Knowledge

UK corporate insolvency law: The times they are a-changin'

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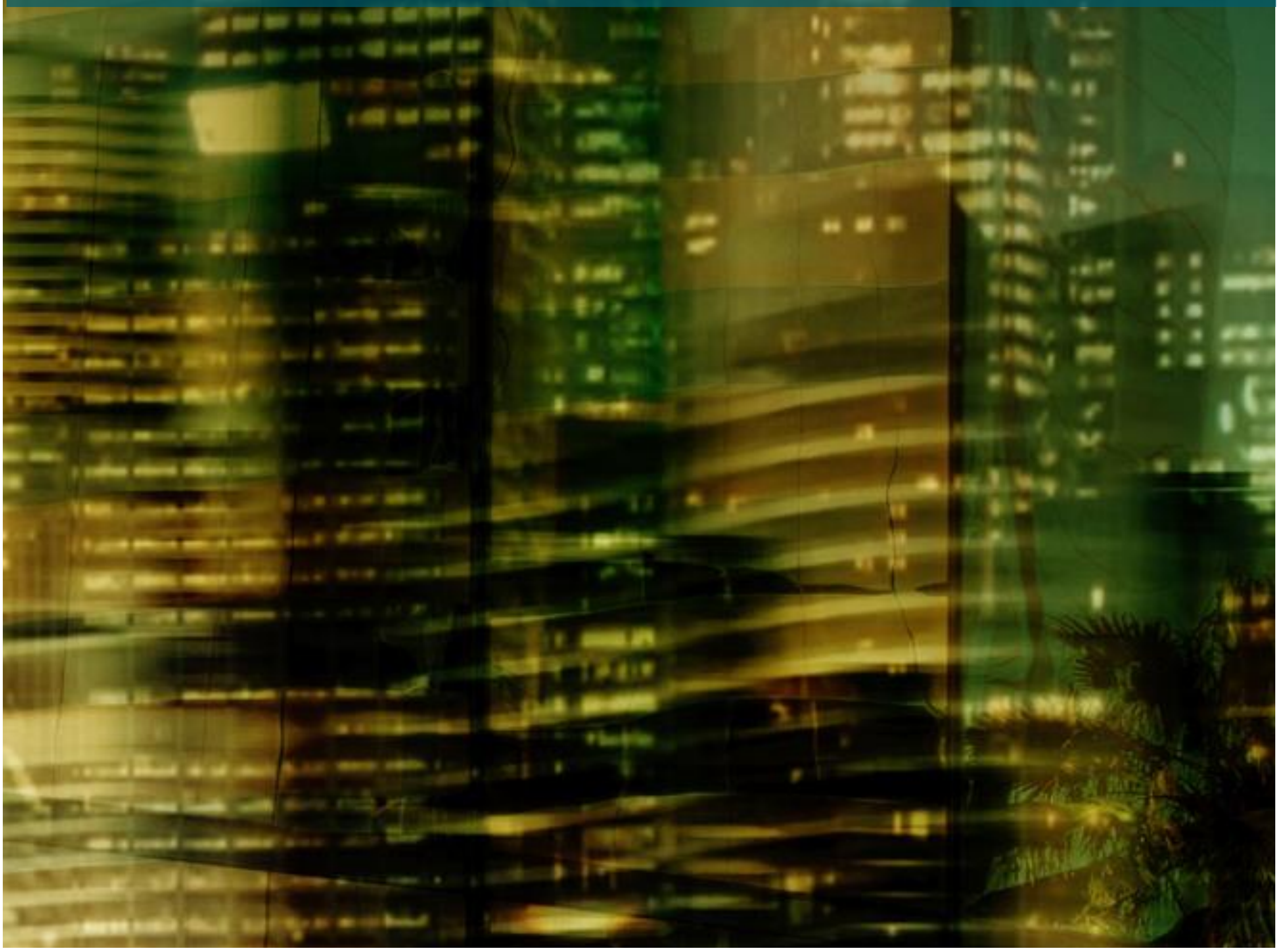

Introduction

Earlier this year, the Insolvency Service published a consultation paper on possible reforms to the UK's existing corporate insolvency regime (*The Insolvency Service: A review of the corporate insolvency framework: A consultation on options for reform (May 2016)*). The main impetus behind the proposed reforms is the Government's wish for the UK to remain at the forefront of insolvency best practice, in order to attract businesses. It believes it can achieve this by giving businesses the best possible chance to restructure their debts and return to profitability when experiencing financial struggles.

The Government is consulting on four proposals:	
1.	Introducing a new restructuring moratorium, available to all companies (except for certain financial institutions), which would act as a "gateway" for businesses to consider their rescue options and/or negotiate a restructuring agreement with their creditors. The moratorium would last for 3 months, with the possibility of an extension if needed and would prevent much the same actions as the administration moratorium currently provides. Whilst in the moratorium, the arrears owed to creditors will be frozen (but the business will be obliged to meet on-going trading costs and debt obligations) and directors' duties will remain unaltered. Subject to satisfying certain eligibility criteria and qualifying conditions, it is proposed that companies may apply for a moratorium using a procedure similar to the "out of court" procedure used in some administrations (i.e. a court hearing will not be necessary). In order to be eligible, the company will need to demonstrate that it is in financial difficulty or insolvent now or imminently. As a primary qualifying condition, the company must be able to show that it is likely to have sufficient funds to carry on its business during the moratorium (this is to ensure creditors are not worse off).
2.	Providing companies with the ability to designate certain supply contracts as "essential" (in addition to those rights which currently exist in respect of gas, water, electricity and IT supply contracts). An officeholder (or a company, if the designation is made during a restructuring moratorium) will be able to file an application at court, the effect of which will be to prevent a supplier from invoking insolvency termination or variation clauses in its supply contract. This will be challengeable by the supplier, in which case the court will be required to approve the company's application. The court will consider whether the continued supply would contribute to the success of the company's strategy and whether alternative supply arrangements can be reasonably made. This right will be applicable in restructuring moratoriums, CVAs, administrations and, if introduced, restructuring plans (see 3 below).
3.	Introducing a new statutory restructuring plan (time limited to 12 months), which would bind both secured and unsecured creditors and give companies the ability to "cram down" dissenting "out of the money" secured creditors, provided those creditors will be no worse off in a liquidation scenario. The Government's aim is to address scenarios where a relatively junior creditor can block or delay a company's rescue, despite the rescue proposal being supported by a majority of senior secured creditors. It is proposed that this new plan may either be introduced as a standalone restructuring procedure, or sit alongside existing procedures, such as CVAs.
4.	Encouraging greater access to rescue finance for distressed companies seeking new funding, with

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possible options including giving "super-priority" status to rescue finance costs in administrations and/or introducing provisions which would in some cases permit companies to grant new security, overriding any negative pledges in its existing finance arrangements.

Comment

Not all of the Government's proposals are original. For example, R3 has in the past recommended introducing a 21 day moratorium against creditor action for struggling businesses. At the time, R3 commented that whilst the UK's insolvency regime is effective, it has an important "capability gap" as there is no breathing space from creditor pressure that allows directors of struggling companies the opportunity to consider rescue options without risking a collapse of the company's supply chain and an increased burden on its cash flow. The Government's proposals would, on the face of it, go some way to addressing this concern and achieving the Government's goal of making the UK an attractive place to set up a business.

Only time will tell what form the reforms will eventually take, if they are implemented at all (particularly given the legislative upheaval which Brexit will necessitate). In fact, in the light of Brexit, R3 has said that it will be asking the Government to carefully consider the timeline for implementing any of its proposals from its consultation to ensure that it doesn’t create any extra uncertainty for the UK’s business and finance community. What is clear is that the UK's corporate insolvency world is experiencing a time of change. Fresh off the back of recent legislative developments aimed at achieving the Government's broader initiative of increasing transparency and trust in UK business (see the Small Business Enterprise and Employment Act 2015), these latest proposals seek to reform an insolvency regime which has not been updated since the credit crunch. Some might argue that it is ripe for review.

The Government's deadline for responses to its consultation paper ended on 6 July. We will provide further updates on the consultation process, once available.

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