

Time for change?

UK corporate insolvency law has remained largely untouched since 1986, which puts incumbent UK regulations well behind the USA, Japan and Germany in terms of efficiency. A Government review of the current process has proposed a number of alterations, which we need to consider carefully – will they provide improvements or is it just change for the sake of change?

The most significant proposal is for the introduction of a formal moratorium, intended to help the more viable business platforms to find a positive outcome in times of hardship. Proposals state that, following an application to the court, this moratorium should last three months and restrict the enforcement rights of existing creditors. This is intended to provide the applicant company with a formal period of time to explore all options, whilst continuing to trade without threat. As part of the designated process, the proposals state that a supervisor should be appointed to guide and advise the corporate during the process for the best chance of a positive outcome.

Current regulations in the UK allow a corporate in distress, either the route of a CVA or the appointment of an administrator, both of which generally result in the failure of the business, the loss of jobs and an immeasurable impact on the trading community. Before reaching this point, many businesses undergoing challenging trading conditions, will consult with a restructuring professional to carry out a detailed review of its trading and financing position. This allows the company in question to explore all options and hopefully move forward in a positive manner.

In simple terms, the proposed new legislation could be viewed as a formalisation of this practice. From our perspective, the assessment of the value of assets of a business during any period of uncertainty tends to result in a downward projection.

Corporates in difficulty need cash and the easiest way to generate this is to sell assets, whether that be inventory, plant & equipment, property or intellectual property. Generally, this will not benefit the secured lender, and could prove detrimental in their attempts to achieve a full recovery.

The formalisation of a fixed standstill period will have a negative impact on asset values. In a distressed situation time is of the essence and bringing the right people to the table with qualified experience in the valuation and disposition of assets is imperative.

When considering the pros and cons of the proposed changes, it is important to consider how they will affect the various parties involved.

Duration

The duration of the suggested moratorium is three months, which is an extended period of time given the circumstances. This is too long and increases the risk that the company's value and asset base could be further eroded to the detriment of all parties, shareholders and creditors alike. Time is critical when a corporate is in distress.

Application

It is absolutely right that the moratorium should be sanctioned by court as long as the application process is transparent and fair to all parties. A clearly defined action plan must be devised and agreed upon with an organized and scheduled action plan in place to be implemented by a supervisor. Without these precautions the reform could be subject to abuse, with less sophisticated businesses using the process for their own benefit.

Creditors

Proposed changes cite that creditors' rights should be restricted with regard to enforcement, essential goods and services must continue and a defined timeline, within which a creditor can challenge the plan, must be in place. If this process is activated at the smaller end of the corporate market, it is unclear whether creditors will be engaged and aware of these regulations. If a moratorium is challenged, the court will need to find sufficient resource to hear and deal with an appeal. Under proposed changes, essential suppliers will be compelled to continue supplying corporates, even if credit insurance arrangements do not cover them. This area really requires clarification, as the process by which a supplier is designated as essential is not clear and many suppliers would likely seek to avoid this classification, potentially putting the applicant at further risk.

Restructuring and Rescue

Current legislation is widely considered not to allow the underlying operational inefficiencies of a corporate to be addressed, rectified and appropriate rescue financing put in place. The proposed introduction of a new restructuring plan as part of the moratorium is a positive move that should protect asset values for the benefit of all parties, as long as the right professional advice is in place. It is vital that any restructuring plan is standalone from any insolvency procedure, and binding on all parties. This becomes challenging when mixing large corporates with the complex debt and financing structures of SMEs.

The principle question is the use of a Minimum Liquidation Value; who decides this number and on what basis? It is a crucial consideration given that the court will use this to assess the viability of an operational plan.

Rescue financing in a distressed situation is generally provided on a super senior basis, ranking ahead of prior security, whether on a fixed or floating basis. This works in some jurisdictions better than the UK and legislating this will have a detrimental impact on not only the way traditional lenders provide and structure their financing package, but also their behaviour when a corporate enters distress. Financing structures provided by ABLs will be impacted. If the super senior process suggested is adopted, it will force ABLs to rethink their appetite for providing funding against an asset pool.

The move to update and strengthen legislation surrounding the UK's corporate insolvency framework can only be a positive one, but more thought needs to go into the processes and tools made available to distressed companies and creditors. Whilst the concept of the moratorium is a good one, it must be positioned carefully, with credible timelines in place, in order to prevent abuse and minimise the risk of already struggling businesses running out of cash. Further research and examination must be carried out before any conclusive changes are finalised in order to give distressed corporates the best chance of reaching a beneficial outcome for all.

Written By Gary Quaife
Managing Director, Gordon Brothers
[e gquaife@gordonbrothers.com](mailto:gquaife@gordonbrothers.com)