

## Covid – 19 coronavirus

### Saving livelihoods and keeping UK businesses going

#### Executive Summary

In a press statement on 28 March 2020, the UK government announced proposed changes to insolvency laws in response to Covid-19:

- Wrongful trading: there will be a temporary suspension of wrongful trading provisions for company directors, applied retrospectively from 1 March 2020.
- Changes to corporate insolvency law: In 2018, the UK government announced plans to introduce new restructuring procedures including (a) a short moratorium that will give companies a breathing space from creditor action to explore options for rescue; (b) a new restructuring plan based on the scheme of arrangement with the ability to cram down a dissenting class of creditors; and (c) provisions preventing creditors from relying on contractual termination clauses as a result of insolvency proceedings. In the recent press statement, the UK government announced that it would be advancing these proposals.

In a welcome announcement in response to the UK's Covid-19 crisis, a government spokesperson confirmed on 28 March 2020 that there would be a temporary suspension of the wrongful trading provisions and an acceleration of amendments to insolvency laws that were proposed in 2018 to provide greater protection to companies in financial difficulty. We await the finer details of these proposals, which should not be expected before Parliament reconvenes on 21 April 2020 at the earliest, but we understand that the suspension of the wrongful trading provisions will apply retrospectively from 1 March 2020. The government has also indicated an intention to bring forward legislation that would allow companies greater flexibility with regard to their annual general meetings, allowing these to be held online or postponing them. A link to the press statement can be found [here](#). These measures are in addition to the government's announcement on 25 March that companies will be able to apply for a three month extension to the obligation to file their accounts with Companies House, more details on this measure can be found [here](#).

Many company directors have found themselves in a difficult position as a result of Covid-19. Under the current rules, if a director is not confident that there is no reasonable prospect of the company avoiding liquidation or administration, he or she must take every step to minimise loss to creditors; this can in some cases involve putting the company into insolvency proceedings. The impact of the Covid-19 crisis on businesses makes it difficult for directors to know whether there is a realistic prospect that their company will be able to ride out the current storm and emerge from the crisis or whether insolvency proceedings are inevitable. They are having to make these difficult decisions without knowing how long the crisis will last, what further measures the government might introduce to slow the spread of the Covid-19 virus and without knowing or being able to predict how developments around the globe will impact upon their supply chain or customer demand. Directors can face personal liability if they make the wrong call leading to concerns that this might lead to earlier insolvency filings than might otherwise be the case. It is therefore to be hoped that this announcement by the government will allow directors the breathing space they need to continue trading for longer and thereby save companies and peoples' livelihoods.

## What will go?

As mentioned above, we expect a temporary suspension of the wrongful trading provisions under section 214 of the Insolvency Act 1986. Directors can be found liable of wrongful trading where:

- (a) a company has gone into liquidation or administration (excluding a solvent liquidation);
- (b) the director, at some time before the commencement of the winding up or administration, knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation or administration; and
- (c) the director cannot make out the statutory defence that they took every step they ought to have taken to minimise the potential loss to creditors.

One of the key concerns for directors in the current climate has been whether, in the face of the wrongful trading provisions, the company could avail itself of the government support packages and thereby take on additional liabilities in circumstances where it was not clear whether or not the company would be able to repay those liabilities in the future. A further concern is that it is extremely difficult for directors to judge whether there is a reasonable prospect of avoiding liquidation or administration given the unpredictable nature of this crisis and a concern that directors would be held liable where they simply, but honestly, made the wrong judgment call. The temporary suspension of the wrongful trading provisions should ease this concern to some degree.

## What will remain?

Even with the wrongful trading provisions temporarily suspended, directors will still need to carefully consider the following:

- (a) directors' duties under the Companies Act 2006 – these will include, but are not limited to:
  - (i) promoting the success of the company – where a company is solvent this amounts to acting in a way that is in the best interests of the shareholders; however, where the company is insolvent or is likely to become insolvent (i.e. insolvency is *probable*), the directors must take into account the interests of creditors and this will not change as a result of the recent announcements;
  - (ii) exercising independent judgment; and
  - (iii) exercising reasonable care, skill and diligence, which, as a minimum, requires directors to take such steps as would be exercised by a reasonably diligent person in that director's position.
- (b) fraudulent trading either as a criminal offence or as a civil offence under section 213 of the Insolvency Act 1986 – a director will be guilty of fraudulent trading where the business of the company is carried on with the intent to defraud creditors or for any fraudulent purpose and they participated in this with knowledge that there was an intention to defraud. Directors will fall foul of this provision where they incur new liabilities knowing that there is no prospect that the company will be able to repay those liabilities when they fall due or shortly thereafter, even if they believe that the company would be able to repay then at some point further in the future; and

- (c) the possibility of disqualification as a director, or the making of a compensation order, under the Company Directors Disqualification Act 1986 (**CDDA**). Directors are at risk of disqualification where the relevant company has become insolvent and where the court considers that the particular director's conduct as a director is such that the person is unfit to be concerned in the management of a company – the court will consider the full range of a director's conduct, including whether they have breached their duties as directors and whether they have been found guilty of fraudulent or wrongful trading. Furthermore, the CDDA also allows the court, where the director has 'caused loss' to one or more creditors, to make a *compensation order* requiring the director to contribute to the assets of the company or to make a payment for the benefit of a particular creditor or creditors. It is hoped that, in the current circumstances, the court would take a more lenient approach in relation to such compensation orders.

For more detail on director duties and potential liabilities please see our [factsheet](#)

## Possible reforms of the insolvency regime

The government announcement also indicated an intention to bring about amendments to the UK's insolvency regime as detailed in two previous government consultations. It is too early to say what form these amendments are likely to take or when they will be introduced, however, the government proposals included the introduction of a new restructuring tool that would allow companies to bind creditors and shareholders to a restructuring even where particular groups or classes of creditors are not in favour; a moratorium for companies in financial difficulties such that their creditors would be prohibited from enforcing their debts for a period of time while a rescue of the company is negotiated; and a ban on the termination of contracts where a company enters into an insolvency proceeding. For more detail on the government's previous proposals please click [here](#).

In the announcement, the government spokesman said "The government previously consulted on changes to the corporate insolvency regime and announced plans to introduce new insolvency restructuring procedures in August 2018 [See link here](#). The new legislation will implement these plans, including a short moratorium or 'breathing space' that will give companies in difficulty time to explore options for rescue."

The only other detail regarding the insolvency law changes was the following:

"Under the plans, the 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;
- protection of their supplies to enable them to continue trading during the moratorium; and
- a new restructuring plan, binding creditors to that plan.

The proposals will include key safeguards for creditors and suppliers to ensure they are paid while a solution is sought.

The government will also temporarily suspend the wrongful trading provisions 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.

Existing laws for fraudulent trading and the threat of director disqualification will continue to act as an effective deterrent against director misconduct."

Commenting on the proposals on behalf of the CLLS Insolvency Sub-Committee and the ILA, Jennifer Marshall said "We welcome and support these proposals. Suspending wrongful trading, in particular, will assist directors in accessing Government or bank funding without concerns regarding personal liability. The insolvency profession in the UK is hugely talented and these reforms, together with existing rescue tools such as administration, could really assist in saving livelihoods."

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