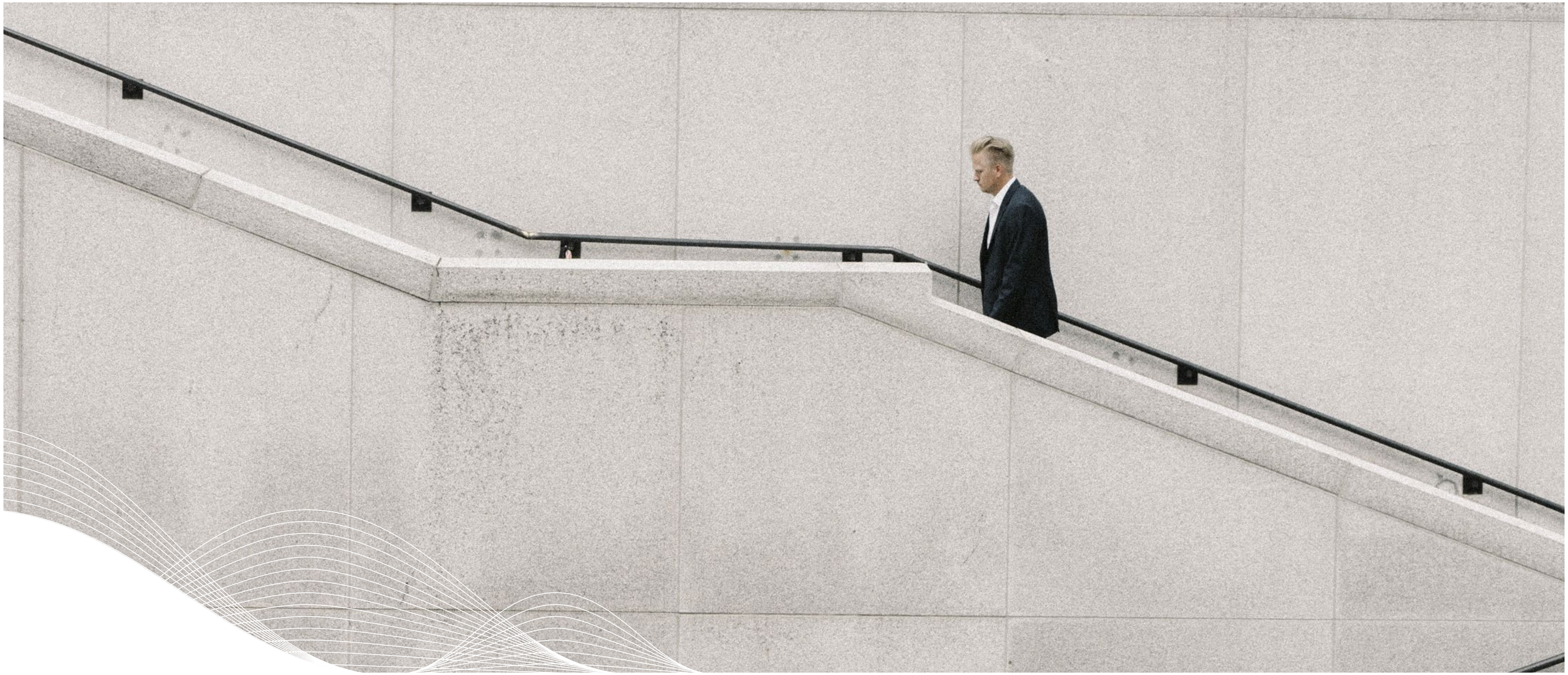

COVID-19 UK: What next for distressed companies and their stakeholders?

DLA PIPER

Government support measures have been extended but will eventually end – what then for companies and their stakeholders?

Key dates and issues for companies and their stakeholders

Significant government support measures have been provided in response to the COVID-19 pandemic, some of which have recently been extended and may potentially be again. However the breathing space afforded to companies will inevitably end at some point, therefore directors will need to be cognisant of the key dates and be making preparations for these. Balance sheets have been and will continue to be damaged and lender and investor appetite for risk has diminished against a backdrop of a recession and the challenges to accurate business forecasting which COVID-19 presents.

Boards will need to consider not just how to survive on a short term liquidity basis but whether they have longer term balance sheet and liquidity issues which need to be addressed. Secured creditors will usually favour turnaround over insolvency, but will only be able to do so if balance sheets and longer term financial commitments can be right-sized to reflect prudent valuation and forecasting.

Companies, shareholders and creditors should be working together to agree solutions. Experience demonstrates that a proactive and consensual approach, with early engagement, presents the best prospect of a successful resolution of financial distress, protecting directors and preserving value for stakeholders. Boards should therefore not delay in seeking to address any balance sheet issues especially where debt levels have started to look insurmountable.

In this note we explore the key dates which all boards and financial stakeholders must be cognisant of. We also identify some of the tools which are available to address overburdened balance sheets. All key dates identified below are correct as at 28 September 2020. However, this is obviously an area that is subject to change at short notice, and some of the deadlines below may subsequently be extended by further measures. We will be updating our website version of this note to reflect any further changes, and this can be found here.

Key contacts

NEIL RILEY
Partner
London
T +44 (0) 20 7796 6260
neil.riley@dlapiper.com

SARAH ARCHER
Legal Director
London
T +44 (0) 20 7153 7727
sarah.archer@dlapiper.com

TOM HITCHCOCK
Associate
London
T +44 (0) 20 7796 6112
tom.hitchcock@dlapiper.com

This article focusses on the position in England and Wales, there are some differences for Scotland which are not covered here. Our colleagues in Scotland would be pleased to discuss the Scottish position, please contact the authors or you usual DLA Piper contact to be put in touch with one of our team in Scotland.

Timeline

September 2020

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
29 SEPTEMBER 2020 Rent quarter day	• Consider overall impact on balance sheet and future liquidity of deferring rent and other lease liabilities. • Potential impact on CVA voting power. • Note the below extension to prohibition on landlord actions.	• Short term liquidity benefit of not paying rent is helpful but what is the longer term prognosis in light of company's real estate requirements and accrued lease liabilities.
30 SEPTEMBER 2020 Wrongful trading suspension lifted	• Basis for criticism of directors. • Potential personal liability to contribute to assets upon an insolvency. • Consider cash flow solvency and longer term balance sheet sustainability. • Board may need to consider commencing insolvency proceedings themselves so as not to worsen the net liabilities to creditors if insolvency is inevitable.	• Are boards engaging with all stakeholders in order to stave off insolvency – who will fund liquidity need now and in future? • Some boards will inevitably need to consider insolvency processes, consensual debt write downs and financial restructuring. • Might a non-consensual insolvency process be planned?
30 SEPTEMBER 2020 Originally scheduled for return of landlord rights and expiry of winding-up restrictions	• Prohibition on landlord actions for forfeiture or exercise commercial rent arrears recovery (CRAR) and restrictions on winding-up petitions were originally scheduled to expire on 30 September, but this deadline has recently been extended to 31 December (see above for further details).	• Provides additional breathing space. • Only defers issues by three months, and obviously will further increase liabilities on balance sheet.

Timeline

October-November 2020

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
31 OCTOBER 2020 End of the Coronavirus Job Retention Scheme (CJRS)	• Note replacement 'Job Support Scheme' (JSS) announced on 24 September, to take effect from 1 November until 30 April (see below for further details). • Consider overall strategy and whether further cost cutting measures are required. • Will employees return to work or will the employer need to make redundancies/alter employment contracts? Has this been budgeted? • If making redundancies, how many? Will collective consultation be required? • Can this be tied in with the end of the CJRS? A 45 day collective consultation period for 100+ redundancies to complete on 31 October would need to have started on/before 16 September. • Will employees move on to the JSS with effect from 1 November? Note redundancy restrictions under JSS – see below.	• Impact of downsizing workforce/ business on company's trading potential – is it a smaller business with lower EBITDA now? • Impact on valuation and need for a financial restructuring?
30 NOVEMBER 2020 CLBILS closes to new applications	• It was announced on 24 September that the initial deadline of 31 October would be extended. • If intending to rely on CLBILS as part of a new money requirement, ensure application is submitted in good time (but monies can be drawn later).	• Will this deadline prompt engagement from company around a new funding requirement? • Consider impact of being a sponsor backed business. • Consider initiating discussions early to avoid last minute requests.

Timeline

December 2020

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
1 DECEMBER 2020 HMRC becomes a secondary preferential creditor for VAT, PAYE and certain other taxes and ranks ahead of floating charges (but not fixed charges)	• Will this alter lender appetite to fund/ ability to borrow/refinance? • Impacts term and RCF lenders and some ABL financiers. • Will reserves be imposed in relation to ABL facilities (reducing liquidity)?	• Implications for lenders relying on floating charge security (eg over stock, equipment or debts where not controlled). • Are there significant accrued VAT and/ or PAYE liabilities? • Where possible, consider taking assignments of assets, rather than security or taking fixed security (as this elevates lender above HMRC). For term and RCF lenders consider refinancing via ABL and/or sharing security with them. • Can the company survive with its current balance sheet? If not, is an insolvency avoidable? If not would an insolvency prior to 1 December result in a better outcome for secured lenders? • Consider other means of compromising unsecured debts eg CVA.
25 DECEMBER 2020 Rent quarter day	• Consider impact on cashflow (and balance sheet if deferred), given imminent return of landlord rights (see below).	• Has the company properly planned for how to deal with accrued rental liabilities, given imminent return of landlord rights (see below)?
31 DECEMBER 2020 Return of certain landlord rights	• Return of ability to forfeit lease for non-payment of rent. • Landlords will be able to exercise commercial rent arrears recovery (CRAR) when 7 days' of rent is overdue. All accrued lease liabilities may need to be paid.	• Has the company properly planned for this in its cashflows?

Timeline

December 2020

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
31 DECEMBER 2020 Restrictions on winding-up petitions and statutory demands lifted	• Return of statutory demands as grounds for winding-up petitions. • Winding-up orders possible even if COVID-19 has caused financial position to worsen. • Temporary suspension means debt may have built up. Creditors may now become 'ransom' creditors. • Particularly acute in sectors with zero/low revenue incurring rent liabilities (see below re landlords).	• Unsecured creditors can wind up debtors if unpaid. • Creditors may be asked to fund emergency payments to stave off unplanned insolvency. • Consider contingency planning.
31 DECEMBER 2020 Audit sign off?	• Many companies have accounting reference dates tied to the end of the calendar year. • Is an unqualified audit achievable, or will material uncertainties be flagged? • Outstanding financial covenant and other breaches must be waived, equity cured or remedied before year end in order to avoid inclusion in audit. • Look forward will take into account deferred liabilities falling due – is the business plan fully funded?	• What is company ask of shareholders in terms of financial support? • What is company ask of financiers in terms of waivers/forbearance/deferrals/new money? • Consider risk of being railroaded due to late ask against backdrop of imminent year end.
31 DECEMBER 2020 End of the Brexit transition period	• Has the business planned for a 'no deal' scenario, if a trade deal is not able to be reached? • If a deal is reached how will this affect the business?	• Consider impact on trading projections, cost base and customer base.

Timeline

March 2021

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
25 MARCH 2021 Rent quarter day	• Absent an extension of government measures and/or agreement with landlords or forcible compromise of landlord arrears via CVA or Restructuring Plan, leases will be payable in full in accordance with their terms. • Usual liquidity considerations apply.	• Usual liquidity considerations apply.
31 MARCH 2021 Deadline for payment of deferred VAT (for 20 March 2020 to 30 June 2020)	• Companies have been entitled to defer VAT due between 20 March 2020 and 30 June 2020 to 31 March 2021. • The government has announced that companies may opt to split deferred VAT into 11 smaller interest free payments to be paid during the 2021-2022 financial year and to be paid in full by no later than 31 March 2022. • Deferred sums could still be significant and should be budgeted for.	• Press for sight of VAT deferral repayment plan. Is it credible? • How is the company prepared to fund this liability? Will the payment scheme be utilised? • It is not known yet how aggressive HMRC will be in its collection of unpaid tax from struggling companies (eg will additional time to pay be granted if requested?). • HMRC will be a secondary preferential creditor for unpaid VAT and PAYE at this point. • Depending on the level of the deferred VAT and PAYE and security held (see above), insolvency prior to 1 December 2020 may be attractive.

Timeline

April 2021

Key dates	For boards/companies	For financial stakeholders including secured creditors and shareholders
6 APRIL 2021 Return of business rates for retail, hospitality and leisure	• 100% business rates relief for the 2020/21 tax year for certain sectors. • Need to budget for the full liability from this point.	• Is the end of the relief fully budgeted?
30 APRIL 2021 Expiry of JSS (CJRS replacement scheme)	• End of proposed CJRS replacement scheme, pursuant to which the government will subsidise one-third of normal working hours not worked by an employee up to a cap of £697.92 per month, provided that (i) the employee works (and is paid for) at least one-third of their normal working hours and (ii) the employer also pays one-third of the normal working hours not worked. • Note that, whilst redundancy planning can take place, employees cannot be made redundant or put on notice of redundancy during the period within which their employer is claiming the grant for that employee.	• As for end of CJRS scheme.

Restructuring tools available

We have set out below a number of the restructuring tools available to companies whose balance sheets are overburdened. Strategies involving one or more of these tools can assist right-sizing a balance sheet by cramming down creditors, converting debt into equity, writing off debt or amending its terms or, if none of the above can be done consensually, leaving certain liabilities behind via an insolvency process. At DLA Piper we regularly advise on strategies involving one or more of these options.

Restructuring tools available

Pre-pack transaction

PROS

- **Speed** – mitigates interruption to trading and detrimental effects on value.
- **Reduced costs** associated with the administration process as compared to a trading administration; better return for creditors.
- **Better PR** – preserves business reputation by only announcing that a deal has been done and it's business as usual – prevents loss of confidence associated with trading insolvency.
- **Job preservation** – also minimises employee claims and maximises return to other creditors.

CONS

- **Sale price accuracy** – without a marketing process valuation can be unclear and a discreet M&A process can leak, while a public one can be value destructive.
- **Litigation risk** – where a valuation or an abridged marketing process is necessary value can be disputed. Also can be reliant on intercreditor provisions and these can sometimes be subject to dispute.
- **Reputational risk** – if certain types of liabilities (eg pension scheme deficit) are left behind.

CVA

PROS

- **Less formal/lower cost** – no court involvement.
- **Debtor in possession** – can continue trading while discussions are ongoing. Directors remain in control.

CONS

- **Thresholds** – requires 75% by value of all unsecured creditors plus majority by value of unconnected creditors.
- **Landlord claims** – not as easy to reduce rent below market levels or prematurely end leases following recent case law.
- **Credit score** will be negatively affected.
- **Secured creditors** will not be bound.
- **Not always a cure** – may be a precursor to insolvency proceedings rather than a permanent solution.

Debt for equity (consensual restructuring)

PROS

- **Rightsizes debt** and preserves potential recovery for lenders following debt write off.
- **Private, out of court process** – meaning less negative publicity and no stigma associated with insolvency.

CONS

- **Unanimous consent** of affected stakeholders required albeit may be achieved against backdrop of threatened enforcement via a pre-pack.
- **Regulatory issues** for banks taking equity (eg ringfencing).

Scheme of arrangement

PROS

- **Flexibility** – can be a compromise or arrangement about anything.
- **Debtor in possession** – no insolvency practitioner is appointed. Negative publicity of formal insolvency is avoided.
- **Binds secured and unsecured creditors** – unlike a CVA.
- **Full consensus not required** – Dissenting creditors in a class can be crammed down if 75% by value and a majority in number of each class approve.
- **Non-UK companies eligible** – only requires a "sufficient connection" to the UK.

CONS

- **Costs** – traditionally costly to implement as predominately used for complex restructurings. However, cost need not be as high for a simpler cap structure.
- **No cross-class cramdown** – all classes must vote in favour. 'Hold-out' or ransom classes can therefore block.
- **No moratorium** – no breathing space to undertake the process (unless combined with administration or statutory moratorium).
- **Post-Brexit recognition** – some uncertainty regarding international recognition of English schemes going forward.

Restructuring plan

PROS

- **Flexibility** – can be a compromise or arrangement about anything as long as it is to deal with the company's financial difficulties.
- **Debtor in possession** – as for a Scheme.
- **Binds secured and unsecured creditors** – as for a Scheme but unlike a CVA.
- **Cross-class cram down** – can be imposed on dissenting classes or "out of the money" creditors/members if relevant conditions are met.
- **Thresholds** – 75% by value approval (within each class) but no requirement for a majority in number or unconnected creditor approval threshold.
- **Non-UK companies** – as for a Scheme.

CONS

- **Cost** – process similar to schemes so costs expected to be comparable.
- **No moratorium** – no breathing space to undertake the process (unless combined with administration or statutory moratorium).
- **Post Brexit recognition** – as for a Scheme.
- **Financial difficulties** – requirement for financial volatility and stress ie cannot be utilised by solvent companies.
- **Valuations** – required in order to ascertain whether any classes can be crammed.
- **Largely untested** in the courts (as yet) and therefore subject to uncertainty