

COVID-19: UK Insolvency and Restructuring

At the present time, due to the global outbreak of Covid-19 and the international response to it, many otherwise economically viable UK businesses find themselves subject to considerable financial pressure. There are a variety of measures that such businesses may consider in order to mitigate this pressure. The [Dorsey & Whitney Coronavirus Resource Center](#) contains a wide range of material, including guidance for businesses struggling to meet [contractual obligations](#) and information in relation to the UK Government's [furlough scheme](#) and its [loan and tax-deferral schemes](#). The UK Government has also issued a (non-legally-binding) [guidance note](#) in which it "*strongly encourages*" parties to contracts "*to act responsibly and fairly in the national interest in performing and enforcing their contracts*" with a view to – among other things – "*avoiding destructive disputes and insolvencies*".

Notwithstanding these various measures and governmental exhortations, the financial impact of the Covid-19 crisis is expected to result in many companies facing insolvency. With a view to limiting the number of such insolvencies, the UK Government recently fast-tracked the Corporate Insolvency and Governance Act 2020 ("CIGA") through the UK Parliament. This briefing outlines the altered insolvency landscape and highlights some practical considerations that may be applicable to struggling companies, their directors, and their creditors. In order to direct to a particular section of this briefing, please click on any of the links below:

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The position of financially distressed companies

Temporary protection from compulsory liquidation

For companies concerned about the immediate threat of liquidation via a creditor's winding-up petition, CIGA has provided some temporary protection.

No petition for the winding up of a registered company can be presented on or after 27 April 2020 on the grounds that the company has failed to satisfy a statutory demand, if such demand was served during the period beginning 1 March 2020 and ending on 30 September 2020. In addition, a petition cannot be presented by a creditor during that period unless the creditor has reasonable grounds for believing that coronavirus has not had a financial effect on the debtor or that the debtor would have been unable to pay its debts in any event.

Mechanisms for corporate rescue

Companies that do not qualify for the temporary protection from compulsory liquidation, or that are concerned about the prospect of such liquidation after the temporary protection is lifted, may wish to take advantage of the statutory mechanisms for corporate rescue. Three such procedures that existed prior to the passage of CIGA are still available. They are:

1. Administration: management of a company is taken over by an administrator (an insolvency practitioner) whose primary aim, if possible, is to restructure and rescue the company as a going concern. The company is protected from legal action from creditors by a statutory moratorium whilst a rescue plan or an orderly wind down of the company's affairs is achieved.

2. Company Voluntary Arrangement: a company comes to an arrangement with its creditors over the payment of its debts (often only paying a proportion of the amount owed). However, such an arrangement cannot affect the rights of secured creditors or preferential creditors without their consent.

3. Scheme of arrangement: a company comes to an arrangement with its members or creditors, such arrangement to be sanctioned by the court. This procedure can be used to effect a solvent reorganisation of a company as well as to effect an insolvent restructure. However, it does not provide for a moratorium whilst any restructuring is negotiated and there is no power to impose a restructuring plan on an entire class of dissenting creditors or shareholders.

CIGA introduces two new rescue mechanisms:

1. Scheme of arrangement for companies in financial difficulty: a company comes to an arrangement with its creditors or members in circumstances where the company has encountered, or is likely to encounter, financial difficulties that are affecting, or may affect, its ability to carry on business as a going concern. The purpose of the arrangement must be to address such difficulties. This arrangement must also be sanctioned by the court but, unlike the scheme cited above, it may be approved even where a class of creditors or members has not agreed to it. This procedure is most likely to be of assistance to large companies dealing with complex debt structures.
2. Moratorium: subject to certain eligibility criteria being met, a company obtains a 20-day moratorium (capable of extension) during which no legal action can be taken by creditors against the company without the court's permission. The directors retain day-to-day management of the company but the moratorium is overseen by an insolvency practitioner, who must be of the view that it is likely that the moratorium will result in the rescue of the company as a going concern. During the course of the moratorium, a plan for rescuing the company will be pursued which might include one of the procedures listed above.

Maintaining supply contracts

A company in financial difficulty considering such procedures might be concerned about the impact of so doing on contracts with its suppliers. It is not uncommon for such agreements to include a clause which provides for the termination of the contract or gives the supplier an option to terminate upon the corporate customer entering into an insolvency or restructuring procedure.

However, in order to prevent the process of business rescue being jeopardised by an abrupt halt in supplies, provisions have been introduced by CIGA which nullify the effect of termination clauses in those circumstances (unless an exemption applies).

Unlike certain other measures introduced by CIGA that are time-limited in order meet the immediate challenge of Covid-19, the new corporate rescue mechanisms and the prohibition on termination clauses represent a permanent change to the landscape of corporate insolvency and restructuring.

If you have any questions regarding the eligibility or suitability of a particular company for any of the procedures outlined above; about the process for adopting such a procedure; or about the enforceability of a particular termination clause, please do contact us and we would be happy to assist.

The position of directors

Directors' duties

Directors of companies will be aware that they are subject to various legal duties in

respect of their directorships. When a company is or is likely to become insolvent, these duties include a duty to consider the interests of the company's creditors. The law further regulates directors' conduct by – among other things – providing a remedy for misfeasance, imposing liability for wrongful trading (discussed below) and for fraudulent trading, and enabling the disqualification of directors in certain circumstances.

Particularly when the solvency of their companies is under threat or may be so in the future, directors should ensure that they are familiar with the various duties to which they are subject.

Temporary protection for wrongful trading

Directors can be held personally liable to contribute to the assets of an insolvent company for "wrongful trading". Wrongful trading is established if a director knows or ought to conclude that there is no reasonable prospect of avoiding insolvency and yet fails to take every step with a view to minimising the potential loss to creditors.

In order to avoid a wave of corporate insolvencies occasioned by directors' fear of personal liability in a highly uncertain business environment, temporary protection from liability for wrongful trading has been introduced by CIGA. In particular, when considering whether or not a director should personally contribute to the assets of a company, the court will assume that the director (if a director of an eligible company) is not responsible for any worsening of the financial position of the company or that of its creditors between 1 March 2020 and 30 September 2020.

However, such protection does not amount to a blank cheque for reckless management during this period. Directors continue to be subject to various duties, including the duty to consider the interests of creditors, and other legal provisions pursuant to which personal liability may be imposed continue to have effect.

Practical tips

Particularly in these uncertain times, directors may wish to consider frequent monitoring of their company's financial position (maintaining accurate management accounts and up-to-date forecasts), holding regular (remote) meetings and ensuring that accurate records of decision making are kept along with supporting information. If appropriate, financial and legal advice should be sought, which – subject to the financial position of the company – might include advice in relation to suitable insolvency and restructuring procedures. It may also be appropriate to consult with creditors.

The position of creditors

In some cases, consultation may, in fact, be the most commercially attractive option for creditors of a corporate debtor. A creditor may take the view that the debtor is a viable long-term source of business which has merely been afflicted in the short term by the economic fallout from the pandemic.

CIGA: safeguards and exceptions for creditors and suppliers

It will be clear from the foregoing that the rights to which creditors will have recourse – in the absence of an amicable settlement with the debtor – have been altered in view of the increased protection afforded by CIGA to financially distressed companies. However, creditors to, and suppliers of, corporate debtors should familiarise themselves with the exceptions and safeguards in the legislation which may be applicable to their circumstances. By way of example:

- A creditor may be able to obtain an order for the compulsory liquidation of a corporate debtor (notwithstanding the temporary general prohibition) if the creditor has reasonable grounds for believing that (i) coronavirus has not had a financial effect on the debtor or (ii) the debtor would have been unable to pay its debts as they fell due in any event;
- During a moratorium, a creditor may apply to court on the grounds that the company's affairs, business and property are being or have been managed in a way that has unfairly harmed the interests of creditors with a view to obtaining an order bringing the moratorium to an end;
- A supplier may apply to court seeking the termination of a supply contract with a corporate counterparty in financial difficulty if continued supply would cause hardship to the supplier; and
- Until 30 September 2020, the prohibition on termination clauses will not apply to small suppliers (as defined in the legislation).

Practical considerations for suppliers

In light of the new prohibition on termination clauses, suppliers may deem it prudent to enquire into a prospective customer's financial status before concluding a supply contract. Suppliers may also wish to maximise the prospect of termination rights accruing before a formal insolvency event occurs – for example, by ensuring that a supply contract provides for an option to terminate in the event of a missed payment by the customer – and to exercise such rights when they arise.

CIGA is a long and detailed statute, much of which is beyond the scope of this briefing. Moreover, some of the provisions of CIGA outlined above do not apply to every company in every case. If you have any questions regarding the impact of the legislation – or indeed in relation to insolvency and company law more generally – please do not hesitate to contact us.

This article has been prepared in collaboration with Edward Granger of Maitland Chambers. Please click [here](#) to access Edward Granger's profile.

This article is intended for general information purposes only and should not be construed as legal advice or legal opinions on any specific facts or circumstances. Members of Dorsey & Whitney are here to help and we will be pleased to provide further information regarding the matters discussed in this article. We have also created a Coronavirus Resource Center containing other briefings and information related to the

current crisis: www.dorsey.com/coronavirus.