K&L GATES HUB

COVID-19: CHANGES TO UK INSOLVENCY LAW TO ASSIST DIRECTORS AND COMPANIES

Date: 29 March 2020

UK Restructuring & Insolvency Alert

By: Jonathan Lawrence, Barry B. Cosgrave

The UK Government announced on Saturday 28 March 2020 that it is amending UK insolvency law to (a) retrospectively suspend the offence of wrongful trading by directors of UK companies (such suspension having deemed to commence on 1 March 2020) and (b) enact legislation to give UK companies the breathing space to allow them to keep trading while they explore options for rescue.

BACKGROUND

Current insolvency rules stipulate that directors of limited liability companies can become personally liable for business debts if they continue to trade when uncertain about whether their businesses can continue to meet their debts. These rules will be suspended.

The Government previously consulted on changes to the corporate insolvency regime and announced plans to introduce new insolvency restructuring procedures in August 2018 (the August 2018 plans) that we considered in a previous alert. The new legislation will implement these plans, including a short moratorium that will give companies in difficulty the time to explore options for rescue. It is not known how exactly the August 2018 plans will be implemented so we set out below the relevant procedures as they stood in 2018.

DIRECTOR WRONGFUL TRADING RULES SUSPENDED AS OF 1 MARCH 2020

Under current law, once a director of a company concludes (or should have concluded) that there is no reasonable prospect of the company avoiding an insolvent liquidation or insolvent administration, he or she has a duty to take every step which a reasonably diligent person would take to minimise potential loss to the company's creditors. If, after the company has gone into insolvent administration or liquidation, it appears to the English courts that a director has failed to comply with this duty, the court can order the director to make such personal contribution to the company's assets as it thinks proper. In normal circumstances this is evidently a situation that a director would be keen to avoid. In current circumstances there will be many thousands of directors who feel themselves exposed to this offence.

The Government said on 28 March that these wrongful trading rules were deemed to be temporarily suspended since 1 March 2020. No time period was announced for the end of the suspension. Relaxation of these wrongful trading rules will reassure directors that the decisions they have made in the month of March and are to make about the future viability of their businesses will not have to be unduly influenced by the exceptional circumstances which are entirely beyond their control. In particular, it is hoped this suspension will assist directors in accessing new UK Government or bank funding without concerns regarding personal liability.

©2005-2020 K&L Gates LLP. All Rights Reserved.

However, existing laws in relation to fraudulent trading and the threat of director disqualification will continue as a block on director misconduct during the crisis. It will remain an offence for a person to knowingly carry on the business of a UK company with intent to defraud creditors of the company, or creditors of any other person, for any fraudulent purpose.

NEW MORATORIUM PROCEDURE

The August 2018 plans envisaged a new preliminary moratorium being available to all solvent companies to give them time to consider restructuring options for rescue, much as in the current UK administration procedure. Despite the moratorium, the company would have to continue to pay its debts as they fall due. A UK company would be eligible to apply for the moratorium if it would become insolvent if action is not taken, but which is not yet insolvent and is able to carry on business and meet current obligations and expenses during the moratorium. Also, the company must have the prospect of agreeing a compromise or arrangement with its creditors on the balance of probabilities (as determined by an independent monitor). The monitor will be a licensed insolvency practitioner who would notify all creditors of the procedure. The monitor would not be able to take an administration or liquidation appointment with the company for 12 months but can act as the nominee or supervisor of a subsequent company voluntary arrangement.

NEW STANDALONE RESTRUCTURING PROCEDURE

The August 2018 plans proposed a new standalone procedure whereby a company could propose a restructuring plan to its creditors. Solvent and insolvent companies would be able to use the process. The new restructuring procedure is intended to closely resemble the existing UK scheme of arrangement (SoA) procedure and therefore SoA case law will be applied in its interpretation. The courts would be heavily involved in examining and approving a proposal. It is for the company to propose plans it thinks will be acceptable to creditors. Creditors and shareholders can submit counter-proposals. The approval of more than (a) 75% in monetary value and (b) at least 50% in number of creditors who vote on the proposal would be required in each class of creditor; plus, more than half (in aggregate) of the value of unconnected creditors (in each class) must vote in support.

Significantly, the new procedure would allow for a cross-class cram-down of dissenting creditors. Dissenting classes of creditors, most importantly those who are 'out of the money,' may be bound to an arrangement that is in the best interests of all stakeholders. The new procedure would adopt a variation on the Absolute Priority Rule familiar, although not identical, to that contained in a U.S. Chapter 11 proceeding. A dissenting class of creditor must be satisfied in full before a more junior class receives or retains anything under the restructuring plan. However, the court may approve a plan which departs from this absolute priority approach where it concludes as follows: (a) it is necessary in order to achieve the aims of the restructuring, (b) is just and equitable in all the circumstances, and (c) at least one class of creditors who will not be paid in full has voted in favour of the plan, as per the rule under the US Bankruptcy Code. It will not be necessary to have an official overseeing the plan in every case and there will be no maximum period over which the plan must be implemented.

NEW PROTECTION OF THE SUPPLY CHAIN

The August 2018 plans provided that the contractual termination provisions for suppliers of goods and services and for contractual licences would no longer allow a supplier/licensor to terminate on grounds that the other party has entered a formal insolvency process, a new pre-insolvency moratorium process or a new restructuring

©2005-2020 K&L Gates LLP. All Rights Reserved.

procedure. However, this prohibition would not prevent termination for reasons of non-payment or other termination provisions upon notice or under fixed term contracts. A supplier would be allowed to apply to court to be exempted from this prohibition if it can establish a significant adverse effect on its own business as a result of having to continue to supply.

TIMELINE

The Government said that legislation to formalise the August 2018 plans will be introduced in the UK Parliament at the earliest opportunity (although no exact date has been given). It said that provisions will be included to enable the changes to be extended if necessary. There will be devil in the detail once the draft legislation is published but the UK Government's policy is clear - to give honest directors a chance to save their companies.

KEY CONTACTS

JONATHAN LAWRENCE
PARTNER
LONDON
+44.(0)20.7360.8242
JONATHAN.LAWRENCE@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2020 K&L Gates LLP. All Rights Reserved.