*.

doing so is proportionate to the purpose, that it requires legislation and that it cannot be done through other subordinate legislation.

37. The made affirmative procedure should be used only for urgent measures where it is not possible for Parliament to scrutinise and approve them before they take effect.²⁶ While some of the uses of the clause 18 power may be urgent, it is sufficiently broad that it could be used for non-urgent matters.

38. The Delegated Powers and Regulatory Reform Committee considered this power. It concluded:

“Given the enormous width of this power and the presumption that what Parliament has enacted it should be for Parliament to change by further enactment, rather than for ministers to change by regulations, we recommend an important restriction on the use of the power in clause 18. Before making such regulations, the Secretary of State must consider there to be an urgent need to do so and that it would not be reasonably practicable to enact primary legislation within the period within which it was considered necessary to act.”²⁷

39. **We agree with the Delegated Powers and Regulatory Reform Committee that the clause 18 power should be restricted. The Secretary of State should be able to lay instruments under the made affirmative procedure only if satisfied that the situation is urgent, and that Parliament would be unable to meet to consider the regulations before they needed to take effect.**

40. Clause 21 requires the Secretary of State to keep regulations made under clause 18 under review and, if satisfied they are no longer expedient or proportionate to their purpose, he or she must make new regulations amending or revoking them. There are no dates specified for when review must take place or what it should involve—instead clause 21(3) appears to require regulations under clause 18 to be kept under constant review during their lifetime. In the Public Health (Control of Diseases) Act 1984 comparable powers are subject to a review period after a set number of days and require a statement to be made to Parliament. **We recommend clause 21 specifies how often the Secretary of State must review regulations made under clause 18 and that a report must be laid before Parliament on each occasion.**

41. The Henry VIII power in clause 18 expires on 30 April 2021. However, it does not affect the continued operations of regulations made under that power, and the Secretary of State can make further regulations to perpetuate or adjust such regulations repeatedly for up to six months at a time. Further, the Secretary of State can, by regulations under clause 22, extend the life of the clause 18 power for up to one year. There is no limit on the number of times the power may be extended.
42. The clause 18 power is for use only in relation to the coronavirus implications for business. While this may appear to be a natural sunset clause for the power, there is no certainty about length of the COVID-19 pandemic nor

26 Constitution Committee, *Fast-track Legislation: Constitutional Implications and Safeguards* (15th Report, Session 2008–09, HL Paper 116), paras 134–139; Constitution Committee, *European Union (Withdrawal) Bill* (9th Report, Session 2017–19, HL Paper 69), paras 220–222

27 Delegated Powers and Regulatory Reform Committee, *Corporate Insolvency and Governance Bill* (14th Report, Session 2019–21, HL Paper 74), para 18

the possibility that other variants of coronavirus may have significant effects on business in the future. **We therefore recommend that clause 22 be amended such that the power in clause 18, which expires on 30 April 2021, is renewable only once, for up to a year.**

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Lord Beith
 Baroness Corston
 Baroness Drake
 Lord Dunlop
 Lord Faulks
 Baroness Fookes
 Lord Hennessy of Nympsfield
 Lord Howarth of Newport
 Lord Howell of Guildford
 Lord Pannick
 Lord Sherbourne of Didsbury
 Baroness Taylor of Bolton (Chair)
 Lord Wallace of Tankerness

Declarations of interest

Lord Beith
Honorary Bencher of the Middle Temple
 Baroness Corston
No relevant interests
 Baroness Drake
Director and Trustee, The People's Pension Trustee Limited
Trustee, Telefonica (O2) Pension Scheme (trust company)
 Lord Dunlop
No relevant interests
 Lord Faulks
No relevant interests
 Baroness Fookes
No relevant interests
 Lord Hennessy of Nympsfield
No relevant interests
 Lord Howarth of Newport
No relevant interests
 Lord Howell of Guildford
No relevant interests
 Lord Pannick
No relevant interests
 Lord Sherbourne of Didsbury
No relevant interests
 Baroness Taylor of Bolton (Chair)
No relevant interests
 Lord Wallace of Tankerness
No relevant interests

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<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

Professor Jeff King, University College London, and Professor Stephen Tierney, University of Edinburgh, acted as legal advisers to the Committee. They both declared no relevant interests.