COVID-19: NEW UK CORPORATE INSOLVENCY AND RESTRUCTURING TOOLS AND REFORMS

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UK Insolvency and Restructuring Alert

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EXECUTIVE SUMMARY

- New legislation will introduce permanent and temporary reforms to the UK restructuring and insolvency regime
- Permanent reforms: company moratoriums; restructuring plans; the prohibition of insolvency termination clauses in supply contracts
- Temporary reforms: suspension of the director wrongful trading offence; restriction on the service of statutory demands and winding up petitions

OVERVIEW

On 20 March 2020, the UK Government published its Corporate Insolvency and Governance Bill (the "CIGB"). When enacted, the new legislation will see the most extensive reforms to the UK's restructuring and insolvency regime in more than 15 years.

The CIGB introduces both (a) permanent reforms and (b) temporary reforms specifically designed to ease the burden on companies and directors caused by the Covid-19 pandemic.

The CIGB has been presented to the UK Parliament and, given the pressure that businesses are facing due to the implications of the Covid-19 pandemic and the UK Government's focus on the preservation of UK businesses, it is expected that the Bill will be passed quickly. This alert seeks to outline the key measures included in the CIGB and the implications for creditors and debtors.

PERMANENT REFORMS TO THE UK RESTRUCTURING AND INSOLVENCY REGIME

Company Moratorium

The CIGB introduces a new company moratorium, during which the company will benefit from a payment holiday from the majority of its pre-moratorium debts. This is designed to give companies breathing space from their creditors while they seek a rescue plan. During this period, no legal or enforcement action can be taken against the company without leave of the court.

This new moratorium will still involve the appointment of a licenced insolvency practitioner (acting as a monitor). However, it leaves the company in the hands of its directors, which brings it more closely in line with the Chapter

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11 process in the United States. The appointment of a monitor should provide some reassurance to creditors. The company benefiting from the moratorium will still have a degree of external oversight with ongoing assessment as to whether the rescue of the company as a going concern remains likely. Arguably, this provides a better balance between protecting the interests of creditors and giving the company the best chance of emerging from its distressed state as a financially viable business.

Insolvent companies or companies that are likely to become insolvent can obtain an initial 20 business day moratorium which can be extended by a further 20 business days if the company files a notice and the relevant documents at court. It should be noted that any extension beyond 40 business days will need the consent of creditors or the court.

Restructuring Plan

The CIGB also introduces a new restructuring plan to compliment the company moratorium as an option for companies in financial difficulty. This is procedurally similar to a scheme of arrangement, allowing solvent and insolvent companies to propose a plan to creditors. The new restructuring plan introduces a “cross-class cramdown”, another feature of the US Chapter 11 style bankruptcies that will allow dissenting classes of creditors to be bound by the plan. Companies will only benefit from this cramdown feature (a) if sanctioned by the court as fair and equitable and (b) if the court is satisfied that those creditors would be no worse off than if the company entered an alternative insolvency procedure. This element is designed to reduce the number of companies having to resort to a pre-pack administration sale or a liquidation.

Termination Clauses

The CIGB introduces a permanent change to the use of termination clauses in supply contracts. In practice, suppliers will often stop supplying or threaten to stop supplying a company that has entered a restructuring or insolvency process, as this presents a significantly greater commercial risk to suppliers. However, the Government is concerned that given the extent of the disruption caused by Covid-19 for businesses across the UK, failure to protect supply chains of businesses and the continuation of trade will endanger the survival of otherwise viable businesses and put thousands of jobs at risk.

In cases where a company has entered an insolvency or restructuring procedure, or obtains a company moratorium, the company's suppliers will be prohibited from stopping supplies or altering the contractual terms, as long as the suppliers continue to be paid. Suppliers that face hardship as a result of the obligation to continue to supply can apply to the court to allow termination of the contract and the measure is not applicable to small company suppliers.

TEMPORARY REFORMS TO THE UK RESTRUCTURING AND INSOLVENCY REGIME

Suspension of Wrongful Trading

Under current law, once a director of a company concludes that there is no reasonable prospect of the company avoiding an insolvent liquidation or an insolvent administration, the director has a duty to take every step which a reasonably diligent person would take to minimise potential loss to the company's creditors. If the court deems that a director failed in this duty, the court can order the director to make such personal contribution to the

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company's assets as it thinks proper. Given the impact that UK businesses are contending with in the wake of the COVID-19 pandemic, there would be many thousands of directors who feel themselves exposed to this offence.

This potential personal liability for wrongful trading has been suspended from 1 March 2020, until the later of (a) 30 June 2020 and (b) one month after the CIGB has been enacted (the “relevant period”). Courts will ignore the actions of a director during the relevant period when assessing the amount of compensation payable by a director who is later found liable for wrongful trading. All other duties of and potential offences by directors of UK companies continue to apply. There is the potential for the Government to further extend this relevant period.

Statutory Demands and Winding up Petitions

The second temporary measure introduced by the CIGB is a provision to restrict statutory demands and winding up petitions being issued against companies where the debt is unpaid for reasons relating to the COVID-19 pandemic. It appears that there is a relatively low threshold for companies to establish that the pandemic has had a “financial effect” on the company, with the company only required to establish that their financial position has worsened for reasons relating to COVID-19.

In practice, this is designed to prevent creditors from threatening winding up proceedings or the issuance of statutory demands as a method of securing payment from companies in such a positIon. These temporary measures are effective from 27 April 2020 and are due to last until 30 June 2020. Again, there is the possibility that this temporary measure may be extended.

CONCLUSION

The permanent reforms have been trailed for a couple of years. The temporary reforms have been put together in a few weeks. It remains to be seen what uptake there will be for the new moratorium process and the restructuring plan procedure. The termination clause proposal and the temporary reforms will have a more immediate effect but may well be challenged in court in relation to their detailed application in individual circumstances.

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