

COVID-19 – Temporary Relaxation of UK Insolvency Laws

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Cash flow and current and future liquidity are now real concerns for many businesses during this COVID-19 pandemic. Increasingly, the attention of directors and the wider economic ecosystem is turning to consider the issues of approaching insolvency and the duties of directors.

In line with the current approach of the UK Government to support businesses, on Saturday, 28 March, the Business Secretary, Alok Sharma, announced that UK wrongful trading insolvency laws are to temporarily change to help give businesses and directors some “breathing space”.

Proposed Changes to Wrongful Trading

- **Under the current insolvency provisions, there is an offence for directors continuing to trade if there was no reasonable prospect of avoiding insolvency:**
 - Section 214 of the Insolvency Act 1986 (the “Act”) gives rise to liability for a company director who failed to take every step to minimise the potential loss to the company’s creditors if they know, or ought to conclude, that there is no reasonable prospect of the company avoiding going into insolvent liquidation and the company does subsequently enter insolvency. These steps may include ceasing to trade in order to avoid incurring further liabilities.
 - The director can be forced to make unlimited personal contributions for additional creditor losses suffered while continuing to trade in breach. Furthermore, directors can face disqualification if found liable.
 - These risks, in normal circumstances, are one of the principal causes for directors to seek protection by commencing administration or liquidation procedures as soon as they become concerned.
 - Proposed changes include a temporary suspension of the wrongful trading rules to remove the threat of directors incurring personal liability during the COVID-19 period:
 - Wrongful trading provisions will be suspended for three months with retrospective effect from 1 March 2020. The legislation will allow further extension if necessary.
 - Legislation to give effect to these changes has not yet been published, but will be introduced at the earliest opportunity. The Government’s announcement is available on the [gov.uk](https://www.gov.uk) website.
 - The Government indicated that these changes will “*give UK 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*”. It also said that relaxation of the wrongful trading rules will “*reassure directors that the difficult decisions they have to make about the future viability of their business will not have to be unduly influenced by the exceptional circumstances which are entirely beyond their control*”.
 - It is hoped that this will help avert some premature and preventable corporate collapses, save jobs and support the economy. It may assist directors to keep businesses going while waiting to access Government or bank funding, and allow them to continue to pay furloughed staff pending receipt of Government employee wage support packages.
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- **However, there are a number of unknowns and potential implications:**
 - The announcement does not modify the circumstances in which a company is deemed unable to pay its debts. Clarification on which companies will qualify for the three-month moratorium would also be welcome.
 - It is unclear how these changes will interact with directors fiduciary duties. It is also unclear what consequential amendments will need to be made to additional offences under the Act, such as false representations to creditors (*section 211 of the Act*); and for falsification of company's books (*section 209 of the Act*).
 - For listed companies, it is unclear how these relaxations will interact with general obligations, for example, not to mislead the market.
 - Director's assessments are made more difficult in the current environment with its inherent challenges to accurate cash flow projections.
 - Some commentators have expressed concerns over unintended real world consequences. These could include the risk of damage to creditor confidence; a widening spread of withholding the payment of invoices across the business sector in general (already happening in the real estate sector with landlord rent payment suspension); and a danger that some companies may misuse the concessions and substantially increase debts they have no prospect of satisfying. It is unclear what the position and remedies of unpaid creditors will be immediately following the end of any such suspensions.

Additional Proposed Changes to Insolvency Rules

- The Business Secretary also announced other changes. The planned UK's Insolvency Framework will add new restructuring tools, including: a moratorium for companies giving them breathing space for from creditors enforcing their debts for a period of time whilst they seek a rescue or restructure; and protection of their supplies to enable them to continue trading during the moratorium. Changes will also be made to enable UK companies undergoing a rescue or restructure process to continue trading. This will include enabling companies to continue to buy essential supplies such as raw materials, broadband and energy.
- The changes may also include limiting creditors' ability to present winding-up petitions, and introduce a three-month moratorium against creditor action where the company is facing temporary challenges as a result of the COVID-19 period.
- These measures build on potential corporate insolvency reforms previously announced in August 2018, which are being fast-tracked in light of the current crisis.
- Depending on how these are implemented, directors could be given greater confidence not just in relation to their own personal liability, but also against creditor actions, at least within the three-month moratorium period. These would arguably have a real world impact on the difficult decisions directors are facing during this period.

Unchanged Legal Duties and Obligations

- **Proposals not yet implemented:** The proposed changes detailed in this note have not yet been implemented, and so the current legal position still applies.
- **Fiduciary duties still apply:** Boards of directors of UK companies should, however, be careful to continue to be aware of, and fulfil, their duties properly. As soon as directors are aware that a company is in financial difficulty, they should seek external advice.
- **Other existing laws, such as fraud and misfeasance and director disqualification, remain unaffected:** These include: fraudulent trading (*section 214 of the Act*), and other fraud-related offences that have added criminal liability; *section 212 of the Act* in which a director is personally liable to account for any misfeasance or breach of any fiduciary or other duty; and false representations to creditors. The Business Secretary cautioned that these would still apply to protect against director misconduct.
- **Caution is still necessary in relation to shareholder distributions, and potential transactions at an undervalue:** Directors will still need to be extremely cautious when considering making any distributions to shareholders. They also will need to be careful in their dealings with creditors generally. Transactions may still be considered

reviewable (e.g., a preference or an undervalue), if the company does later go into liquidation or administration. So actions such as granting additional security, agreeing new supply terms, paying certain creditors only, and senior severance payments, should still all be carefully evaluated.

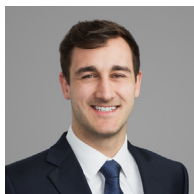
- **Directors should hold frequent board meetings and clearly document thinking processes and steps taken:** Despite the announced relaxations, directors are still well-advised to act prudently and take the normal steps in cash strapped situations. These might include weekly board meetings, more frequent running of solvency tests and assessment of the business' financial position. Directors should encourage regular documenting of the Board's assessment of the reasonable prospects of the business and ability to pay debtors.

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