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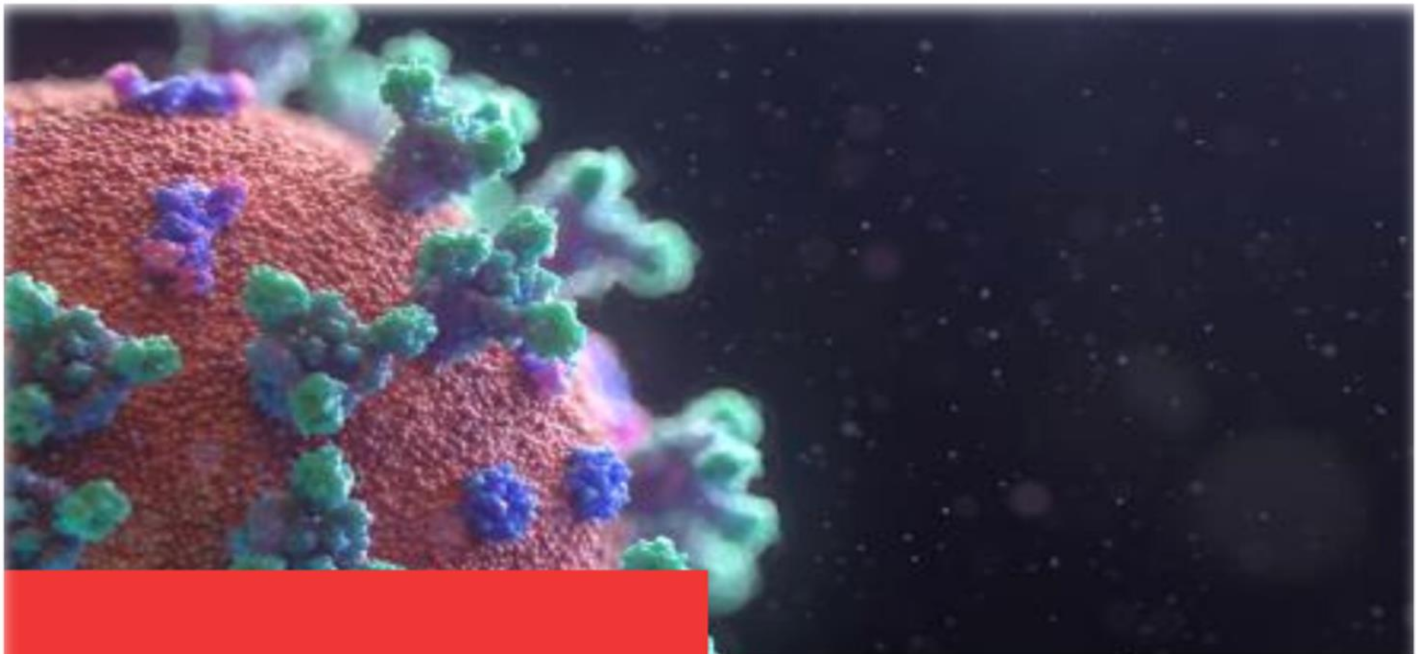
REPORT : SESSION 1



Prof. Rebecca Parry

About the Speaker

Professor Rebecca Parry is the Co-Director of the Centre for Business and Insolvency Law at Nottingham Trent University. Her main research interests lie in the area of insolvency law and, in particular, international and comparative insolvency law with a focus on the UK, China, India, the USA and the EU. She has interests in related areas of company law, notably directors' duties and director disqualification, as well as in insolvent partnerships. In recent years she has developed a strong interest in insolvencies with potentially large public impacts, including cloud computing insolvencies

*Picture used is created by Fusion Medical Animation

Background

The global economy is facing severe economic damage from the COVID-19 pandemic that could arguably be much more disastrous than ‘2009 Financial Crisis’. According to the latest forecast by Oxford Economics (April,14,2020), global GDP is expected to contract by almost 7% in the first half of the year i.e. almost double the decline recorded during the global financial crisis. Even the most viable businesses are in deep waters. Certain Sectors such as travel, tourism, hospitality have been heavily hit. Insolvency laws across the globe need to rapidly adapt to change and reemerge in a position of strength. Governments worldwide have been taking unprecedented measures to bring changes in their insolvency laws to prevent the outbreak of insolvencies post-crisis.

At this point in time, it is pertinent to understand country perspectives on insolvency laws across the globe and COVID-19’s impact on business. In this backdrop the Centre for Insolvency and Bankruptcy, IICA is organizing a series of webinars, bringing together academicians from top notch universities across the world to deliberate upon the Impact of COVID-19 on Insolvency laws in their home country and share insights on measures adopted across nations while navigating through this new normal. The speakers will be from countries such as India, Australia, Japan, Netherlands, Singapore, China, Israel, Germany, Sweden, United Kingdom, & USA.

The first session of the series was this Prof. Rebecca Parry on Covid 19 and its impact on the Insolvency Laws in The United Kingdom

Introduction

In the United Kingdom ("**UK**"), corporate insolvency law has well-developed rules governing the collection and distribution of the assets of an insolvent company on a winding up. The main statutory sources of corporate insolvency law are the Insolvency Act 1986 and the Insolvency Rules 2016, which supplement the Insolvency Act 1986 by providing the procedural framework for the insolvency regime.[1]

Winding up is addressed under Parts IV and V of the IA86, which identify the circumstances in which a company may be wound up on a compulsory or voluntary basis. In normal circumstances an interested party can present a petition to the court for the compulsory winding up of a company, often in cases where the company is unable to pay its debts.[2] As discussed below, in the wake of COVID-19 winding up cases that were presently before the courts were adjourned. In contrast voluntary liquidation generally does not involve the court and it is commenced by a resolution of the company. In a case where the company is solvent the procedure will be termed a members' voluntary liquidation, depending on whether the directors are prepared to make a statutory declaration that the company will be able to pay its debts in full, together with interest at the official rate, within a period of 12 months from the commencement of the liquidation. Otherwise the proceedings will be termed a creditors' voluntary winding up.

Additionally, there are three procedures that offer possibilities for companies to continue trading, although sometimes their function is to enable higher returns to creditors in the event of the company's liquidation. The first two are set out in the Insolvency Act, 1986, whereas the third is found under the Companies Act 2006 –

a. **Administration –** Administration is designed as an important means of protection for the company undergoing insolvency process through the imposition of moratorium and thereby putting a stay on the numerous claims from the respective creditors and ensuring a potential route to revival in the process. The process essentially involves the appointment of an administrator, who oversees the whole procedure. At the time when administration was first enacted it entailed excessive involvement of the courts, which increased the time in initiating the insolvency procedures, which was catered to

[1] https://thelawreviews.co.uk/edition/the-restructuring-review-edition-12/1197442/england-wales#footnote-065

[2] This does not result in a stay or moratorium on the enforcement of security against the company, however a secured creditor wishin got commence or continue proceedings must obtain the permsission of the court.

through a change in law in 2002, after which a company could be placed into administration "out of court" in a case where an insolvency practitioner was willing to state that the purpose of administration was reasonably likely to be achieved and also that the company was unable to pay its debts, or was likely to become so. In such a case an appointment can be made out of court by filing documentation with the court and no court order is required. However in some circumstances a court order must be obtained, such as where the company is in provisional liquidation. The main purpose of administration is to rescue the company as a going concern, although more commonly this procedure will be used to enable a sale of the company's underlying business or assets, so as to enable higher returns to creditors than would be possible under an immediate liquidation and the company will ultimately be liquidated. In part this rise in "prepacks" is due to the expense of administration, which requires the appointment of an administrator to take control of the company.

An administration appointment will provide the company with the protection of a moratorium and this procedure is therefore specifically useful in the UK, especially in times like that of Covid-19 where courts are not functioning properly, as it allows the insolvency procedure to go on, without the effective involvement of courts and under the expert supervision of an administrator. It has been recognized that many companies that are well managed will suffer difficulties as result of Covid-19 and, as discussed below, practitioners have developed a protocol that enables the administrator to entrust the management to remain in control of the company.

b. **Company Voluntary Arrangement ("CVA") –** The CVA is a simpler procedure, as compared to administration, and entails a framework in which the company's directors can, with the support of a nominee insolvency practitioner, propose and reach an agreement with the majority of creditors (75%) <u>by the corporate debtor</u> to restructure the debt and also potentially the company's members. It doesn't normally involve the imposition of moratorium, <u>although small companies obtain that</u>.

c. **Scheme of Arrangement –** A scheme of arrangement, although not being an insolvency procedure technically, is a procedure specifically suited for large companies in the long run. It is binding on the creditors, once it has been sanctioned by the court. However, the scheme of arrangement is not particularly suited for the current Covid-19 circumstances as it relies heavily on the court, firstly calling the meeting of all creditors to reach an agreement and then another to confirm the agreed proposal, which is practicably difficult to be achieved in the present Covid-19 circumstances.

Criticisms of Existing Procedures

The existing procedures under the UK Insolvency Law, as laid down above, are not structured specifically to carry out the restructurings of micro, small and medium enterprises ("**MSMEs**"), something which not only needs attention in UK but also across the globe. Considering the fact that MSMEs constitute a bulk of enterprises in UK, it is imperative, in the longer run, to examine the needs of MSMEs and the framework of their restructurings so as to blend the insolvency law to make room for relatively cheap and effective ways for MSMEs to be restructured.

In addition to this, the existing procedures were devoid of an option for the corporate debtor to obtain a moratorium without ceding control to the insolvency practitioner. Since insolvency proceedings are done under the anchor of the insolvency practitioner, with the corporate debtor ceding control to an administrator, and due to an evident lack of trust in the company directors in the UK, he/she is the best person to suggest or turn down the proposal of moratorium. This omission is in the process of being addressed by reforms which are being rushed through Parliament.

Impact Of Covid-19 On Businesses And Measures Taken By The UK Government

The deleterious impact of Covid-19 has been clearly seen on profitable enterprises, which had been faring well at the start of the year, as well as some enterprises, which had to close down temporarily. Mr. Chris Williamson, in his piece in the Financial Times, had predicted that the closure of businesses and preventive measures, like social distancing, undertaken to curb the impact of coronavirus would cause the business activity to fall more steeply, as compared to the global financial crisis of 2008.

Keeping in mind that the first victim of the coronavirus was detected in the UK on 30th January, 2020 and the number of cases have been rising steadily since then, the UK government in March, 2020 announced a range of measures, including the Coronavirus Job Retention Scheme, where the UK government offered to pay 80% of the wages of the furloughed employees, with a subsequent imposition of lockdown, effectively from 23rd March, 2020.

As far as the revival of the companies is concerned during this global pandemic, financing measures on part of the State play an instrumental role to ensure that viable companies are able to absorb the disruption caused, with a caveat that such measures should not be utilised towards the revival of those companies which are incapable of revival in any circumstances or which would have been inevitably pushed into insolvency, regardless of the disruption caused by this global pandemic outbreak. As far as the revival of latter form of entities are concerned, measures of private financing would ideally be more suited, as the private lenders would not only have better expertise to assess the situation and then accordingly push for revival. This approach will help to reduce the exposure of public money in reviving such corporations, although government guarantees discussed in the next paragraph, present risks of liability.

Further, focusing on the UK government's financing incentives, there are essentially three initiatives, first is the Covid Corporate Financing Facility, according to which the UK government will invest in companies making a material contribution to the economic activity in the UK or basically, high profile companies. Second, in line, are the Coronavirus Business Interruption Scheme ("**CBIS**") for small medium enterprises, being the most in the UK, with an annual turnover of up to 45 million GBP and the Coronavirus Large Business Interruption Loan Scheme ("**CLBIS**") for enterprises with an annual turnover of over 45 million GBP. The latter schemes offer government backed guarantees to incentivize commercial lending for the enterprises covered under the schemes.

Measures To Support The Directors

It is noted that in the present Covid-19 circumstances, there are a lot of profitable companies which, regardless of the fact that they are being run by cogent and sound management, are facing severe difficulties. In such cases, it is not feasible to replace the incumbent management or cede the control to an insolvency practitioner. In pursuance of this, the insolvency profession in the UK has devised an administration protocol which talks about an agreement during the administration process of a corporate debtor, according to which an insolvency practitioner will agree to give control of the corporate debtor to the incumbent management or directors. This protocol will allow the company to be placed under moratorium, even though it will be under the control of the existing directors.

Certain proposals, which have been the subject of consultation and discussion in UK for some years but were not previously implemented owing to a lack of legislative time given the BREXIT, are now poised for rapid implementation. The Corporate Governance and Insolvency Bill 2020 is expected to complete the Parliamentary processes in June 2020 and to receive Royal Asset soon after. One of those proposals includes the imposition of a self-moratorium which means that the companies need not be placed into administration for the imposition of moratorium. Another proposal is the introduction of a restructuring plan, which is similar to a scheme of arrangement and increases the possibilities of courts to *cram-down* i.e. approve the plan even if it has been rejected by the most classes of impaired creditors. Additionally, the proposal of continuation of supply arrangements is also being considered, which will neutralize the applicability of those clauses of the agreement between the corporate debtor and the supplier that allow the contract to terminate, if the corporate debtor is placed into administration. Continuation of supply arrangements will ensure that the suppliers continue to honour their agreements, even when the company has been placed into administration.

Other Government measures have eased the financial burden on companies. With the enactment of the Coronavirus Act, 2020 in UK, section 39 of the Act authorizes the government to fund the sick pay or cover the salaries/ payments of those people who have been unable to work due to coronavirus. Further, according to section 82 of the Act, restrictions have been imposed on the landlords and/or companies to exercise the rights of forfeiture so as to ensure the survival of the recipient of such services.

Additionally, winding up applications, that had been filed in the UK courts, have also been adjourned/deferred till June 2020, owing to the fact that such applications require more robust discussion and courts are ill-equipped to deal with such applications presently.

Suspension Of Wrongful Trading Liabilities

In some European jurisdictions, unlike the UK, the directors of a corporation are held liable, if they fail to file for insolvency of the requisite corporation. During Covid-19 circumstances, most of these European jurisdictions have gone ahead and temporarily removed those provisions which imposed such liabilities on the directors of the corporation, who have failed to file for insolvency proceedings, thereby providing relief to directors.

As opposed to the continental European countries, under the provisions of section 214 of the Insolvency Act, 1986 in UK, wrongful trading is a civil liability that enables a director to be ordered to pay compensation to the creditors, in cases where the corporation is in administration or liquidation and the directors knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation.

The applicability of the business judgement rule, which basically makes the directors immune from any liability to the corporation for their decisions, has been seen differently under the UK laws. Instead, a functionally equivalent test is applicable in the UK, which states that the director, in order to avoid liability for wrongful trading, will have to defend that he/she took every step with a view to minimizing the potential loss to the company's creditors.

Owing to the Covid-19 circumstances, the UK government has suspended the provisions for wrongful trading for three months from 1st March, 2020. It is submitted that such suspension of liabilities may not be necessary, as the directors will anyway be subjected to a lower threshold to ensure that losses to the creditors are minimized. The suspension of wrongful trading provisions will not effectively undermine the creditor protection and directors will still be subject to duties which can still make the director liable in certain circumstances. Further, other grounds for liability of the directors still remain and have not been suspended, like the fraudulent trading provisions, transaction avoidance laws etc.

Measures To Support Insolvency Practitioners

Since the Insolvency Practitioner profession is quite a sophisticated one, comprising of well trained and highly qualified insolvency practitioners having financial underpinnings in bonds and insurance markets, these insolvency practitioners are subject to certain disciplinary rules and deadlines set by the professional bodies. Considering the Covid-19 circumstances, the professional body of insolvency practitioners in the UK has announced that it will be lenient in looking at any non-compliance of statutory deadlines by the insolvency practitioners. Further, the professional body has also enabled the Insolvency Practitioners to delay the payment to the creditors, until markets have recovered, as distribution in present times might lead to a lower return.

Uncertainties Associated With The Reforms

With major reforms being carried out in the wake of Covid-19 circumstances, there has been a cloud of uncertainty in the minds of Insolvency Practitioners pertaining to the applicability and operation of those reforms, for example, the impact of the Coronavirus Job Retention Scheme. In light of this, the Insolvency Practitioners have been applying to the courts for directions and seeking clarity on the respective reforms. However, courts, even though were not entirely happy as such a direction or an order would require full-fledged hearings and court proceedings which is not feasible presently, have issued directions to Insolvency Practitioners so that the administration could continue with clarity and smoothly, for instance the *Carluccio's*[3] and the *Debenhams*[4] cases.

[3] *Re Carluccio's Ltd* [2020] EWHC 886 (Ch)
[4] *Re Debenhams Retail Limited* [2020] EWHC 921 (Ch)

Questions & Answers

Q1. Should directors be allowed to continue to manage the corporation in Pre-Packs?

A1. Pre-Packs are relatively low cost restructuring or workout mechanisms, where, rather than a company entering a period of ongoing trading during administration, a sale of the company's underlying business will be agreed prior to administration and will be concluded soon after the administration appointment. There have been criticisms of prepacks, in particular where the sales have been made to connected parties, such as directors. However prepacks can offer a cost effective and swift means for the resolution of the company's difficulties and can result in higher returns to creditors than an immediate liquidation. Prepacks are arguably acceptable, including in cases where the sale is made to directors, provided that appropriate professional standards are followed by the administrator.

Q2. Can the UK Procedures/Pre-packs be made applicable to the India insolvency framework?

A2. Since the corporate and legal structure of every country is unique and is not comparable, the applicability of UK procedures to India would differ starkly on the issue of the competence and skills of the resolution professional/administrator in India, as most of the insolvency procedures in UK are carried out by the highly qualified Insolvency Practitioners.

Q3. Does the Coronavirus Act, 2020 in England absolutely remove the landlords' forfeiture rights or is it limited to deferring such rights?

A3.These rights are merely suspended temporarily, initially lasting for three months and this period may be extended by the government.

Q4. Is there a new safe harbour for the directors, considering the suspension of wrongful trading liability provisions in the UK?

A4. The suspension of wrongful trading liabilities removes only one potential ground for liability of directors and directors can sill be held liable if they breach their directors' duties. Therefore they don't enjoy an entirely safe harbour and they must still maintain diligent and professional standards.