Proskauer

[Podcast]: Navigating Your Board through the COVID-19 Crisis – Practical Steps

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Partners Elisabeth Baltay, Mark Fennessy and Andrew Wingfield are joined by Richard Fleming, European Head of Restructuring at Alvarez & Marsal, for a podcast discussion on the key considerations that board directors of English companies should keep top of mind while navigating through the coronavirus (COVID-19) pandemic. Tune in as we discuss the recommended steps whilst considering new UK insolvency legislations and other business challenges the virus brings.

Proskauer · Navigating Your Board Through The COVID-19 Crisis: Practical Steps

Andrew Wingfield: Thank you very much for joining us today, and welcome to this Proskauer podcast, where we will look at what practical steps all directors can take to help them manage through the COVID-19 crisis.

My name is Andrew Wingfield, a corporate partner here at Proskauer, and I'm joined today by my fellow partners, Mark Fennessy and Elisabeth Baltay, along with Richard Fleming, who heads up the European Restructuring team at Alvarez & Marsal, a leading consultancy firm that helps clients deal with challenges in disruptive markets.

Though the circumstances change day by day, I would like to set the stage with a bit of context. The current situation is perhaps different than previous financial crises because of the unprecedented speed at which the virus has spread across borders and became such a global phenomenon. This has led to uncertainties around how the health impact of the pandemic will have to be dealt with by businesses, along with the evolving domestic and global response from governments.

Let’s start with Mark, who leads our European turnaround and restructuring business. He’s familiar with guiding boards and companies through sudden impacts and financial stress.

Mark, we’ve seen an awful lot of these challenges in previous distress situations, but in terms of immediate actions, what are you seeing management teams doing now, and what are the particular challenges they are facing?

Mark Fennessy: Thank you, Andrew. You’re absolutely right: these are completely unique and unprecedented times. There’s a great deal of uncertainty as to what the future holds for many individuals and many companies.

However, turning to the more immediate future what we are seeing with our corporate clients, many of which were in growth mode before now, is a rapid shift to survival mode. What most companies are doing is mitigating the impact of a complete drop off in revenue on company balance sheets, straddled with fixed costs.

Three actions we’ve seen include: firstly, as this is a crisis we’ve seen initial firefighting. Many boards are looking at the government furlough-type arrangements and other government support packages to the extent they can access those.

Secondly, in terms of variable costs we are seeing many variations of liquidity and cash flow maintenance strategies being put in place with all non-essential op ex and uncommitted cap ex being cut.

Thirdly, many of our clients are undertaking a targeted review of their suite of contracts, looking in particular at termination clauses: FM, or force majeure, and MAC, or material adverse change clauses, are the ones getting special attention at this time.

I’m often asked what companies will make it through this crisis. In my view, the companies that will come through this successfully are those that manage their suppliers and customers properly. It is unclear as to when the current crisis will settle down, so those companies that don’t run out of cash, quite frankly, will have a better chance of survival.

Andrew Wingfield: Thanks Mark. Can you expand on what you see as some key strategies being put in place at the board level to manage the crisis?

Mark Fennessy: Well Andrew we are really seeing again, three things, which are the main focus for most boards of directors.

Firstly, many boards of directors are revisiting their systems of corporate governance and adopting very clear communication strategies to engage at the earliest possible time with their key stakeholders: creditors, suppliers, and employees. CFOs are adjusting the basis of forecasting to dispense with pre-COVID notional projections to weekly cash flow forecasting based on actual receipts and payments.

Secondly, it is absolutely key to understand the collectability of a company's revenues. Having the notional profit on your books doesn't help if you're not actually collecting the money to service your own liabilities. You can bet your bottom dollar others in the supply chain are managing their liquidity positions.

Thirdly, conversely, on the other side of the balance sheet, directors are going to have to keep a very close eye on the money they are spending. Almost every company we are coming across right now is looking at discretionary spend. And we're seeing companies cut discretionary spending right down to the bare minimum.

Company directors are reducing their own compensation packages, some by up to 50 percent, and have stopped or paused declaring dividends. Banks have been politely asked by regulators and the government not to pay dividends or cash bonuses, and these are sensible policies because at this time retaining cash must be more important than paying a dividend for most companies.

Andrew Wingfield: Thank you, Mark. It will be interesting to see whether the regulators also ask insurance companies to pause declaring their dividends.

There have been some substantial developments also, Mark, in U.K. insolvency legislation. Could you, for the benefit of our listeners, expand on the impact of these for companies and how directors are responding to these changes?

Mark Fennessy: You're absolutely right, Andrew. In terms of insolvency law changes on the 28th of March the government announced emergency amendments to U.K. insolvency law, in light of the COVID 19 pandemic. These changes are intended to give firms greater confidence to continue trading, including offering them more protection from creditors and are, in my view, a welcome intervention by the government.

And the proposals, very broadly, cover three things. Firstly, a moratorium for companies, giving them a breathing space from creditors enforcing their debts for a period of time, while they seek a restructuring or a rescue; secondly, a new form of restructuring plan, which would be binding on all creditors; and thirdly: the suspension of the wrongful trading provisions in U.K. insolvency law, to give company directors protection against personal liability when continuing to trade during this COVID emergency. Now, some people may actually ask: what is wrongful trading.

Wrongful trading can occur when directors of a company, which is insolvent, continue to trade and accrue additional unpaid liabilities. In those circumstances the directors may be personally liable for those additional liabilities.

And while wrongful trading laws may be relaxed, the laws in relation to misfeasance, fraudulent trading, and director disqualification will continue to apply, as will provisions prohibiting antecedent claw-back transactions such as preferences, which Elisabeth will touch on later, and transactions that are undervalued. So for instance, funding overseas subsidiaries: if the company's treasury operations are in the U.K. it presents a particular challenge right now.

Andrew Wingfield: Mark, may I ask why that is?

Mark Fennessy: Well, Andrew, the simple answer is that that, at this time, the U.K. directors need to act in the best interests of their creditors. Now we believe that we will start seeing directors running an argument that funding foreign subsidiaries allows the group to be held together. And that makes a lot of some in most, if not many instances.

So the other side of the argument is that cash is the most valuable asset at this moment in time, and sending it overseas could deny those creditors with any prospect of a dividend if the company files for insolvency.

It's important to remember that any proposed amendments to the existing insolvency regime are not likely, by themselves, to change the actual solvency position of the company and are unlikely to give the blanket protection many directors are hoping for. It is important to note that directors will still owe their statutory duties to the company and to its creditors.

Therefore, it is key that any on-going actions being taken by the company are done with input from professional advisors to steer clear of personal liability if this type of situation arises.

Thanks, Mark. I'm going to jump in here because you talk about directors managing liquidity and I think this is a good prompt to bring in our guest speaker, Richard Fleming from Alvarez & Marsal. Richard, we're delighted to have you on this podcast.

While, say, the board of Ocado will be facing a different challenge to the board of, say, EasyJet, do you think that boards generally are equipped to deal with this type of complex, fast-moving disruption?

Richard Fleming: Thanks Andrew. I think it's worth saying that no director goes into business to fail, and managing a failure in this sort of crisis isn't something that most people are geared up to do. And we really are in a global war against this virus, both from a social and economic point of view, and I can confirm that we are seeing the same issues affecting businesses in every country that we operate in. The boards we have spoken to have all taken the pain relief offered by government assistance, drawing down on working capital facilities, and reducing op ex and cap ex as best they can. But this is pain relief and not the cure.

So one of the key issues we are helping boards with is the actual skillsets in the board room itself. Any board needs to examine whether the skillsets are appropriate during the current time of crisis, as opposed to the time of "business as usual," when growth and ample liquidity have primacy and take action to bolster with external resource from an adviser and executive perspective as appropriate.

Now this crisis is also exposing what are the luxuries or "nice to haves" in corporates. There is a growing realization in corporates we're advising that some surgery around the operational footprint may be required in order to reemerge in a sustainable way. This may mean a new start up has to be shut or paused, a geography needs to be cut free, and it certainly means that the first wave of cost cutting needs to be much harder, all of which is uncomfortable and will require difficult choices and decisions. We have been living with this crisis long enough to make this type of thinking a necessity, and planning or contingency planning on various scenarios needs to be undertaken right now.

The third area of critical importance to boards is starting to work through what reemergence is actually going to look like. How will your customers react? What financial state will key suppliers and customers be in? What will demand be like for your products and services? The answers will be very different to February 2020.

Corporates that have drawn down their working capital facilities and taken advantage of liability deferral opportunities need to be mindful that many of the liabilities have not gone away; they have accumulated and been deferred, but will need to be dealt with as re-emergence takes place. Planning for dealing with the pain sharing between shareholders, debt providers, suppliers and employees needs to start and needs to factor in the prospect of a potential further shut down in the event a suitable cure is not found quickly enough. We plan to go into further detail around reemergence in a future podcast. Simply, the pressure on corporates and boards is here to stay for some time.

Thanks, Richard. On the basis that directors should treat this situation as a true crisis I would like to ask Elisabeth, a partner in Proskauer's private credit restructuring group, about how, practically speaking, directors should manage their personal liability during this crisis.

Elisabeth Baltay: Thanks, Andrew.

It's an interesting question. As the others have mentioned, directors are having to balance their cash flow to keep the company solvent and meet their debts as they fall due.

Whilst they may have achieved some breathing room from the HMRC deferrals, the furlough rules, and often from their lenders, they still face the threat of suppliers and third party contractors demanding payments. In addition, their legal and financial advisors may well be asking them for deposits or payments on account.

The five key practical tips here include:

1. Directors need to hold regular board meetings and to document those occurrences in detail. Every decision to pay one creditor instead of another, or to agree to defer any of their debtors, will need to be considered in light of the duties Mark discussed earlier;
2. The directors will need to justify why a payment is business critical, why it does not constitute preferring a creditor over others or, if it does, why that payment

should be made nonetheless. They will want to consider that each action is not detrimental to their secured creditors' position or recovery whilst balancing any threats of legal action from unsecured creditors;

3. Directors may also wish to engage their own legal counsel, acting for them in their capacity as directors. The company would be responsible for the related fees, but this gives the directors active and ongoing legal support to make the decisions on a daily basis;
4. Directors should also review the coverage under their D&O insurance; and
5. In addition, the board may be seeking waivers or deferrals from their secured creditors. In some cases, lenders are asking for amendment fees, significant increased margins, additional information undertakings and fee coverage for advisors.

Whilst the secured loan is clearly a business critical financing lifeline, directors will need to consider whether they are incurring unsustainable additional indebtedness, and whether the fee arrangements significantly impact their cash flow.

That being said, the directors must be careful if they are being selective in paying competing secured creditors under different facilities, where doing so may well constitute a preference.

Whatever the decisions--what decisions the directors make, it is essential that until any new legislation is passed they continue to act within the boundaries of the current wrongful trading rules, as we have no certainty regarding the extent of lifting any restrictions.

Andrew Wingfield: Thank you, Elisabeth.

There is a lot here to consider, and a number of practical steps boards can take to mitigate the impact of the COVID-19 crisis.

Just to wrap up: thank you very much indeed to those of you listening. For further guidance on risk management measures, practical steps businesses can take, and resources to help manage ongoing operations, you can contact any one of our speakers today, or visit our Coronavirus Resource Center, available on the Proskauer.com home page.

I hope you all stay well and cope as best you all can with the challenges that everyone is facing in the current environment. Take care everybody.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. Visit our Coronavirus Resource Center for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

Related Professionals

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