Bates Wells

Charity Insolvency and Rescue Mechanisms:

A Coronavirus Guide

1. Background

1.1 This brief guide should be read in conjunction with our general guide on managing solvency in a crisis, which can be found here: https://bateswells.co.uk/2020/03/charity-governance-and-solvency-a-coronavirus-guide/.

1.2 This guide assumes that you have serious concerns about the solvency of your charity and may need to try one of the rescue mechanisms described here. If you have reached this point, you will need to appoint an insolvency practitioner and should take legal advice.

1.3 These mechanisms can be expensive and, depending on your individual circumstances, you may choose to engage in an informal rescue procedure with creditors.

1.4 You may also wish to explore a merger with another charity as a means of combining assets and liabilities and keeping both organisations alive. We cover this very briefly.

2. The Corporate Insolvency and Governance Act 2020

2.1 The government introduced new legislation recently to assist companies (including charitable companies and Charitable Incorporated Organisations ("CIOs")) undergoing a rescue or restructure process to continue trading, giving them breathing space that could help them avoid insolvent liquidation, and to temporarily suspend wrongful trading provisions for a period of seven months. This suspension will apply retrospectively from 1 March 2020 until at least 30 September 2020 (the period in which companies are thought to be suffering most acutely from the impact of the coronavirus pandemic).

2.2 This suspension of wrongful trading provisions will mean that liquidators and administrators will not be able to take account of any losses to creditors which result from continued trading while this suspension applies. This will reduce the threat of personal liability for trustees of charitable companies and CIOs if the charity eventually falls into insolvency. The aim is to encourage companies to continue trading and keep people employed during this time.

2.3 The legislation temporarily suspends the use of statutory demands (written demands from creditors) and winding up petitions where coronavirus has prevented a company paying its debts. Any petitions which are made will need to be reviewed by the court. This suspension will apply to statutory demands made from 1 March 2020 to 30 September 2020 and statutory demands used as the basis of a winding-up petition at any point on or after 27 April 2020.

2.4 The new legislation also brings in three permanent insolvency measures:

Bates Wells

2.4.1 A "company moratorium" during which companies can pursue a rescue plan (such as a company voluntary arrangement ("CVA")) without creditors being able to take legal action for a period of 20 business days (extendable to 40 business days).

2.4.2 Where a company enters into an insolvency or restructuring process, the termination clauses in contracts with suppliers which allow them to terminate on the grounds of insolvency will be automatically suspended, preventing suppliers from stopping or threatening to stop supplying the company.

2.4.3 Companies that enter into a restructuring process will be able to form a "restructuring plan", which dissenting creditors would be forced to sign up to if they would be no worse off under the restructuring plan than they would be in the most likely outcome were the restructuring plan not to be agreed.

2.5 The government has not announced any COVID-19 specific amendments to the directors' duty regime in the UK and the existing laws on fraudulent trading and director disqualification will continue to deter against directors misconduct.

2.6 If your organisation is facing serious financial difficulty as a result of the crisis, these changes to insolvency law could provide vital breathing space to help you to continue trading, explore rescue options and perhaps ultimately avoid insolvent liquidation. Directors and trustees should still seek appropriate expert advice as available solutions and the comfort afforded by the Act will vary based on the organisation's individual circumstances.

2.7 This new legislation is not relevant to unincorporated charities.

2.8 Please see here for our full update on the Act and how it may benefit your organisation.

3. Voluntary Winding Up

3.1 If there are enough assets to ensure the charity can be wound up solvently, there is a method of doing this for all types of charity. This guide assumes the charity is, or expects to be, beyond that stage.

4. Company Administration

4.1 In an administration, an insolvency practitioner is appointed as an administrator for a company (including a charitable company) in financial difficulties. The administrator must try to achieve one or more of the three following objectives:

4.1.1 to rescue the company as a going concern (i.e. as a solvent company); or

4.1.2 (if the first objective is not possible), to achieve a better result for the company's creditors than would be likely if the company were wound up (without first being in administration); or

4.1.3 (if the second objective is not possible), to realise the property of the charity in order to make a distribution to creditors.

4.2 There are three routes into administration: (i) by court order; (ii) by a notice filed at court by the holder of certain types of security (known as a 'qualifying floating charge holder'); or (iii) by notice filed at court by the company or its directors.

Bates Wells

4.3 A key feature of the administration process is that it includes a statutory moratorium, which is essentially a period during which creditors cannot take certain enforcement actions against the company except with the consent of the administrator or the court.

4.4 This means that the company may be able to continue operating through the administration; jobs can sometimes be saved; the statutory moratorium stops any legal action being taken against the charity by its creditors, which prevents the financial position of the charity becoming worse; and this in turn reduces the risk to directors of wrongful trading claims

4.5 Administration is relevant to CIOs and limited companies.

5. Company Voluntary Arrangements (CVAs)

5.1 A CVA can be used by an insolvent charitable company to pay its creditors over a fixed period and/or to accept a reduction in their debt. In certain circumstances, if the creditors agree, the company can continue to deliver its services and operate through a CVA.

5.2 A CVA is implemented through a CVA agreement, which binds all unsecured creditors (including known and unknown creditors), but only binds secured creditors or certain 'preferential creditors' (e.g. certain employee claims and contributions to pension schemes) if they agree to the proposals. A secured creditor is one that has a charge over the company's assets.

5.3 Unlike an administration, a CVA does not automatically result in a statutory moratorium to protect the company from creditors taking action to recover their debts. However, certain companies can currently opt to take the benefit of a 28 day moratorium (by application to the court for a CVA moratorium).

5.4 A CVA can allow the company to continue operating with its directors retaining control. It allows for creditor pressure to be taken off the company and enables it to write off or reschedule repayment of unaffordable debts.

5.5 CVAs are relevant to CIOs and limited companies.

6. Unincorporated Charities

6.1 Unincorporated charities fall outside the insolvency regime for companies. It is possible for the trustees to enter into informal arrangements with their creditors when faced with insolvency.

7. Pre-pack Sales

7.1 A 'pre-pack' is not a special type of insolvency procedure; it is simply a term used to describe a sale of the business or assets of an insolvent company by an insolvency officeholder (typically an administrator), where the preparatory work (identifying the purchaser and negotiating the terms of the sale) has taken place before the appointment of the insolvency officeholder. The sale is then concluded almost immediately after the appointment of the insolvency officeholder. A pre-pack does not require the sanction of either the court or creditors and may be used in circumstances where it may not be an option for an administrator to continue operations.

Bates Wells

7.2 A pre-pack sale generally limits the value-destructive effect of an insolvency filing and can often save more jobs than an administration.

7.3 This would not usually be suitable for a charity but may be suitable for social enterprises or subsidiary trading companies.

8. Merger

8.1 Merging two charities can be a complex and lengthy procedure and can be difficult to achieve while trying to save a charity that may collapse imminently. However, that has certainly been achieved before.

8.2 There are several ways of achieving this and in each of them the charity with which a merger is proposed will need to conduct a due diligence exercise to fully understand the nature and extent of the assets and liabilities that it is being asked to take on.

For further information please contact your usual Bates Wells advisor or:

Philip Kirkpatrick
Head of Charity and Social Enterprise
T: +44 (0)20 7551 7762
E: p.kirkpatrick@bateswells.co.uk

Samara Lawrence
Solicitor
T: +44 (0)20 7551 7940
E: s.lawrence@bateswells.co.uk

Keya Advani
Solicitor
T: +44 (0)20 7551 7764
E: k.advani@bateswells.co.uk