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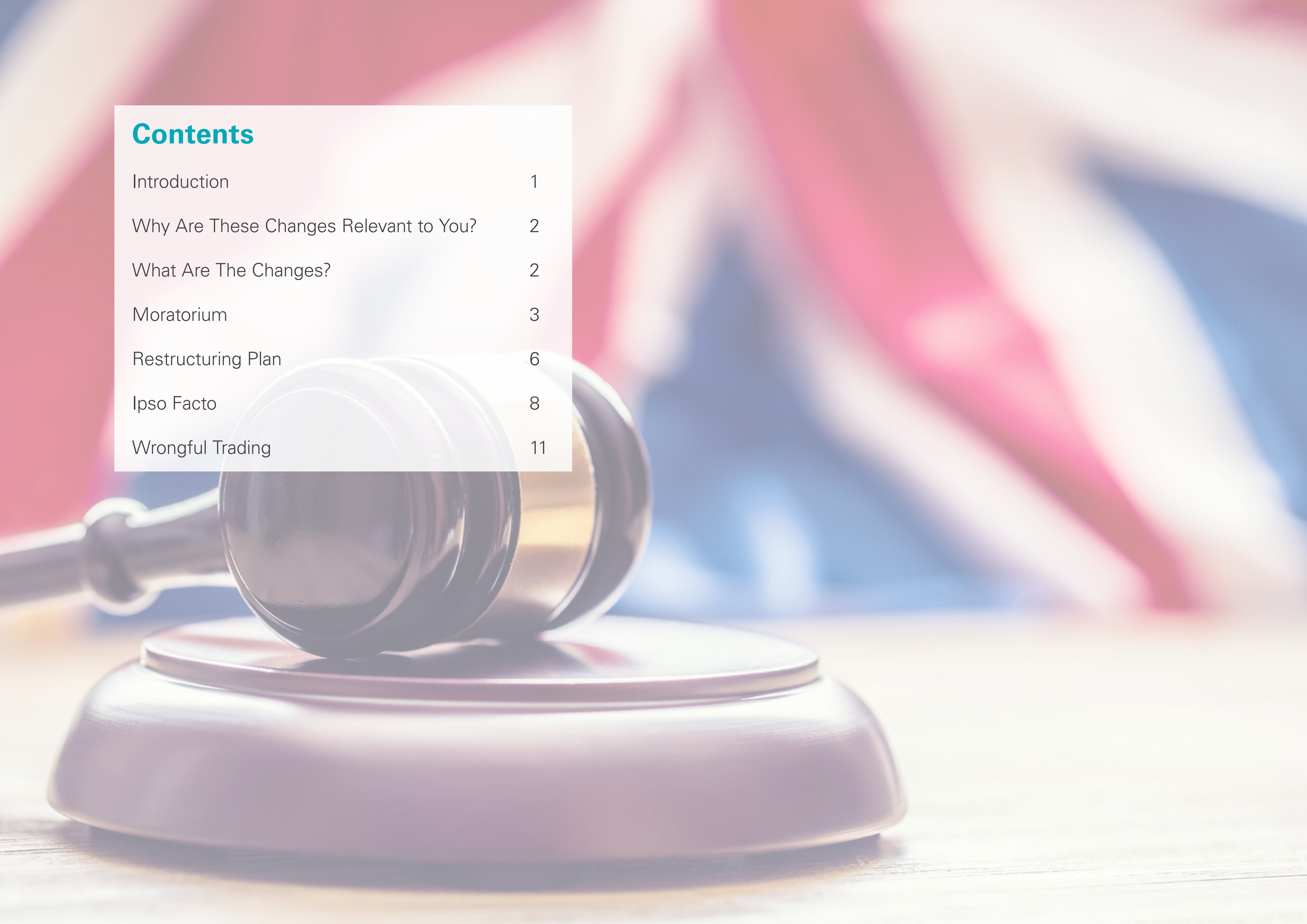
Changes to the UK Insolvency Regime – What The Act Means For UK Businesses

29 June 2020



Contents

Introduction	1
Why Are These Changes Relevant to You?	2
What Are The Changes?	2
Moratorium	3
Restructuring Plan	6
Ipso Facto	8
Wrongful Trading	11

Introduction

On Thursday 25 June 2020 the Corporate Insolvency And Governance Act received Royal Assent. The Act represents the biggest overhaul of the UK's insolvency legislation for over 30 years. Whilst significant parts of the Act were put forward for consultation a couple of years ago, the rationale for introducing these changes now and for fast-tracking them onto the statute book appears to be the Government's desire to give businesses additional support and options as they navigate their way through the difficulties presented by the COVID-19 global pandemic. Having said that, the majority of the changes introduced by the Act will have permanent effect, albeit there are some additional temporary provisions which will only apply for such period as the Government considers necessary to address the immediate issues presented by COVID-19.

Why Are These Changes Relevant to You?

The COVID-19 pandemic has had a significant impact on many businesses and sectors. Many businesses that were well run, financially viable and with a good business model have now been faced with the unprecedented challenge of having to mothball and effectively cease trading for a period of at least three months. Very few businesses had planned or budgeted for such a dramatic change in their business models. Accordingly, there should be no shame in a business saying that it may need to make use of some of the additional restructuring tools provided by the Act in order to allow the business to recover from the impacts of COVID-19.

Many other businesses will be in a more fortunate position; either not being as severely affected, or having had sufficient financial operational strength prior to lockdown so that the business does not need the additional support of these measures. However, virtually every business will find that some businesses within its supply chain, customer base or that it otherwise engages with are impacted by the changes. In those circumstances, it is just as relevant for those companies to understand how the Act and these new measures could affect customers, suppliers and third parties that they engage with.

What Are The Changes?

Corporate Moratorium

This is a stand-alone "debtor–in-possession" moratorium which most companies can seek the benefit of. The Moratorium can be for up to 40 business days without creditor approval and 12 months with it. It prevents secured creditors from enforcing or appointing an administrator and prevents most other creditors from taking any enforcement action as well. The Moratorium is supervised by an independent insolvency practitioner who acts as monitor. Our attached Quick Guide provides further details of the way in which the moratorium works and its impact on the various stakeholders who will be involved.

Restructuring Plan

One of the tools which is currently available to businesses looking to restructure is the Scheme of Arrangement. This is a court-regulated arrangement that allows a company to restructure its debts and deal with different classes of stakeholders in different ways. The Restructuring Plan could be seen as the little brother/sister of the Scheme of Arrangement. It is still court-driven, but is intended to be more widely used by SMEs and smaller corporates. One material change that it introduces is the concept of "cross-class cram-down" whereby a group of dissenting stakeholders can still be bound by the Restructuring Plan, provided the court ratifies it. Again, you will find attached a Quick Guide which provides more details of the way in which the Restructuring Plan works.

"Ipso Facto" Termination Clauses

Many suppliers' contracts incorporate automatic termination provisions for when a customer enters an insolvency process. These are intended to allow the supplier to stop supplying when the counterparty enters insolvency. They are often used to leverage a payment for unsecured debts and/or to change the terms of supply in an insolvency scenario. The Act provides a general prohibition on these sorts of clauses, meaning that in most cases, the supplier cannot terminate supplies simply because the customer has started an insolvency process. Again, you will find some more details about how the Ipso Facto regime will work in the attached Quick Guide.

Temporary Changes

One of the major concerns which directors have when a company starts to suffer financial distress is the risk of personal liability for wrongful trading. The Act introduces temporary changes relaxing the wrongful trading provisions, which will be for an initial period from 1 March 2020 until 30 September 2020. You will find further details of these temporary measures in the attached alert. At the same time, the Act restricts the use of statutory demands, winding up petitions and the making of winding up orders during the same period. These measures are intended to provide additional respite for businesses as they seek to navigate the choppy waters of COVID-19. Please see our blog for further information on the temporary changes to statutory demands and winding-up petitions.

On 25 June 2020, Royal Assent was given to the Corporate Insolvency and Governance Act 2020 (the "Act") and it became law. One of the aims of the Act is temporarily to amend corporate insolvency laws to give companies the best possible chance of weathering the storm of the COVID-19 pandemic.

One of the significant measures can be found at clause 10 of the Act. This is the temporary relaxation/suspension of liability for wrongful trading under sections 214 and 246ZB of the Insolvency Act 1986. The intention of this measure is to allow directors to ensure that their businesses continue through the COVID-19 pandemic without fear of personal liability for wrongful trading. However, wide drafting may have raised as many questions as the answers it provides.

Changes to the UK Insolvency Regime – The New Moratorium

EMEA – UK – 29 June 2020

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

As part of these measures, a 'new debtor-in-possession moratorium' has been introduced to existing legislation that will enable companies to have a minimum 20 business days breathing space without threat of creditor action. Under the moratorium, the day-to-day running of the business remains in the directors' control, under the supervision of a licensed insolvency practitioner (the monitor) and subject to certain restrictions.

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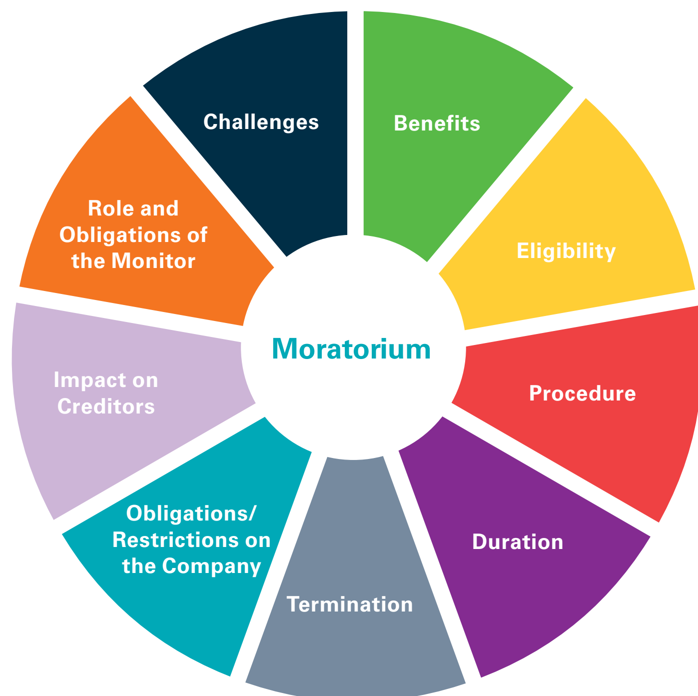

Benefits

- The moratorium is a stand-alone process and does not have to be a pre-cursor to a formal insolvency process.
- The directors remain in control of and continue to trade the company in the usual course of business (subject to monitoring by an insolvency practitioner), but must pay the business costs that accrue during the moratorium.
- Creditor pressure is removed.
- The company benefits from a payment holiday from certain debts; primarily trade creditors, tax liabilities and property costs.
- Most companies facing cash flow issues will be eligible.
- The procedure is intended to be streamlined and cost effective compared to other insolvency processes.
- There is no requirement to obtain secured creditor consent to the process.

Eligibility

All UK companies are prima facie eligible, if the company is, or is likely to become, unable to pay its debts as they fall due unless (a) specifically excluded (e.g. banks and other regulated entities) or (b) the company has been subject to a previous insolvency process in the last 12 months.

Procedure

The company and monitor file documents at court confirming that the company is, or is likely to become unable to pay its debts as they fall due and that it is "likely that the moratorium will result in rescue of the company as a going concern".

For overseas companies, or those subject to a winding up petition, the company will have to make an application to court

The moratorium comes into effect upon filing the relevant documents at court or upon the court making an order.

Duration

The initial moratorium period lasts for 20 business days, commencing the day after the moratorium comes into force.

It can be extended by a further 20 business days by the directors or by up to 12 months with creditor and/or court approval and if the company proposes a CVA or "new" restructuring plan the moratorium period will automatically extend until the proposal is disposed of or plan approved.

Termination

The moratorium will end:

- Upon the expiry of 20 business days (unless extended);
- Automatically if the company enters into an insolvency process (e.g administration or CVA); or
- When the monitor files a notice at court to terminate the moratorium because:
  - the company has not paid debts payable in the moratorium period (see below for details of which debts remain payable); or
  - the monitor determines that the moratorium is no longer likely to result in the rescue of the company as a going concern

Obligations and Restrictions on the Company

During the moratorium period, the company is obliged to pay certain debts including:

- The monitor's remuneration and expenses (although pre-moratorium remuneration and expenses are explicitly carved out);
- Goods or services supplied during the moratorium;
- Rent (for the moratorium period);
- Wages, salary and redundancy payments (not limited to those falling due during the moratorium); and
- Debts or other liabilities arising under a contract or other instrument involving financial services. This means that the usual capital and interest payments due to lenders will likely still be payable (unless otherwise agreed with the lender).

The company/directors are also obliged to do the following:

- Provide and comply with requests for information from the monitor;
- Display the name of the monitor and that a moratorium is in force on its website(s) and business documents (e.g. invoices, orders form, business letters);
- Display notice of the moratorium at its business premises;
- Notify the monitor when the moratorium is extended or comes to an end; and
- Notify the monitor before taking any steps to enter insolvency proceedings.

During the period of the moratorium the company must not:

- Obtain credit over £500 (unless the creditor is informed a moratorium in force);
- Grant security over property, without the monitor's consent;
- Enter into certain contracts (e.g. market contracts and financial collateral arrangements);
- Pay pre-moratorium debts exceeding £5,000 (or 1% of the value of all unsecured debts as at the start of the moratorium) without the consent of the monitor;
- Dispose of property subject to a security interest or hire purchase unless disposal is in accordance with the terms of the agreement or with the Court's permission; or
- Dispose of any other property, unless: (i) the disposal is in the ordinary course of business; (ii) the monitor consents; or (iii) there is a court order.

Impact on Creditors

During the period of the moratorium, creditors cannot:

- Commence insolvency proceedings against the company; and
- Pre-moratorium creditors cannot apply to court to enforce their debt.

In addition, creditors cannot (without court consent):

- Take steps to enforce security or repossess hire-purchase goods;
- Commence or continue with legal processes (except certain employment claims); and
- Landlords cannot take steps to forfeit a lease.

The moratorium also suspends a secured lender's ability to crystallise its charge or appoint an administrator.

The position and rights of retention on title ("ROT") creditors is going to be a potentially challenging one. An ROT supplier is a pre-moratorium creditor for which a payment holiday would apply, but also because of the stay on proceedings imposed by the moratorium they wouldn't be able to enforce their ROT rights. Therefore the company could potentially be free to deal with the stock in the ordinary course of business, but wouldn't necessarily be obliged to pay the ROT supplier for that stock. The moratorium could have the (potentially unintended) consequence of the moratorium adversely affecting ROT creditors.

Role and Obligations of the Monitor

The monitor is not involved in the day-to-day decisions but must monitor the company's affairs in order to determine whether it remains likely that the moratorium will result in the rescue of the company as a going concern.

The monitor can sanction the disposal of the company's assets outside of the usual course of business, agree for the company to grant of security or pay pre-moratorium debts and is obliged to terminate the moratorium in certain circumstances.

Challenges

- A creditor, director, member of the company or any other person affected by the moratorium may apply to the court to challenge the moratorium on the grounds that an act, omission or decision of the monitor during a moratorium has unfairly harmed them.
- A creditor or member of the company may apply to the court on the grounds that, as a result of an actual or proposed act (or omission) of the directors, the company's affairs have been managed in a way that has unfairly harmed them.
- Examples of where challenges may be brought could be by an ROT creditor (whose stock is being sold and they aren't proposed to be paid) or by a supplier who is being forced to continue to supply because on unfavourable terms because their "ipso facto" termination clause is now invalid.

COVID-19 Temporary Provisions

Until 30 September 2020 the eligibility criteria is relaxed such that companies that are subject to a winding up petition or have been subject to a CVA, administration or another moratorium in the last 12 months will be eligible for a moratorium.

Also, if the financial position of the company has worsened due to COVID-19 the moratorium can still be extended provided (disregarding the worsened position) the moratorium would still likely result in the rescue of the company as a going concern.

Directors' Duties

Directors should be mindful that they comply with their directors' duties when considering a moratorium and a restructuring more generally, taking appropriate professional advice. We have produced a quick guide covering directors' duties, particularly in the context of COVID-19.

New UK Insolvency Legislation – the Restructuring Plan

EMEA – UK – 29 June 2020

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

As part of these measures, a new restructuring plan (RP) has been inserted into existing legislation to enable companies to enter into an arrangement with their creditors. The RP (similar to a scheme of arrangement) will, if approved by the court, enable companies to bind all creditors (including potentially both secured and other dissenting creditors) by "cramming down" their debts.

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Benefits

- The "cross-class cram down" (see further below), which is a new concept compared to schemes of arrangement, allows a degree of greater flexibility.
- The RP may also give more manoeuvrability to a creditor of a class who can pass the "75% value" test, without needing to also pass the "majority in number" test of a scheme of arrangement.

Eligibility

- The RP will apply to most UK companies who have encountered, or are likely to encounter, financial difficulties that are affecting, or will or may affect, their ability to carry on business as a going concern.
- There are a handful of restrictions and the Secretary of State can make regulations to exclude certain companies from the scope of the RP.

Procedure

- The company (or its administrator or liquidator), a creditor, or a member proposing the RP must seek a court order convening creditor and/or member meetings (as relevant) in order to vote on the proposed scheme.
- The company must provide all parties required to attend the meeting(s) with a statement setting out the key aspects of the proposed RP.
- Every creditor or member affected by the RP must be allowed to participate in the meeting (unless the court is satisfied that none of the members of the class have a genuine economic interest).
- A meeting or meetings are convened at which the attendees are separated into classes and will be required to vote on the proposed RP. At least 75% in value of each relevant class of creditors must vote in favour of the RP for it to proceed to sanction, subject to the cross-class cram down, referred to below.
- A class will likely be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult with a view to their common interest, as per the current rules on schemes of arrangement. Determining how classes are to be split is often a delicate balancing exercise.
- The RP will become effective upon delivery of the relevant sanction order to the Registrar of Companies and will bind the company and all creditors of each relevant class. Since the court can decide that certain creditors do not have an economic interest in the outcome of the RP (and therefore cannot vote at the meeting) it is not clear from the Act whether those creditors would be bound. It would not make sense for a creditor with no economic interest in the outcome to be able to undermine a sanctioned RP, but this will need to be clarified.
- If a RP is applied for within 12 weeks from the end of a new moratorium (see below), debts created during that moratorium cannot be compromised in the RP (unless the relevant creditor agrees).

Timing

- The legislation does not prescribe the length of the RP.
- Creditor approval and court sanction to the timing of the arrangement will be key to establishing how long the RP will run for.

Dissenting Creditors

- Votes on the RP will be calculated solely by the relevant debt or shares (i.e. 75% in value of the creditors or members of a class have to vote in favour for the RP to be implemented) but the court can override this in certain circumstances,
- Cross-class cram down: if a class of creditors or members votes against the RP, the court can still sanction it if two conditions are met:
  - *Condition A*: none of the members of the dissenting class would be worse off than under a relevant alternative (i.e whatever procedure the court considers would be most likely to occur in relation to the company (perhaps most likely administration) if the RP were not sanctioned), and
  - *Condition B*: at least 75% by value of a class of creditors or members, which would receive a payment in such alternative procedure, had still voted in favour of the RP.

Impact on Secured Creditors

- Secured creditors will be keen to explore the extent to which they might be crammed down in the RP and whether the safeguard in condition A above gives them protection, when compared to an administration.
- For the RP Act provisions to have real value and purpose, the ability to cram down dissenting secured creditors in certain circumstances will need to be effective for it to prove a useful tool for financially stressed companies.
- Where a company has availed itself of the new moratorium and that moratorium itself constitutes an event of default under lender security, that could automatically accelerate the entire secured debt. Alternatively, lenders may seek to issue a notice accelerating their debt. If all the lender debt is allowed to become due and payable during the moratorium period, and since a new moratorium debt cannot be compromised within the RP, it may not be possible to put forward a workable RP unless the secured creditor has consented. Again, further clarity would be welcomed.

The New Moratorium

In addition to the RP regime, the Act introduces a 'new moratorium'.

This will provide a simple way for companies who cannot or are unlikely to be able to pay their debts, to obtain the benefit of a moratorium for an initial 20 business days, with the option to extend that by a further 20 business days (up to 12 months with creditor/court consent), providing breathing space from creditor pressure and a payment holiday for certain debts. The ipso facto provisions will also apply when a company enters a new moratorium.

Similar to a Chapter 11 restructuring in the US, the company remains in the directors' control during the period of the moratorium, but is 'monitored' by an insolvency practitioner.

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

As part of these measures, a new provision has been inserted into existing legislation which will curtail the ability of suppliers to terminate supply contracts when a customer becomes insolvent (the so called 'ipso facto regime').

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Restrictions on Termination

Most contracts for the supply of goods and services contain a termination clause (also known as an ipso facto clause) which, on the occurrence of an insolvency-related event, either:

1. Automatically terminates the contract, or
2. Entitles the supplier to terminate the contract.

The Act introduces changes to existing UK insolvency laws that will prevent a supplier from terminating a supply contract because its customer has entered a 'relevant insolvency procedure'.

In short, unless the supplier falls within the definition of exempt suppliers or exempt contracts, the supplier cannot terminate the supply contract (for insolvency-related reasons) and will have to continue to supply under the terms of the contract, despite the fact that its customer is insolvent.

What is a 'relevant insolvency procedure'?

A 'relevant insolvency procedure' includes administration (from the date of the appointment - not from the date of any notice of intention to appoint), administrative receivership, company voluntary arrangements (CVA), liquidation, provisional liquidation, the new moratorium (see further below) and restructuring plan.

Exemptions

The following specific suppliers and contracts are exempt from the ipso facto regime:

- Suppliers classed as '*essential suppliers*' (which will be dealt with under the existing essential supplier regime).
- Certain persons involved in financial services.
- Contracts involving certain financial services.
- Suppliers classed as '*small suppliers*' – but only for a limited period.

Small Suppliers

For a temporary period (ending on 30 June 2020 or one month after the legislation comes into force, whichever is later) small suppliers will be exempt from the changes and can (if they chose) terminate the supply contract.

This is a temporary exemption designed to address the current difficulties faced by UK companies as a consequence of COVID-19 and will capture suppliers who meet at least two of the following three criteria:

- Employ less than 50 people.
- Have a balance sheet with assets totaling £5.1 million or below.
- Have a turnover of £10.2 million or below.

The criteria differs slightly when the supplier has been trading for less than one year.

When the temporary period expiries (unless extended) small suppliers will be caught by the new ipso facto regime and will not be able to terminate their supply contract for insolvency-related reasons.

Protection For Suppliers

The Act introduces measures designed to balance any perceived unfairness:

Hardship

A supplier can apply to court seeking an order exempting them from the ipso facto regime and allowing them to terminate. However, in order to do that, the supplier will have to demonstrate that it will suffer hardship, as a consequence of continuing to supply. There is no definition of hardship and a supplier is likely to find that demonstrating hardship will be challenging, as the court will have to balance whether the supplier's hardship outweighs the interests of creditors.

Payment

Claiming hardship for reasons of non-payment is unlikely to be sufficient, given the other protection afforded to suppliers, i.e. that the supplier is entitled to be paid for any goods or services supplied post-insolvency.

Further, in the case of the customer entering a 'new moratorium' (see further below), if the company fails to pay for supplies made during the moratorium period, the supplier will be paid ahead of other creditors in any subsequent insolvency – including charge holders.

Can Suppliers Change Their Terms of Supply?

The Act also prevents suppliers from doing '*any other thing*' upon a company becoming subject to a relevant insolvency procedure. The explanatory notes to the Act indicate that this is aimed at preventing suppliers from changing payment terms, but this will not prevent suppliers reviewing and amending terms and conditions with customers pre-insolvency.

Payment of Pre-Insolvency Debts

- Under the new measures, a supplier is expressly prohibited from making the payment of pre-insolvency debt arrears a condition of continuing supply.
- There is no mechanism to make an office holder personally guarantee the payment of ongoing charges.
- Any pre-insolvency debts are unsecured debts and will only be paid (pari passu) following payment of insolvency expenses, and secured charge holders.
- If a customer applies for the new moratorium, the company is expressly prohibited from paying pre-moratorium debts (subject to statutory minimum payments).

When Can A Supplier Terminate?

A supplier is able to terminate a supply if:

- The office holder consents (in an administration, administrative receivership, liquidation and provisional liquidation).
- The company consents (in a CVA, statutory moratorium or a restructuring plan).
- The court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission.

It should, however, be noted that the prohibition limits the ability to terminate a supply contract for reasons of insolvency. A supplier can still terminate the contract on other grounds (such as non-payment or breach of contract), however only where the contractual right to terminate arises post insolvency.

The ipso facto regime impacts supply contracts under which there is a continuing obligation to supply. A supplier can refuse to accept individual orders and cannot be forced to supply a customer that has entered a relevant insolvency procedure, unless they are already under an obligation to supply.

Retention of Title

The ipso facto regime does not impact a supplier's rights to enforce a retention of title clause (ROT), but if the company is in an insolvency process, there may be a moratorium in place that prevents the supplier from enforcing ROT.

In administration, a supplier cannot enforce ROT without the consent of the administrator or court. Under the new moratorium, the supplier is prohibited from enforcing ROT (without court consent) but may be required to continue supplying the company under the supply contract. The difficulty here is that typical ROT clauses usually permit a customer to sell stock subject to ROT 'in the ordinary course of business' (and the new moratorium permits a company to continue to trade) but because the moratorium is in place, the supplier cannot enforce its ROT to recover payment for pre-moratorium arrears. To preserve the value of ROT, a supplier may wish to consider amending its terms and conditions to accelerate payment of future supplies if its customer enters a new moratorium, so that it is in a better position to negotiate payment.

Mitigating the Impact

Suppliers should consider:

- Keeping on top of payment terms. Once a customer enters a relevant insolvency procedure, any arrears are unlikely to be repaid in full. As a result, suppliers should ensure that receivables are paid when due, consider reducing payment periods and review and (if necessary) tighten debt collection procedures.
- Reviewing terms and conditions. It is good practice for any business to ensure that their terms and conditions are up to date and fit for purpose.
- Suppliers should pay particular attention to:
  - Their rights and remedies under these arrangements (including any applicable notice and cure periods).
  - Considering whether to terminate the arrangement prior to entry into an insolvency process (e.g. following a NOI).
  - Understanding when title to goods passes and reviewing ROT clauses.
  - Whether to amend the terms and conditions to tighten alternative termination rights (such as placing minimum purchase obligations on the customer).

The New Insolvency Moratorium

In addition to the introduction of the ipso factor regime, the Act introduced a new insolvency moratorium.

This will provide a simple way for companies who cannot or are unlikely to be able to pay their debts, to obtain the benefit of a moratorium for an initial 20 business days, with the option to extend that by a further 20 business days (up to 12 months with creditor/court consent), providing breathing space from creditor pressure and a payment holiday for certain debts. The ipso facto provisions will also apply when a company enters a new moratorium.

Similar to a Chapter 11 restructuring in the US, the company remains in the directors' control during the period of the moratorium, but is 'monitored' by an insolvency practitioner.

Walking the Tightrope of Wrongful Trading

Changes to the UK Insolvency Regime

UK – 29 June 2020

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

One of the significant measures can be found at clause 10 of the Act. This is the temporary relaxation/suspension of liability for wrongful trading under sections 214 and 246ZB of the Insolvency Act 1986. The intention of this measure is to allow directors to ensure that their businesses continue through the COVID-19 pandemic without fear of personal liability for wrongful trading. However, wide drafting may have raised as many questions as the answers it provides.

Changes to Wrongful Trading Laws

The Act states that during the "relevant period", in determining whether wrongful trading has occurred, the court will "assume" that a director is not responsible for the worsening of the financial position of a company or its creditors. This effectively relieves the director of any liability for wrongful trading during this period.

The relevant period in question is from 1 March 2020 until 30 September 2020. It is important to note that this period can be extended by 6 months at a time or shortened by secondary legislation.

A number of companies are excluded from these changes. Firstly, the new measures do not apply to companies listed in schedule ZA1 of the Insolvency Act 1986 such as insurance companies, banks and investment firms. Building societies, friendly societies and credit unions are also exempt, along with any company carrying out a regulated activity under Section 4A FSMA. Before relying on the Act in respect of wrongful trading, directors should consider whether their company is among the excluded categories.

Interestingly, there is no requirement for the worsening of the financial position of a company to be attributable to the COVID-19 pandemic. This creates a very wide scope for potential application (and possibly abuse) of the new measures and it remains to be seen how this will be assessed.

Potential for Exploitation?

Many have noted that the broad drafting of the Act to include companies that have not necessarily been directly affected by COVID-19 seems to leave potential for exploitation. However, it is important to consider whether there was a workable alternative. If the Act distinguished those companies that are affected by COVID-19 from those that are not, there would have been a requirement for directors to be certain that their company's difficulties are exclusively related to COVID-19 before they made the decision on continued trading. It was felt that such a requirement was "a test too far". Where there was any doubt about continued trading, directors would probably have erred on the side of caution and ceased trading to avoid potential personal liability. This in turn would lead to the insolvency of the company and the overriding objective of this temporary measure (namely to save otherwise viable businesses) would not be achieved.

Potential Risk?

The flexibility of the "relevant period" may also be cause for concern for some directors. A shortening of the relevant period with relatively little notice may result in a director facing exposure to liability for wrongful trading. While it seems unlikely that there would be a shortening of the relevant period soon, it is possible that a six-month extension may be shortened in the future. If a director has committed to a course of action that will take a number of months to be fruitful, a shortening of the relevant period could leave a director facing a decision whether to stop this course of action to the detriment of the company and its creditors, or continue with it and risk liability for wrongful trading.

Suspension or Relaxation?

The wording of clause 10, which states that "the court is to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period" will also raise questions for directors.

The fact that there is an assumption by the court that directors will not be responsible for any worsening of financial position opens up the possibility that such an assumption may be rebutted (although here is no reference to a rebuttable presumption in the Act itself). The possibility of a rebuttable assumption suggests that the liability for wrongful trading is being relaxed as opposed to suspended.

Concerns have been raised about such a blanket suspension of liability for wrongful trading. However, the Government was keen to point out that other protections for creditors will continue to apply. For instance, directors' duties under the Companies Act and directors' disqualifications actions are unaffected by the changes in the Act. Therefore, notwithstanding these changes, directors should continue to act honestly and reasonably and take professional advice if they find themselves in this situation.

Other Changes to UK Insolvency Law

In addition to the temporary changes to the UK wrongful trading laws the Act introduces permanent changes to the UK Insolvency regime including:

New Moratorium for Companies

This will provide a simple way for companies who cannot or are unlikely to be able to pay their debts, to obtain the benefit of a moratorium for an initial 20 business days, with the option to extend that by a further 20 business days (up to 12 months with creditor/court consent), providing a breathing space from creditor pressure and a payment holiday for certain debts.

Similar to a Chapter 11 restructuring in the US, the company remains in the directors' control during the period of the moratorium, but 'monitored' by an insolvency practitioner

Protection of Supplies to Enable a Company to Continue Trading During the Moratorium

This new provision will prevent suppliers of goods and services from terminating a contract because of an insolvency event and potentially jeopardizing the rescue of a business. This will apply to existing UK insolvency procedures (including administrations, CVAs and liquidations) as well as the new moratorium.

New Restructuring Plan

This new insolvency tool will enable companies to propose a plan that (subject to obtaining requisite consent and court approval) will bind all creditors, including dissenting and secured creditors, whether or not they vote in favour of the plan, through the use of "cross-class cram down".

Conclusion

It is clear that a number of businesses are facing unprecedented financial challenges and that the government has sought to recognise this with changes in the law. However, questions remain as to how measures in relation to wrongful trading will operate and whether directors are actually being afforded the protection that is suggested at first glance.

In the circumstances, directors should continue to take early advice and not treat the new measures as a "get out of jail free" card? In reality, there should be no change in the need for directors to exercise reasonable behaviour to ensure that they do not fall foul of the new legislation or incur liability for misfeasance or breach of duty under existing legislation. More detailed guidance can be found in our directors' duties alert.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations, nor should they be considered a substitute for taking legal advice.

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Key Contacts

John Alderton
Partner, Leeds
T +44 113 284 7026
E john.alderton@squirepb.com

Susan Kelly
Partner, Manchester
Cross Border Restructuring
Practice Co-Chair (UK & Europe)
T +44 161 830 5006
E susan.kelly@squirepb.com

Russ Hill
Partner, Birmingham
T +44 121 222 3132
E russell.hill@squirepb.com

Devinder Singh
Partner, Birmingham
T +44 121 222 3382
E devinder.singh@squirepb.com

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