

Insolvency and Restructuring Update
Rosling King LLP



On 28 March 2020, the Government announced its proposals for amending current insolvency laws as a result of COVID-19, the intention being to reduce the burden on businesses and encourage trading during the pandemic.

Under the proposals, directors can cautiously take some comfort in the Government's decision to suspend wrongful trading provisions with retrospective effect from 1 March 2020. In addition, the Government is fast-tracking proposals for new restructuring tools (originally proposed in 2016 but modified since), including a moratorium for companies seeking rescue or restructure. These changes seek to encourage companies to keep trading during this difficult and unprecedented time.

Alexander Edwards and Alexander Pelopidas, Partners in Rosling King LLP's insolvency and restructuring team, look at the new proposals.

1. Suspension of Wrongful Trading Provisions

Perhaps most significantly for directors, wrongful trading provisions will be temporarily suspended with retrospective effect from 1 March 2020 for an initial 3 month period (to be extended if required). This is to encourage directors to use their best endeavours to continue trading throughout the pandemic, without the threat of personal liability.

Under insolvency law, directors of an insolvent company might be required to personally contribute towards payment of the company's liabilities if they knew, or ought to have known, that there was no reasonable prospect that the company would avoid becoming insolvent and they failed to take any steps to minimise the loss to creditors. The aim is to encourage directors, without the potential underlying threat of personal liability for wrongful trading, to rely on the Government's support package and / or seek alternative funding in order to keep their businesses going amidst the uncertainty caused by COVID-19. However, directors should still obtain professional advice from solicitors and/or insolvency practitioners if they are worried about the consequences of continuing to trade amid the COVID-19 disruption.

Furthermore, it is important to note the laws relating to fraudulent trading and director's duties remain in force as well as those relating to preferences and transactions at an undervalue, which should continue to deter directors against misconduct.

It is questionable how much this really changes the landscape for directors who should still approach their duties in the same way and seek professional advice as appropriate. It is also difficult to imagine circumstances in which an insolvency practitioner might bring a wrongful trading claim currently given the level of unprecedented uncertainty and trading difficulties; unless the financial difficulties started before and separately from the pandemic. In any event, the Government's response should be seen as encouraging and seeking to support a more benign response to directors running their businesses in the current circumstances.

2. Moratorium

New legislation is proposed to introduce a statutory moratorium of 28 days initially for financially distressed companies by providing them with extra breathing space from creditors. Companies will apply for it using an out-of-court process. It is important to note that companies who wish to rely on the moratorium must be ultimately viable and therefore this does not apply to companies that are already insolvent. Further, companies relying on a moratorium are advised to use this additional period of time to seek a rescue or restructure.

Interestingly for directors, the statutory moratorium will be accessible to companies of any size. Directors will have the discretion to apply for the moratorium, subject to meeting the requisite eligibility and qualifying conditions. Further, the initial 28-day period can also be extended by an additional 28 days, provided that the qualifying conditions continue to be met.

The Government recognises that it might take more time to put together a successful rescue proposal for those larger companies with a more complex debt structure, in which case it might be possible to extend the moratorium beyond 56 days. However, such companies must be able to show that there is a good prospect of achieving a better outcome for creditors, and this must be approved by more than 50% secured and 50% unsecured creditors by value. Directors might have to apply to the court if it appears impracticable to seek consent from creditors.

Any company which successfully seeks a moratorium will be closely monitored by an insolvency practitioner. As the statutory moratorium is designed to assist healthy companies with relatively minor / short-term cash flow issues, companies must demonstrate that they can pay creditors throughout the moratorium period, and creditors are entitled to challenge the moratorium if they believe that any of the qualifying conditions have not been met.

3. New restructuring plan

The Government has confirmed its approval of a new restructuring plan capable of binding all creditors (including dissenting creditors) by way of “cross-class cram down” provision. However, directors must be able to demonstrate that dissenting classes of creditors will be no worse off than they would be in liquidation. The threshold of approval is 75% in value (of gross debt) of creditors within each class.

Interestingly, directors should note that there are no financial conditions that must be met in order for companies to qualify for the new restructuring plan i.e. solvent and insolvent companies may apply. The Government’s proposed initiative encourages early action; solvent companies should use this tool to address emerging financial difficulties, as this might lead to a better outcome for both creditors and stakeholders. Further, whilst the statutory moratorium will not be a pre-requisite to seeking creditor approval of the new restructuring plan, qualifying companies can use the moratorium as a shield whilst they formulate their restructuring plan.

Whilst we await further details as with regards to the structure of the new restructuring plan, directors can take comfort in the apparent flexibility of the proposals and, in order to avoid

unnecessary costs, there will be no prescribed supervisor and parties will be free to determine the appropriate time period for the restructure. Further, whilst the proposal must be initiated by the company, it is important to note that creditors and shareholders will be entitled to put forward a counter proposal.

4. Supplier termination clauses

Another key proposal is prohibiting the enforcement of termination clauses by a supplier of goods and services against a company in an insolvency procedure. This is designed to encourage companies to continue trading during this challenging period. This will apply to those contracts whereby the termination clause allows the contract to be terminated on the ground that one party has entered into formal insolvency. However, suppliers will be able to enforce termination clauses on other grounds under the contract, such as where notice has been given in accordance with the contract.

Further guidance from the Government is awaited, however it is likely that we may see exemptions for certain types of services and, subject to obtaining prior court approval, suppliers might be able to enforce such clauses if their own solvency is threatened as a result.

5. Conclusion

Whilst further Government guidance is awaited on the new restructuring tools, the proposed changes to insolvency law should be viewed as positive steps to support trading during this difficult period.

However, although these changes will assist businesses to some degree, the majority of the insolvency law landscape remains in place, as do current restructuring tools (e.g. CVAs, administrations etc.). Businesses in financial distress should still consult with their professional advisors so that directors can navigate their duties and implement their strategies with confidence.

Should you wish to discuss these changes in more detail or explore any restructuring options available to you at this time, please contact Alexander Edwards or Alexander Pelopidas or any other member of the RK team.