Browne Jacobson

New insolvency laws during the COVID-19 crisis

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Please note: the information contained in this legal update is correct as of the original date of publication

On Saturday, 28 March 2020, Business Secretary, Alok Sharma MP, announced changes to the insolvency regime as part of the governments overriding objective "to help UK companies which need to undergo a financial rescue or restructuring process to keep trading" by giving "those firms extra time and space to weather the storm and be ready when the crisis ends whilst ensuring that creditors get the best return possible in the circumstances."

The changes to the insolvency regime announced by Mr Sharma include:

1. a moratorium for companies giving them breathing space from creditors enforcing their debts for a period of time whilst they seek a rescue or restructure;
2. protection of their supplies to enable them to continue trading during the moratorium;
3. a new restructuring plan, binding creditors to that plan;
4. key safeguards for creditors and suppliers to ensure they are paid while a solution is sought; and
5. a temporary suspension of wrongful trading provisions with retrospective effect from 1 March 2020 to give company directors greater confidence to use their best endeavours to continue to trade during this pandemic emergency without the threat of personal liability should the company ultimately fall into insolvency.

Legislation in relation to these changes is due to be brought forward at the "earliest opportunity".

Moratorium

A Government consultation in August 2018 envisaged a new moratorium to help business rescue; giving financially distressed companies which are ultimately viable a period of time when creditors (including secured creditors) could not take action against the company allowing it to make preparations to restructure or seek new investment. Whether or not the current changes will be modelled on the outcome of that consultation remains to be seen but it would appear to be a good starting point. However, given the changes that have been made to the wrongful trading provisions it is equally possible that more wide-reaching changes could be made to prevent any creditor action connected to the current emergency pandemic.

Supply to Businesses

Over the coming days, the government will no doubt provide further details of the proposed new rules. However, rather than there being completely new rules, it seems likely that the government will simply extend the existing essential supplies regime under sections 233 and

233A of the Insolvency Act 1986 which, together with the changes to the wrongful trading provisions, was a proposal made by the City of London Law Society.

The existing insolvency provisions prevent suppliers of utilities (e.g. gas, water, electricity) and other goods and services where the supply is for the purpose of enabling or facilitating anything to be done by electronic means (e.g. website hosting, advice/assistance in connection with IT, data storage and processing, computer hardware and software, point of sales terminals) from terminating or threatening to terminate supply under the supply contract unless arrears are paid.

Wrongful Trading

Directors have been concerned, perhaps unnecessarily, about their potential personal liability for wrongful trading during the current COVID-19 crisis.

Under section 214 of the Insolvency Act 1986, directors can potentially become personally liable to make a contribution to the company's assets if, before the commencement of the winding up of a company or it entering administration, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation or insolvent administration. Section 214 is already flexible in nature as the remedies are largely discretionary and there are exemptions for directors who take every step with a view to minimising the potential loss to creditors (on the basis that, at that point, the creditors' interests are paramount).

Given the significant impact on the turnover of businesses during the COVID-19 crisis and the fact that those businesses may be taking on further debts to survive, it is understandable that directors may be concerned about whether or not to continue and if they will be personally liable for doing so. The government has sought to address these concerns by temporarily suspending the wrongful trading provisions. However, rather than seeking to legislate on an urgent basis (with the inevitable issues that arise from that) it may have been better for the government to declare that directors, provided they are acting reasonably and responsibly in light of the extreme pressures put on them by COVID-19, already have protection under the existing wrongful trading provisions.

The current messaging could erroneously lead directors to believe that they can keep their businesses afloat without proper regard to their continuing duties as directors. Of course, that is not the case and Mr Sharma was keen to emphasise that "all of the other checks and balances that help to ensure that directors fulfil their duties properly will remain in force". These will include actions against delinquent directors under section 212 of the Insolvency Act 1986 for misfeasance or breach of duty, potential disqualification and actions under section 213 for fraudulent trading.

Even though the government is temporarily suspending the wrongful trading provisions, directors should still be fully aware of their continuing duties and the consequences of not complying with them. In addition, given that directors may in the current crisis have a greater desire to pay connected creditors or otherwise prefer one creditor over another, they should consider whether such transactions are likely to be deemed a 'preference' or 'transaction at an undervalue' which could be susceptible to challenge at a later date.

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