Financial relief for struggling businesses: new UK insolvency legislation now in force

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CATEGORY:
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For UK businesses grappling with cash flow, workforce and financial commitments with the continuing effects of the COVID-19 pandemic, further options are available from today, 26 June 2020. Below is a summary of what is included.

The Corporate Insolvency and Governance Act is now in force in the UK, following rapid passage through Parliament and Royal Assent. The new legislation includes a raft of temporary measures aimed at bringing relief to businesses struggling through.

However, the Act also brings into force some major permanent changes – in one of the biggest shake ups in UK insolvency law for over 15 years.

These permanent changes include:

1. The introduction of a new free-standing 'debtor in possession' moratorium procedure, which will provide protection from creditor action for companies, to allow them to restructure while remaining under the day to day control of their existing management – but under the supervision of a licensed insolvency practitioner;

2. The introduction of a new restructuring tool. The new mechanism will be similar in nature to a 'scheme of arrangement' but with the addition of a mechanism to bind in dissenting classes of creditors. This will be a useful tool for consensual restructurings, particularly for companies with complex syndicated debt structures involving multiple classes of creditors;

3. New and wide-ranging (and controversial) measures aimed at preventing termination of contracts for supplies of goods and services to companies after they have been placed into insolvency. Under these changes, even if the relevant contract provides a specific termination right on the insolvency of the customer, the supplier will have to continue supplies unless the insolvent customer consents to termination or the Court permits termination (on the basis that not doing so would cause 'hardship' to the supplier).

Temporary relief

The Act sets up a protected period which will last until 30 September 2020, during which time a series of measures will be in place temporarily to give protection to companies who might otherwise face action from creditors. In view of their emergency nature, the Act provides for these measures to take effect retrospectively from the date the policy was announced by the Government.

The key provisions include:

1. Voiding statutory demands – a statutory demand is a formal demand for payment of an outstanding debt. If not disputed, an unsatisfied statutory demand is a basis for a Court to put a company into liquidation, so that its assets can be sold off to satisfy creditor debts. This is a tool used by creditors of recalcitrant debtors which generates very significant pressure to meet payment demands because of the risk that the company will be lost altogether if payment is not made. In order to guard against aggressive creditor enforcement action, the Act provides that all statutory demands served on companies in the protected period from 1 March 2020 until 30 September 2020 are automatically void, and cannot be used to establish a company's insolvency;

2. Staying 'winding up' petitions – all winding up petitions (the Court process used to put a company into liquidation) which are presented since 27 April 2020 are effectively stayed until 30 September 2020. The courts will not permit the petition to be advertised or make a winding up order unless it is satisfied that the COVID-19 pandemic is not the reason why a company cannot pay its debts. In practice it will be very difficult to establish this – as any pre-existing financial difficulties which companies may have had are likely to have been exacerbated by the pandemic, and may not be readily disentangled from its effects;

3. 'Suspension' of wrongful trading provisions – in normal circumstances, one of the means by which directors of insolvent companies are held accountable to creditors is by the operation of 'wrongful trading' liability. That is, directors who know or ought to know that a company is insolvent and will not be able to avoid winding up or administration must take all reasonable steps to mitigate creditor losses if they permit a company to continue to trade. If they do not do so, directors can be personally liable to contribute to the company's assets and make good creditor losses. The temporary measures mean that courts will assume the director is not responsible for any worsening of the financial position of the company or its creditors during the period from 1 March 2020 until 30 September 2020. There is no requirement to show that the company's worsening financial position was due to the COVID-19 pandemic. However, as we previously observed here, there are no changes to directors' duties and there may be other sources of directors' personal liability even in the protected period;

4. Temporary suspension of restrictions on termination – the new measures preventing suppliers from terminating contracts to supply goods and services to insolvent companies will not apply to 'small businesses' until after the protected period ends on 30 September 2020. To qualify as a small business, a company must meet one of the following two criteria: a) annual turnover of not more than £10.2 million (or an average of £850,000 each calendar month if the supplier is in its first financial year); b) balance sheet of not more than £5.1 million; and/or c) 50 or fewer employees.

If you need legal advice or assistance in relation to financial difficulty or implementing any of the new measures, please get in touch.

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