Navigating Business Instability Caused by Covid-19
While all sectors of the world’s economy are affected by the coronavirus outbreak, the hospitality industry has been hit particularly hard. The Organisation for Economic Co-operation and Development anticipates that there will be a two per cent reduction in global GDP for every month of country lockdown and this would further delay the revival of the hotel and leisure market sector’s supply chain as well as in adjacent sectors, although there will be a point of recovery for the sector, and Governments can help with the recovery of the market by introducing measures that encourage the renewal of tourism initiatives. The business and personal leisure travel market will return only once both employers and individuals feel comfortable in doing so.

We all need to understand the impact on Cash, Working Capital and Profitability for the sector. This guide details key action points and legislation businesses need to consider as they enter the ‘new normal’ alongside what to do if you or your suppliers are in financial distress.
Check your contracts - how to minimise the impact of supply chain on cash

A key issue faced by operators across all sectors and jurisdictions is supply chain disruption as a result of Covid-19. This disruption can have both operational implications e.g. difficulty obtaining products required to provide a service to customers, as well as financial implications where suppliers or customers are unable to pay for goods or services received.

Here we focus on providing tips to minimise the financial impact and ensure businesses are aware of the options available to them in order to recover debts owed, whilst also appreciating the importance of protecting long standing customer/supplier relationships in certain situations.

In particular we would recommend all businesses to follow the below action points:-

• **Know and understand your rights.** It is important to seek and obtain legal advice at an early stage where payment is not forthcoming. Your business will undoubtedly have written terms that govern most of your counterparty relationships. If, as a result of non-payment or otherwise, you believe a customer or supplier is in distress, it is a good time to revisit and review those agreements to understand exactly what rights you have. A restructuring & insolvency lawyer will be well placed to advise you on such rights after reviewing the relevant agreements and/or contracts. In particular, terms and conditions within these documents will contain remedies that should be considered whether and when to exercise. There may also be applicable notice and cure periods that need to be followed in order to exercise remedies, including termination.

• **Stay on top of payment terms.** You should have an acute awareness of invoice dates, dates when payments are due and the method of payment.

• **Monitor distressed suppliers as they often fall behind on receivables.** If you believe a customer or other counterparty is suffering distress, then you should monitor collections carefully to avoid slippage in payment.

• **Collect.** This is easier said than done in practice. You may have a longstanding relationship with a customer which precludes you from demanding payment on time every time. Moreover, the economic crisis caused by the coronavirus pandemic has most businesses looking for concessions now, so you may feel obliged to be flexible as we navigate the new normal way of doing business. Whatever the scenario however, it is better to have the payment in hand prior to an insolvency. The longer you put off receiving payment, the more likely it is that you may never receive payment, especially if the customer files for insolvency. This is a business risk that should be carefully managed.

• **Properly terminate an agreement.** The termination of an agreement should be completed once legal advice has been sought. Timing is of the utmost importance as if the termination occurs before insolvency commences this can change the landscape, particularly in light of the recent changes to UK Insolvency Laws that may prevent you from being able to terminate post-insolvency, regardless of what your rights are under the contract.
Check your contracts - how to minimise the impact of supply chain on cash - cont...

- **Understand precisely what you can do when a supplier/customer is in breach.** This is critical to effectively managing through the distress of a supplier/customer. This is not to say that every remedy should be exercised. Again, this is a balancing-act of applying collection pressure with maintaining the relationship you have with a customer and legal advice will assist in determining the appropriate action to take.

- **Understand shipping/delivery terms.** In particular when title to goods passes. An intervening insolvency during the shipment of goods on credit can often create problems for the company supplying the goods. The intervening insolvency may raise questions about whether the goods are or are not property of the insolvent estate.

- **Ensure that a supply contract incorporates a robust retention of title clause.** This will put you in a better position to secure the return of your goods if your customer files for insolvency, or at least in a better position to receive payment post-insolvency.

- **Consider prepayment.** Prepayment may also be necessary under circumstances where a customer is suffering distress. Consider whether a new modified agreement or a modification of existing rights makes sense. Be aware that distress often results in a breach or default in an agreement. This may provide an opportunity to negotiate an adjustment of payment terms.

- **Bookings.** Ensure that all bookings receipts/monies are placed in a separate account which cannot be mixed with everyday funds used to manage the business in the usual course of business.
What happens if a customer or supplier commences an insolvency process?

The whole landscape changes once the insolvency of a customer or supplier commences. A business needs to be mindful of this and in particular the following key points:

- You may be prevented from bringing or continuing litigation, enforcing contractual rights and other actions against the insolvent company.
- You may be able to stop goods in transit.
- You may be able to recover goods from the insolvent company if you have a valid retention of title claim.
- You should consider freezing any payments owing to the debtor/insolvent company to determine whether you can offset those against monies owed to you.
- You should assess payment history to determine whether and to what extent you have a claim in the insolvency.
- You should timely file a proof of claim for any and all amounts owed.
What should businesses do if they are struggling financially as a result of Covid-19?

The initial crisis management phase (including managing the impact of a supply chain) may not be enough to ward off a real financial struggle for many businesses. It is highly likely that businesses will find it harder to meet their liabilities due to the reduced need for goods and services. In such a predicament it is sensible for a business to consider restructuring in order to preserve their long term survival and viability.

There are various different methods of restructuring which can assist a business to weather the unpredictability caused by Covid-19. The two most common are discussed below:

1. **Restructuring of finance** – If you are struggling to pay your debts as they fall due, restructuring your debt to release more capital and/or make payments more manageable is a sensible idea. You should consider accessing the various government support schemes available including the Coronavirus Business Interruption Loan Scheme to access additional funds to assist with your financial obligations whilst business activity and income is lower. However, you will need to be mindful of any clauses in existing loan documents which prohibit you from obtaining any further debt finance and you may need to seek the lender’s permission to incur the additional debt.

   Another way to restructure your debt payments is to enter into a Company Voluntary Arrangement with your creditors where the creditors will collectively agree to postpone payments or to receive a lower payment for a period of time. It is recommended that you obtain expert legal advice before restructuring your business’ debt.

2. **Internal reorganisation of assets and liabilities** – It is imperative that during economic uncertainty you consider ways of streamlining your business structure, maintaining functionality but reducing costs wherever possible. There are many ways which this can be achieved which include selling a particular business operation to an external purchaser, considering whether a particular operation/function can be outsourced and combining teams which provide similar services so they share resources and sit under one management team. In addition assets which are no longer required can be sold and office locations which have become redundant can be closed at the expiry of existing leases or sold if possible.

   If you currently operate a large business with several operations you can consider reorganising the entire business, creating separate subsidiary companies for each operation to protect the assets of each subsidiary should another subsidiary be required to cease business. Finally employees need to be considered, if staff are not required at present you should consider furloughing them in accordance with the government furlough scheme and if the reduced need for employees is going to be permanent, consideration of undergoing a formal redundancy process should take place as early as possible. Again, it is recommended that you seek independent legal advice before undertaking an internal reorganisation of your business.
In an effort to help companies maximise their chances of surviving during Covid-19 and beyond, the government has now enacted its Corporate Insolvency and Governance Act 2020 (the “CIGA”) which is predominantly aimed at protecting the economic recovery of businesses. The Act contains fundamental changes to insolvency law and regulations, and when it comes into force will have the following impact:

**Supplier termination clauses**

Currently suppliers will often stop supplying or threaten to stop supplying a company that has entered into an insolvency process or a restructuring procedure. The supply contract often provides the supplier with the contractual right to do this, but such supplies can often be crucial to achieve continued trading and to rescue the business.

There are already measures in place to stop certain key suppliers (e.g. utility companies) from stopping supplies only by reason of the company's insolvency and where their supplies continue to be paid for. However, the Act prohibits all suppliers from stopping supplies due to the company's insolvency if the supplies continue to be paid for. It will also prevent suppliers from amending the contractual terms in order to force increased payments.

There are however exceptions (which mainly apply to FCA regulated companies) and suppliers can be relieved of the obligation to continue supplies if it causes hardship to the supplier's business and there is a temporary exception for small company suppliers during the Covid-19 pandemic. There are also continuing exemptions under the Act for utility companies, communications and IT providers and financial service providers, all of whom will be able to cease supplying an insolvent company purely by reason of their insolvency.

**Moratorium**

Importantly, the Act seeks to give struggling businesses formal breathing space to create a turnaround plan. This breathing space will be given by way of a free-standing moratorium, during which no legal action can be taken by any business against the struggling company without the leave of the court. This is seen as a vital tool to provide companies with a temporary cash-flow problem caused directly by the pandemic, an opportunity to survive.

The initial moratorium provides protection from creditor action for 20 business days, but this can be extended for a further 20 business days without consent or for longer with consent of the creditors or the court. Importantly this moratorium will not be tied to a formal insolvency process e.g. the administration moratorium, which has always been the case previously. Businesses need to be aware that the implementation of this moratorium may further delay the recovery of any debts owed to it by a struggling company.

**Restructuring Plan**

The Restructuring Plan (RP) is a new route allowing a business in financial distress to come to an agreement with creditors, with the court’s approval. It is based on the existing ‘scheme of arrangement’ process, which keeps the company’s directors in control and it is not a formal insolvency process. The difference from the existing process is the new ‘cross class cram down’, which allows the court to approve an RP notwithstanding creditor dissent. The court can approve the RP if:

- the court is satisfied that none of the dissenting class would be any worse off than they would be in the event of the most likely alternative; and
- at least 75% of at least one class of the creditors approves the RP and that class would have an economic interest in the company in the event of the most likely alternative.

**Temporary suspension of wrongful trading**

Personal liability for wrongful trading will be temporarily suspended for directors who continue to trade a company throughout the pandemic whilst being uncertain whether the company will be able to avoid insolvency in the future. Insolvency practitioners will be prevented from making a claim against a company’s directors for any losses caused to the company or its creditors as a result of wrongful trading during the suspended period. The suspension applies for a period of three months with retrospective effect, from 1 March 2020 until 30 September 2020 and may mean directors in distressed companies are more willing to continue trading in situations where they would previously been forced to close potentially viable businesses.
Conclusion – navigating the ‘new normal’

Don’t take an inflexible approach. We all have to adjust and consider immediate and critical contingency planning now to navigate the “new normal” business world.

When this is over, it will not be business as usual. This pandemic will change the way of life, and the way we work and do business across the board.

Streamlining your corporate structure, increasing liquidity and adapting to new ways of working (including remote working and/or operating in a way where employees and customers are able to social distance) is going to be fundamental to have any real chance of coming out the other side of this pandemic as a fully operating business.

This Management Guide was written for the Institute of Hospitality by DWF Law.

If you have any questions or would like more advice on navigating the ‘new normal’ please contact Natasha Atkinson, Partner, DWF:
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