Mercer & Hole

Corporate Restructuring - benefits to business

A technical update

Welcome to our Corporate Advisory Technical Update

There's been a huge shift in the corporate landscape these past four months as dramatic changes forced upon our normal way of life have filtered through to impact businesses.

Reacting to these changes, mitigating their impact on profits and keeping up to date with the numerous emergency government business support schemes has been more than enough to keep directors and professional advisors busy. There's a chance therefore that you will have missed some details of our new insolvency law, the catchily titled "Corporate Insolvency and Governance Act 2020" (CIGA), given royal assent on 26 June 2020, and other insolvency related developments such as an administration protocol and HMRC moving towards the front of the creditor queue.

The new law is made up of temporary amendments to the Insolvency Act 86, aimed at relieving pandemic related pressure on companies, and a number of brand new rescue focused processes, which add to our already world class insolvency legislation. As things stand the temporary amendments will cease to have effect on 30 September, but like the Furlough scheme, which was initially to last three months but has been extended to October, there is a chance they will be extended when the time comes.

Chris gets the ball rolling with an excellent summary of the new Moratorium procedure. As some of the temporary provisions relate to this new process, Chris has focused on what a Moratorium might look like if it's started during the period while they are still in force.

I have prepared two articles which give a quick summary of the temporary changes made to two sections of the Insolvency Act: wrongful trading and winding up petitions. The wrongful trading change was aimed at giving anxious directors comfort that they can 'wait and see' but, as I have warned, doesn't take anything away from a director's duties; and the winding up amendments have been effective in restricting the actions of aggressive creditors.

Henry has addressed light touch administrations, an emerging concept whereby directors of companies in administration remain largely in control of the business

Continued over...

In this issue

July 2020

via powers delegated to them by the administrator. It's an interesting development which, as Henry explains, could become more commonplace in the right circumstances.

Ed's article on the change in status of certain HMRC debts is one not to skim over. With floating charge security being impacted, certain lenders may be scrambling to improve their position and directors who have personal guarantees could be among the long-term losers.

Finally, Peter addresses the other new rescue focused process, the Restructuring Plan. It has similarities to a scheme of arrangement but lends itself to larger companies with complex funding structures.

We hope you find this summary useful, but please do not hesitate to get in touch should you have any questions. Similarly Chris Laughton, Henry Page, Peter Godfrey-Evans, Steve Smith and Ed Ellis and I are always happy to take a call on any other corporate advisory matter that you may need assistance with. We have been saying it a lot lately, but taking restructuring or rescue advice early is critical if the business is going to be given the best chance of survival.

Dominic Dumville
Corporate Restructuring Partner
020 7236 2601 / 01727 869141
dominic.dumville@mercerhole.co.uk

How will the "Covid Moratorium" work in practice?

A moratorium under the so-called temporary measures provisions of the Corporate Insolvency and Governance Act 2020 ("the Act") is not quite the same as the moratorium we will have once those temporary provisions expire.

New procedures and temporary measures
A new moratorium procedure to give stressed and distressed companies a breathing space is a key part of the Act. But so too are the temporary measures, introduced to deal with the consequences of the COVID-19 pandemic. For moratoriums put in place by 30 September 2020, the new procedure is subject to temporary modification. We're therefore considering here the practical implications of what we have available now, the modified "Covid moratorium".

The Covid moratorium
A moratorium is a debtor-in-possession procedure for companies that are or are likely to become insolvent. The company's directors remain in control and the company is legally protected against action by secured or unsecured creditors. A moratorium lasts 20 business days and can be extended. It is overseen by a monitor, a licensed insolvency practitioner, whose role is not to be involved in management of the company, but to ensure that the company continues to qualify for a moratorium.

Qualification for a moratorium
To be eligible for a moratorium or for the moratorium to be able to continue, a company must:

a. not be a bank or financial institution (as set out in Schedule 1 of the Act);

b. not be subject to an insolvency procedure;

c. in the monitor's view, be likely as a result of the moratorium to be rescued as a going concern, but for the effects of coronavirus; and

d. pay moratorium debts as they fall due.

The attractions of a moratorium
A moratorium puts the company's directors firmly in control, provided that the monitor's view is that the company continues to qualify. Creditors cannot take enforcement action or bring legal proceedings. Only the directors can trigger an insolvency procedure, not a creditor (secured or unsecured) or the monitor. However, if in the monitor's view the company fails to qualify for a moratorium, the monitor must end the moratorium. Otherwise it is for the directors to use the moratorium to further the interests of the company and its stakeholders in accordance with their directors' duties. It is not necessary to rescue the company as a going concern; the moratorium may simply lead to a better outcome from a subsequent insolvency process.

Financial qualifications
It is unlikely to be difficult for a company considering a moratorium to show that it is or is likely to become insolvent.

The more challenging test for the company to pass and for the monitor to adjudicate is that, but for coronavirus, the moratorium would have been likely to lead to the rescue of the company as a going concern. This will require:

a. identifying the company's financial position before coronavirus had any effect (probably straightforward);

b. projecting the company's likely position from before coronavirus to the present on assumptions that disregard the effect of coronavirus (potentially difficult to satisfy the monitor that a particular result, or better, was likely); and

c. projecting forward from the present, adjusted for the effect of coronavirus, to show that a moratorium would have been likely to lead to rescue of the company as a going concern (potentially difficult to satisfy the monitor that rescue was likely).

Another challenge for companies considering a moratorium is the need for moratorium debts to be paid as they fall due, not least because cash flow difficulties are one of the primary consequences for companies of coronavirus.

Companies suitable for a moratorium
To be able to benefit from a moratorium, a company is likely to have been healthy before coronavirus and should now be either cash rich or cash generative. Those that are not suitable will need to consider an alternative insolvency procedure. In any event, stressed and distressed companies should seek professional assistance.

If any of the above resonated with you, please do not hesitate to contact me or one of the corporate restructuring partners.

Chris Laughton
Corporate Advisory Partner
020 7236 2601
chris.laughton@mercerhole.co.uk

Corporate Insolvency and Governance Act 2020 ("CIGA") – Wrongful trading

The headline, 'Wrongful trading temporarily abolished', when it was announced three months ago sounded far more controversial than what we now see in the Act.

Section 214 of the Insolvency Act 1986 ("the Act") states that a director or shadow director can be made liable for losses arising after the moment when that person should have known that there was no reasonable prospect of avoiding insolvent liquidation. In other words, when they should have stopped the music, rather than carrying on and 'hoping for the best'. The temporary amendment brought in by CIGA simply states that when the court is determining the contribution to the losses that a director should make, the court must assume that the director was not responsible for any worsening of the financial position of the company or its creditors between 1 March 2020 and 30 September 2020.

A few words of caution for directors overseeing companies in a position of uncertainty:

- While it may be extended in due course, the temporary amendment will be lifted on 30 September, when directors can once again be found personally liable for losses arising after that date. If during the coronavirus period a company's financial position has suffered to such an extent that it cannot be reasonably expected to avoid liquidation, the directors need to be proactive lest they be accused of not preventing the losses arising after 1 October; rent, utilities, payroll and HMRC liabilities for example.
- Also s212 of the act which provides a remedy for breaches of directors' duties, remains as it always has been: If 'an officer of the company' is found to have breached their fiduciary or other duty 'the court may… examine the conduct of the [officer]… and compel him to contribute such sum to the company's assets….. as the court thinks just.'

Regardless of the specifics of s214 and the temporary amendment thereto, when a company is in a dire financial position the directors have a duty to assess the situation and do what's best. If a liquidator can present evidence to the court that had an assessment been undertaken it would have been obvious to the director that the company was beyond the point of no return, and that by doing nothing the he/she allowed the position to worsen, the court could be persuaded that it's 'just' to compel that director to contribute to the losses arising as a result of their inaction, with no need of the wrongful trading provisions.

For advice on Corporate Insolvency and Governance Act 2020 and wrongful trading please feel free to contact me or one of the corporate restructuring partners.

Dominic Dumville
Corporate Restructuring Partner
020 7236 2601 / 01727 869141
dominic.dumville@mercerhole.co.uk

Corporate Insolvency and Governance Act 2020 ("CIGA") – winding up provisions

All of us in business have done a lot of crystal ball gazing since the pandemic began to take hold and it's no different when trying to react to CIGA, and in particular its temporary provisions.

While CIGA states that these temporary provisions will only take effect during the relevant period (defined as ending on 30 September) it also includes what are often referred to as 'Henry VIII Provisions' which give the government power to make further amendments without having to go back to parliament.

If the government's dealings with the Job Retention scheme are anything to go by (it was initially introduced for three months but has since been extended), we may see the temporary amendments remaining in place into the autumn.

It appears as though the overriding objective of the temporary provisions is to give any business struggling due to the Covid-19 pandemic every chance of survival. Anyone considering taking steps to wind up another company, a slow paying customer perhaps, will need to take a moment to look at the specifics of the case. Simply issuing a statutory demand and waiting for the time limit to expire will no longer suffice. Petitions presented after 27 April 2020 on the back of a statutory demand served after 1 March 2020 will be automatically void, regardless of the debt and the circumstances surrounding it.

Furthermore, it is not currently possible to wind up a company on insolvency grounds unless the creditor can persuade the court that the Coronavirus has not had a financial effect on the company. The Act then goes on to provide that the court can wind up a company that has suffered to some degree due to the Coronavirus if it can be shown that the grounds of the petition (an unpaid judgment debt or proving to the court the company's insolvency) would have occurred even if coronavirus had not taken its toll. This will not be an easy task and in many circumstances there will be a lot of grey areas.

For example, a Company is unable to pay its debts owing to the loss of its largest customer in February 2020. The customer operated out of its head office in Paris and terminated the contract owing to the uncertainty around Brexit. The headlines of this case would certainly suggest the financial hardship suffered by the company is unrelated to the epidemic. However, if its directors make representations to the court that they could easily have replaced the lost income with new customers but for the lockdown and a dramatic decline in demand, the case becomes less cut and dried. Clearly it's difficult to say whether or not a judge would have sympathy for such an explanation, but given the other generous business support schemes introduced by the government, the courts may take the view that the objective of the Act is to give every company the best chance of survival and err on the side of caution.

The Act also deals with the unique and messy set of circumstances where a company has been wound up after 27 April. That winding-up order is void and the official receiver, liquidator or provisional liquidator may be directed to restore the company to the position it was in before the petition was presented. Although the officeholder will not face any liability for acting in accordance with the void order, there will be questions asked about who should fund losses suffered during the period when the company was thought to be in liquidation.

Dominic Dumville
Corporate Restructuring Partner
020 7236 2601 / 01727 869141
dominic.dumville@mercerhole.co.uk

Light Touch Admins

On a company entering administration it's not uncommon for the directors to be side-lined.

The law provides that the administrator has a duty to manage the company's affairs, business and property and no director may exercise a management power without the consent of the administrator.

But as a situational specialist an administrator is well placed to manage at a high level, deal with the impact of administration on the company and consent to the company's management conducting day to day operations. Company managers and directors frequently have relevant industry skills and experience that administrators do not.

How can the relationship between the administrator and a company's directors be arranged to make best use of their respective skills and experience? Well, it's for the administrator to decide what's in creditors' best interests in each case, but the prospect of viable businesses needing the protection of administration to enable them to restructure and overcome the three months or more of closure forced on them by the coronavirus pandemic stimulated the development of a useful tool.

In April 2020 the Insolvency Lawyers Association and the City of London Law Society produced a consent protocol. The main features of this template are the identification of broad management powers which can continue to be exercised by the directors and the identification of specific conditions with which the directors must comply in order to exercise those powers. Where the primary objective of an administration is to rescue the company as a going concern, the consent protocol is intended to provide a framework to allow the directors to play a central role in stabilising and rescuing the company under the administrator's supervision. Cases where the protocol is adopted have been dubbed 'light touch' administrations.

To date there have been at least two high profile light touch administrations, Debenhams and Victoria's Secret. While a recent announcement by the administrator of Victoria's Secret stated that an agreement had been reached with another retailer to sell parts of the business, the detail within the administrators' reports to creditors will indicate to what extent the management were permitted to remain in office and whether there has been a genuine cost saving.

The protocol is an eminently sensible idea. In practice I have adopted similar protocols on trading administrations historically and thanks to the lawyers and insolvency practitioners who developed the idea, we're now even better placed with a template protocol available for use in future situations.

While the administrator has the ability to delegate management (but not the administrator's own) powers to a director, it is the administrator who retains responsibility. The extent to which a light touch administration can remain 'light touch' is therefore dependent on a number of factors, first amongst which is the level of trust between the administrator and the board, as well as the reliability of management information, and the speed with which it can be produced.

Other stakeholders sometimes see the directors as part of the problem for an insolvent company, but these are not normal times. Good businesses have hit rock bottom through no fault of their own. The pandemic has affected the global economy and the protection of the administration moratorium should not be outweighed by the cost of oversight of the administrators.

The light touch administration protocol does not claim to be a one size fits all remedy but alongside the new moratorium, the restructuring plan, company voluntary arrangements and more traditional trading or pre-pack administrations, it provides the UK restructuring and business community with a range of tools with which to fight the spiralling corporate debt pile, and crucially to help get British business moving again.

At Mercer & Hole we have always sought to identify the most appropriate solution for each individual business which requires the assistance of our corporate restructuring team and we welcome the expansion of the toolkit to allow us to play our part in the recovery of UK Plc.

Henry Page
Corporate Advisory Partner
020 7236 2601
henry.page@mercerhole.co.uk

The Restructuring Plan

The so-called restructuring plan is a tool introduced by the Corporate Insolvency and Governance Act 2020 that is most likely to be used by large companies.

. It has been designed to facilitate overcoming a company's financial difficulties by means of a compromise or arrangement between the creditors and/or members of the company.

It is similar to a Scheme of Arrangement under Part 26, Companies Act 2006. Indeed, the restructuring plan legislation forms a new Part 26A of the Companies Act. However, a principal distinction of a restructuring plan is that the company must have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.

The plan needs to be approved by 75% of a class of creditors or members who would receive a payment or have a genuine economic interest in the company if the plan were not to proceed. The court can then compel all other classes of creditors or members to accept the plan, provided that no creditor or member in the dissenting classes would be worse off than if the plan did not go ahead. This is the mechanism for cross-class cram down, which is a notable feature of the restructuring plan procedure.

A restructuring plan can be proposed by a company subject to a moratorium, by an administrator or a liquidator, or (probably less likely) by a creditor or member.

Since 26th June 2020 when the new law came into effect the UK's first restructuring plan has already been proposed by Virgin Atlantic. The plan, which already has the backing of key financial stakeholders, is scheduled to be put before a stakeholder meetings during the week commencing 17 August.

If any of the above resonates with you please do not hesitate to contact me or a member of our corporate restructuring team.

Peter Godfrey-Evans
Corporate Advisory Partner
020 7236 2601 / 01908 605552
peter.godfreyevans@mercerhole.co.uk

Changes in HMRC's status

The government plans to make HMRC a preferential creditor for certain taxes in formal insolvency processes from 1 December 2020.

HMRC currently ranks as an unsecured creditor and has done since the introduction of the Enterprise Act 2002. Under the new legislation taxes collected by the business on behalf of other taxpayers (including VAT, PAYE income tax, employee National Insurance Contributions and student loan deductions) will rank as a secondary preferential creditor, payable after debts secured by a fixed charge, the expenses of the insolvency practitioner and ordinary preferential creditors (employees), but before debts secured by a floating charge and debts owed to unsecured creditors.

The rules relating to taxes owed by businesses themselves (corporation tax and employers' National Insurance Contributions) are unchanged.

Impact on lenders

The change in HMRC's status is likely to have a big impact on certain classes of creditors and lenders in particular should carefully consider the effect on the recoverability of their loans. HMRC is very often the largest creditor in an insolvency and the change in legislation effectively moves elements of HMRC debt up the ranking of creditors, potentially reducing the return to both floating charge and unsecured creditors.

This effective devaluation of floating charge security is expected to be keenly felt in the Asset Based Lending ("ABL") industry. The assets secured by a floating charge are usually current assets such as a receivables ledger, cash or stock, assets that ABLs often rely upon for their security. Consequently, ABLs are likely to have less confidence in their security under the new regime, which could have a significant impact on the ABL industry and its customers going forward.

.

HMRC's response to the pandemic

The position for lenders has been further complicated by government measures introduced to combat the impact of the Coronavirus pandemic on businesses. The government has announced that businesses will not have to make VAT payments during the period from 20 March 2020 until 30 June 2020 because of the Coronavirus pandemic. Businesses now have until 31 March 2021 to pay liabilities that would have been due in this period. Businesses can only defer:

- Quarterly and monthly VAT return payments for periods ending in February, March and April 2020;
- Payments on account due to between 20 March 2020 and 30 June 2020; and
- Annual accounting advance payments due between 20 March 2020 and 30 June 2020.

This is likely to further worsen the floating charge lender's position; not only will HMRC have secondary preferential status (for certain taxes) from December but they may also have a larger outstanding balance at that time because of payments being deferred.

How should lenders react?

Robust and realistic Management Information (MI) is likely to be more important than ever. Lenders should fully understand the tax position of the clients in their portfolio. If it is considered that the floating charge security has been devalued to the extent that the lend is no longer viable on a typical ABL basis (secured against floating charge assets) ABLs may look to change their business model and lend against assets that can be secured with a fixed charge. This may well influence the type of insolvency process favoured by ABLs to recover their debts.

Knowledge is likely to be key to giving ABLs confidence about their lends. A pragmatic step to achieving this is likely to be engaging a reputable firm to prepare an Independent Business Review (IBR) where clients are carrying a lot of crown debt.

How should directors react?

Any director who gave a personal guarantee in support of a company entering into a borrowing facility, perhaps confident that it would never be called upon, should take a moment to reconsider the position. If the relevant HMRC debts have crept up to the point where in the event of an insolvency HMRC would receive the lion's share of the floating charge assets, there is now an increased risk of their personal guarantee being called upon.

Of course, these concerns only arise if the company goes into insolvency on or after 1 December 2020. Any director who knows or should know that a company is or will probably become unable to pay its debts as they fall due has a duty at common law to act in the interests of the company's creditors as a whole. Any director whose company falls into that category, or who is unsure about whether the company falls into that category, should take professional advice.

At Mercer & Hole our Corporate Restructuring team have a wealth of experience in working with distressed companies, contact a member of our team today if you require advice and assistance.

Edward Ellis
Corporate Restructuring Manager
020 7236 2601
edward.ellis@mercerhole.co.uk

London
020 7236 2601
london@mercerhole.co.uk

St Albans
01727 869141
stalbans@mercerhole.co.uk

Rickmansworth
01923 771010
rickmansworth@mercerhole.co.uk

Milton Keynes
01908 605552
miltonkeynes@mercerhole.co.uk