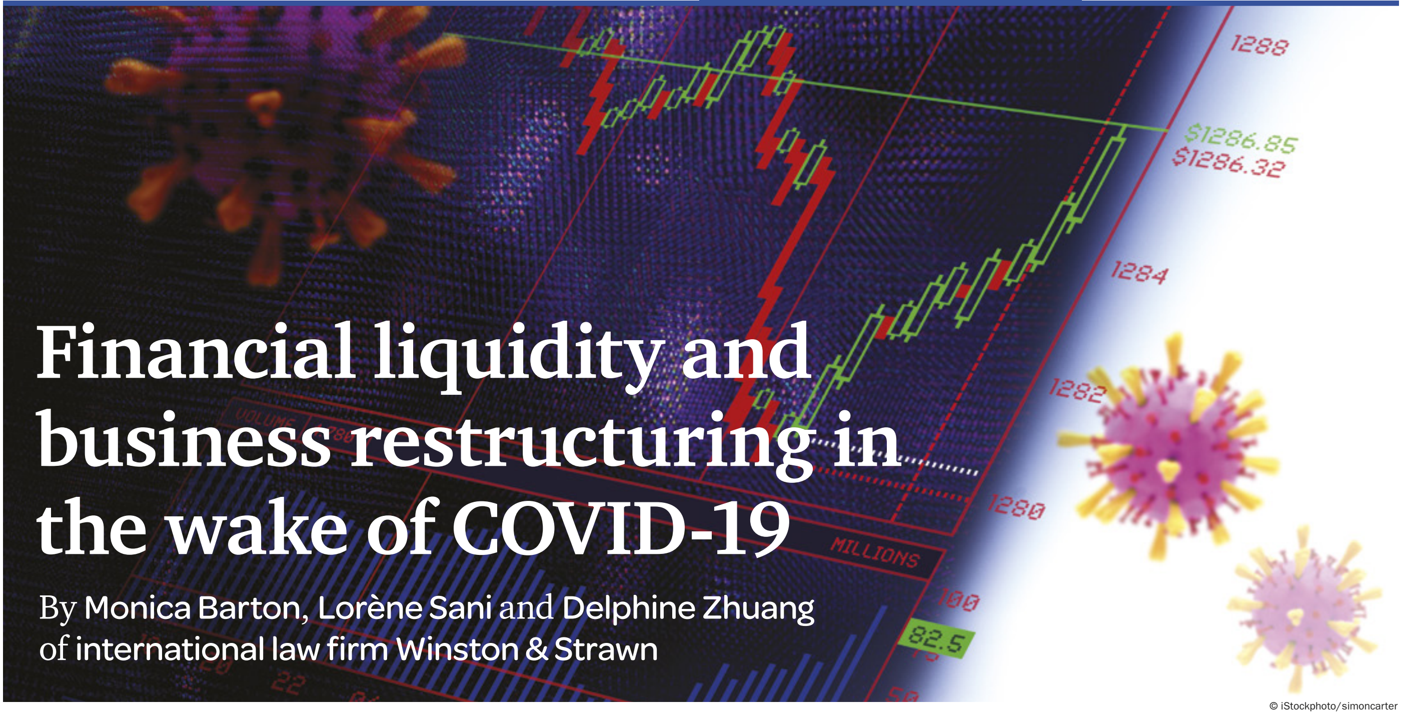

Financial liquidity and business restructuring in the wake of COVID-19

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The protracted impact of COVID-19 on financial liquidity is due to reach an inflection point for European businesses. As lines of credit reach their limits and businesses begin to assess the long-term damage from a global lockdown, restructuring will be a priority discussion.

Businesses will have to make difficult decisions, identify available funding and assess the role that private capital will play. As restructuring commences, it will be crucial to understand the effect on cross-border applications. And finally, when companies have exhausted restructuring options, is there a path back to liquidity whilst avoiding insolvency?

Government-backed funding measures

Firstly, businesses in need of cash will still be able to apply for State-backed loan schemes. The Government has issued a series of public support funding measures since the start of the COVID-19 crisis in the UK to help firms bridge through COVID-19 related disruption to their cash flows. On 22 September 2020, British banks' lending to businesses under the State-backed loan schemes neared £58 billion, as showed by monthly finance ministry figures.

These loans include: the Bounce Back Loan Scheme (BBLS), which enables smaller businesses to access finance more quickly during the coronavirus outbreak (up to £50,000); the COVID-19 Corporate Financing Facility (CCFF) under which the government purchases commercial paper issued by investment grade, non-financial corporates; the Coronavirus Business Interruption Loan Scheme for SMEs (CBILS) offering loans of up to £5 million; the Coronavirus Large Business Interruption Loan Scheme (CLBILS) offering loans of up to £250 million; and most recently a new scheme for innovative companies (future funds).

The CBILS and CLBILS are loans that will be delivered through accredited lenders backed by the British Business Bank. The government through the British Business Bank will provide a guarantee of 80% of the loan, and lenders will pay a fee (which will vary according to the length of the underlying facilities) to benefit from the government guarantee on each CLBILS facility whilst borrowers will remain responsible for repaying the loan. Finance provided can include loans, asset finance facilities, revolving credit facilities (including overdrafts) and invoice finance facilities lasting from three months up to three years.

Together, CLBILS, CBILS, BBLS and CCFF offer support to UK enterprises across the spectrum from the smallest to largest. Larger companies can elect to apply for assistance via CLBILS, BBLS or via CCFF depending on their requirements and subject to eligibility. Most of these State-backed loan schemes offer interest-free debt for a year but exclude financial corporates which either hold banking licences or is an insurer.

These State-backed loan schemes are temporary measures to help businesses on a short-term basis and the schemes are scheduled be discontinued through Winter 2020. On 24 September 2020, the Government announced that CBILS, CLBILS and BBLS have been extended to 30 November 2020. As for CCFF, they will be closed to issuers on 31 December 2020 and closed to new purchases on 23 March 2021.

After these dates, business will still need funds to help restart company growth, make vital investments, rehire workers and restructure debt.

Beyond Government schemes

It is likely that government interventions will prove to be insufficient in the medium term. Banks will be able to provide financing after this period, however their rules are more rigid than those of the private lenders and they may not be able to provide finance on the terms small and medium sized businesses need. This is where private capital can play an important role. Such an environment presents opportunities for private lenders and asset buyers to fill the void. As the market reaction to COVID-19 leads to declining debt and asset prices, many borrowers and their private equity sponsors may consider repurchasing debt, selling assets or refinancing with private lender capital. They have increased their cash reserves since the start of the crisis, with the primary reason being to provide liquidity for investing in opportunities in alternative assets.

Over the near term, debt funds are looking for par recovery opportunities in publicly traded companies where the debt is trading well below par, where conviction is strong that companies will survive the downturn and where diligence is more easily conducted and transparency is higher. Equally, companies dealing with 'essential services' have been the focus of private funds. For many publicly traded issues, price discovery is an issue as there are relatively few trades on which to base bids. Valuation of companies is proving to be particularly difficult in this period, and widespread concerns around economic impact of potential renewed lockdown measures across Europe are pushing PE houses to be over-cautious.

The private equity firms with the largest direct lending funds have extensive distressed debt and special situations capabilities. They will seek out opportunities to provide bridge financing with an attractive risk/return profit and some will engage in 'loan-to-own' investing, which seeks control over companies in distress.

Cross-border applications

Each private equity firm will need to do some diligence on the relevant country of incorporation of the companies they are injecting money into. In France, the Government has introduced a €300 billion State guarantee scheme for new money loans to be granted to French entities by financial institutions and crowd-funding intermediaries, excluding debt funds. This State guarantee scheme is a short-term measure due to end by December 2020. As in the UK, companies unable to benefit from French State guarantee scheme can seek funds from private lenders.

Debt funds injecting new money in French companies that are facing difficulties (financial or legal, existing or foreseeable) but haven't opened any insolvency proceeding yet can be part of the French 'conciliation' procedure and benefit from the 'new money privilege' (ie being paid in preference, ahead of any other secured creditors in case the company is subject to an insolvency proceeding at a later stage) if the conciliation plan is sanctioned by the French court. This new money privilege has been extended to lenders injecting new money to distressed companies during the safeguard and reorganisation proceedings (*sauvegarde et redressement*) in accordance with the recent COVID-19 related legislation (French Ordinance No 2020-596 of 20 May 2020), provided that the company is (i) already subject to a safeguard proceeding or a reorganisation proceeding or (ii) has opened one of those proceedings between 22 May 2020 and 17 July 2020.

In France, foreign investment funds can buy stakes in distressed companies and can also be bidders in case of a sale plan (*plan de cession*) of a business subject to an insolvency proceeding. A sale plan (total or partial sale) provides for the transfer of assets, contracts and employment contracts of the debtor to a third-party purchaser and allows creditors to propose alternative reorganisation plans and facilitate debt-to-equity swaps when existing shareholders refuse to vote in favour of such a measure. As the sale plan is an asset plan, the debts of the debtor are not transferred to the purchaser of the distressed business. The sale plan process is construed as an open bidding process where there is no exclusivity to the benefit of one bidder. At the end of the process, the court has to accept the offer that allows the most prolonged maintenance of employments attached to the assets assigned and the payment of the creditors, under the best conditions and that presents the best guarantees for its implementation. Debt funds can either be independent bidders or support and provide financing for companies willing to buy a distressed company.

If the company has several businesses in France and in the UK, the Companies Voluntary Arrangement (CVA) procedure is one of the UK procedures listed in Annex A to the EU Insolvency Regulation 2015 (Regulation 2015/848) (the Recast Regulation—which will have effect in the UK likely until 31 December 2020) and is, therefore, available as both a main insolvency proceeding and a secondary insolvency proceeding. The ability to commence a CVA in respect of a company incorporated in a member State other than the UK will be limited to those entities with their centre of main interests, or an establishment, in the UK. In this sense CVAs may be of more limited application than schemes of arrangement, which are not subject to the Recast Regulation.

Avoiding Insolvency

If a restructure is not possible, companies may want to consider the following schemes that could provide a path to liquidity but do not mandate insolvency:

(1) **Companies Voluntary Arrangement (CVA)**, which allows a company to agree a composition or an arrangement with its (mostly unsecured) creditors in satisfaction of some, or all, of its debts. It is implemented under the supervision of an insolvency practitioner, but the existing management remains in place throughout the life of the CVA. Technically, there is no statutory requirement that the company proposing a CVA be insolvent or unable to pay its debts, but in practice a CVA is used where there is at least a risk of insolvency.

(2) **Scheme of arrangement**, which is a formal arrangement between a company and its creditors or members and which essentially consists in a commercial deal between them all, in order to vary contractual rights of the creditors (ie vary the amounts owed to them, the repayment dates or the methodology for determining their claims, or involve a write-off of debt or a debt for equity swap). It is available for insolvent and solvent companies. Once the scheme and the terms have been drafted, it will be approved and sanctioned by the court.

(3) **The Corporate Insolvency and Governance Act (CIG Act) which came into force on 26 June 2020, provides for a new restructuring plan (similar to the scheme of arrangement, subject to the main differences below) which can be used for solvent companies.**
   (a) The percentage for the plan to be approved is 75% of creditors in value (instead of the majority)
   (b) The plan will enable cross-class cram downs i.e. the proposals may be sanctioned by the court notwithstanding that certain classes may have voted against it, subject to certain safeguards for minority interests, in particular that at least one in-the-money class consented and that the dissenting class(es) would not be worse off than in the event of the 'relevant alternative'. The effect of this is that a compromise can be imposed on 'out of the money' creditors who might have formed a hold-out class in a scheme. It will also facilitate a debt for equity swap, something that schemes cannot achieve without requisite shareholder consent. The 'relevant alternative' is whatever the court considers most likely to occur in relation to the company if the compromise were not sanctioned, eg the sale of the business as a going concern in a pre-packaged administration sale or (most likely) a liquidation sale of the business, either of which may result in significantly lower returns for all stakeholders. This could open up the possibility for challenge by creditors who have differing views on what the counterfactual scenario might be in a particular case, for example the possibility of an alternative deal, which might provide more favourable treatment.
   (c) Virgin Atlantic Airways Limited is the first company to seek to implement a restructuring plan under the new CIG Act (*Virgin Atlantic Airways Ltd* EWHC 2376 (ch), [2020] All ER (D) 08 (Sep)). In this case, each class of creditors voted overwhelmingly in favour of the restructuring plan. Therefore, the court did not need to consider cross-class cram down. NLJ

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