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INSOLVENCY INSIGHTS

creditorservices@menzies.co.uk
menzies.co.uk/creditor-services

EDITION 3

WELCOME TO THE THIRD EDITION OF OUR INSOLVENCY INSIGHTS MAGAZINE!

Back in early 2024, the Government began to see early signs of economic recovery, and Rishi Sunak, the Prime Minister at the time, suggested that 2024 could be the year that the economy "bounces back." Inflation, which has recently fallen to around 2.2% as of August 2024, indicates that we are moving in the right direction. However, corporate and personal insolvencies are still on the rise, signalling that while some parts of the economy may be stabilising, the cost-of-living crisis and the Bank of England base rate – currently at 5% – continue to have a significant impact. With the change in Government and an upcoming Autumn Budget, it remains to be seen whether the "bounce back" is continuing. In any event, a recovering economy will present opportunities, but it remains crucial to closely monitor clients, spot early warning signs, and act quickly to recover debts.

In this edition of Insolvency Insights, we discuss the possible warning signs of business strain and the importance of speed to avoid the worst case scenario. We also explain the possible options for landlords if their customer's go insolvent and how to stay clear of zombie companies.

We also take the opportunity to explore the roles and responsibilities of creditors within the insolvency process. Delving into their rights, strategies and influences during this critical time.

We hope you find this resource useful. If, upon reading, you have any insolvency related questions or wish to discuss your specific circumstances, please let us know.

Additionally, if you'd like to collaborate or be featured in an upcoming edition, please do reach out – we'd love to hear from you.

Giuseppe Parla
Director at Menzies LLP
gparla@menzies.co.uk
+44 (0)20 7465 1919

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INSIDE THIS EDITION:

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Blink and you could miss it – everything you need to know about the deemed consent process

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RECOGNISING THE SIGNS OF BUSINESS STRAIN

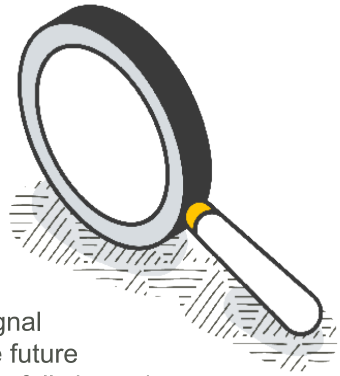
The number of insolvencies in the UK has reached its highest point in 30 years, and experts anticipate that more businesses will shut down due to increasing inflation and persistent supply chain issues. During this time, it is essential to keep track of indications that business customers might be encountering difficulties and act quickly when signs occur that a company may be at risk of shutting down. Implementing preventative measures at an early stage can ensure businesses are aware of the current circumstances and buy some all-important time to make improvements, providing them the best chance of improving their financial situation.

Typically, inadequate cash flow is one of the primary signs that a business is experiencing financial difficulties. If businesses are defaulting on their bills or having to negotiate extended payment terms with creditors, most likely they are experiencing financial challenges. Addressing these signs early on can be key in avoiding potential financial crises and safeguarding the interests of the company. One common sign to pay attention to is significant changes in the volume or rate of orders. Insufficient communication with suppliers can frequently be the cause of this issue, and a sudden decrease in orders could signify cash flow problems or internal disruptions and uncertainty. Persistent delays in promptly settling invoices with suppliers can also indicate inadequate cash flow.

If your client is not working with a well-known lender, it's possible that they're paying a higher rate of interest. This could suggest financial instability. You can find such information on Companies House under the 'Charges' tab.

Alongside this, there are additional factors that could contribute to signs of business stress. Restructures and changes in strategy can be an indicator of financial trouble. This often manifests in changes in key personnel or leadership and suggests internal disruption with a company's current course. Another obvious sign is inconsistent or evasive communication. If a company is not transparent in their communication or provides unclear explanations regarding payment delays or financial matters, it may be necessary to investigate further. This is especially important if there are indications that the company may be trying to conceal financial difficulties.

For credit controllers, monitoring clients who are nearing or surpassing their credit limits is key. This includes staying up to date with their payment schedules. Although infrequent breaches may not be alarming, persistent breaches require much needed attention as this could be a sign of overextension or liquidity issues. This operates in conjunction with payment delays or defaults, as well as an increase in either debtor or creditor days. If a business extends payment timelines or requests a change to credit terms, it can cause certain suppliers to stop providing essential components and again indicates financial difficulties within the business. If a payment cannot be efficiently pursued, it may signal potential cash flow issues in the future and credit controllers should carefully investigate any abrupt fluctuations in these figures as they may indicate underlying issues.



To conclude, there are multiple signs that can help to predict late or non-payments from businesses struggling to maintain cash flow. By being able to identify these indicators and trends, credit controllers can take prompt action and initiate transparent and timely dialogue to prevent the debt from becoming irrecoverable. Having a thorough comprehension of the financial situation is crucial in order to provide a tailored approach that can prevent, in a worst case scenario, a chain reaction of insolvencies.

Giuseppe Parla
Director
gparla@menzies.co.uk
+44 (0)20 7465 1919

WHAT CAN BUSINESSES DO TO PROTECT AGAINST BAD DEBT?

Scan the QR code below to find out more

CONSIDERATIONS FOR LANDLORDS WHEN CUSTOMERS GO INSOLVENT

For landlords, dealing with insolvent tenants can create significant challenges, particularly in the case of corporate tenants. Such tenants can cause disruptions to rental income streams and create uncertainties. As a landlord, understanding your rights and options is crucial to mitigate risks and protect interests. This article delves into the rights granted to landlords during various insolvency processes, as well as the benefits and drawbacks associated with them.

ADMINISTRATION

If a company goes into Administration, an Insolvency Practitioner is appointed to manage its affairs and realise the company's assets, with the goal of optimising the payout to creditors. Administration triggers a moratorium, which places a protection around the company. This means that a landlord cannot take any legal action without going through the Court.

Should the company choose to remain in the premises beyond the Administration date, the rent may be settled as an expense from the Administration estate. However, to prevent further liabilities, the landlord may want to contemplate accepting a surrender of the lease in such circumstances. This will enable the landlord to rent out the property again and secure a new tenant.

Alternatively, the Administrator may assign the lease if the company is sold as part of a pre-packaged Administration. In these circumstances, it is advised that the landlord obtains legal advice and considers potentially negotiating any supplementary conditions as part of the assignment. Although the Administration process allows for the potential restructure of the company's operations and possibly protecting the lease and rental income for landlords, landlords have restricted control over the process and decisions are made by the Administrator with the creditor's best interest in mind.

CREDITORS' VOLUNTARY LIQUIDATION (CVL)

Shareholders typically resolve to place the company into liquidation and appoint a Liquidator which is subsequently agreed with creditors. In most cases, the company will have ceased trading before entering into Liquidation.

Similarly to Administration, if the company decides to remain in the premises, the rent expenses will continue to incur and is payable as part of the Liquidation expenses.

The advantage of a CVL process for Landlords is that the Liquidator may look to disclaim the lease on their appointment which will provide for a relatively swift resolution. The landlord may issue a claim in the estate for any outstanding rent arrears and future rent liabilities, however, they do have a duty to mitigate the future rent arrears by marketing the property for re-let.

COMPANY VOLUNTARY ARRANGEMENT (CVA)

A CVA is an agreement between the company and its creditors that outlines a strategy for paying off the company's debts over a specific timeframe. The creditors, including the company's landlords for overdue rent, will have the opportunity to examine the proposals and vote on the proposed agreement.

The implementation of a successful CVA could enable the company to continue its business activities, safeguarding future rental income and allowing the landlord to recover a portion of their previous debt through the CVA's repayment scheme. However, the amount recovered may not cover the entire sum owed and could result in some debts being written off.

Any continuation of trading will likely require renegotiating the lease terms which may not be as advantageous as the previous ones. Landlords are recommended to initiate early communication with the Insolvency Practitioner upon receiving a CVA proposal.

COMPULSORY WINDING UP (CWU)

The CWU process is overseen by the Court, which will issue an order to place the company into Liquidation. Landlords have similar rights and consideration as in a CVL, such as any rent arrears that are outstanding and future rent obligations can be claimed within the Liquidation estate. Any distributions from the Liquidation estate will depend on the realisation of assets in the Liquidation and will be distributed based on the order of priority under Insolvency legislation.

Ultimately, landlords' rights vary depending on the insolvency process undertaken, each offering advantages and disadvantages. Early engagement with the Insolvency Practitioner is advisable in all circumstances in order for the landlord to consider the implications on their rental income and rights. In addition, seeking professional advice can protect their rights and mitigate any potential losses.

Alexandra Davies
Senior Manager
adavies@menzies.co.uk
+44 (0)33 0912 9577

THE RESPONSIBILITY OF CREDITORS IN INSOLVENCY PROCEEDINGS:

RIGHTS, STRATEGIES AND INFLUENCES

Creditors hold a significant role in insolvency proceedings, with considerable influence over the process and its outcomes. Their involvement is essential, not only in protecting their financial interests but also in ensuring that the proceedings are conducted fairly and efficiently. This article explores the rights and strategies of creditors during insolvency and examines how they can sway the outcome of insolvency cases.

CREDITORS' RIGHTS IN INSOLVENCY PROCEEDINGS

1. Right to Information

Creditors have a fundamental right to be kept informed throughout the insolvency process. They are entitled to have access to detailed information about the debtor's financial situation, including a list of assets and liabilities, details of the debtor's creditors, and reports on the progress of the insolvency proceedings. This transparency enables creditors to make well-informed decisions and protect their interests.

2. Right to Participate in Meetings

Creditors have the right to attend and vote at creditors' meetings, because they serve as crucial forums for discussion where creditors can discuss and vote on key matters. These may include: the appointment of Insolvency Practitioners; approval of proposed restructuring plans; or, key decisions about the liquidation proceedings. The collective voice of creditors can significantly influence the course and direction of the proceedings.

> **"Creditors have the right to challenge decisions made during the insolvency process."**

3. Right to Fair Treatment

Creditors are entitled to fair and equitable treatment in the distribution of the debtor's assets. The insolvency process is governed by a hierarchy of claims, ensuring that secured creditors, unsecured creditors, and other stakeholders receive their entitlements in accordance with the legal framework. This structured approach attempts to balance the interests of all parties involved.

4. Right to Challenge Decisions

Creditors have the right to challenge decisions made during the insolvency process. If they believe that an Insolvency Practitioner's actions are not in the best interests of the creditors or if there are allegations of misconduct, creditors can seek redress through the courts. This oversight is vital in maintaining the integrity of the insolvency process.

THE ROLE OF A CREDITOR

1. Forming a Creditors' Committee

In an Administration or Liquidation process, Creditors will be given the opportunity to form a creditors' committee. This committee represents the interests of the general body of creditors and acts as a liaison between the creditors and the office-holder. By collaborating, the committee can exert greater influence over the proceedings and ensure that the creditors concerns are addressed.

2. Monitoring the Progress of the Case

Active monitoring of the progression of the case is crucial. Creditors should regularly review reports and financial statements, attend meetings, and ask relevant questions. By staying engaged, they can ensure that the Insolvency Practitioner acts in the best interests of all stakeholders and adheres to legal and ethical standards.

3. Utilising Legal Advice

Engaging legal advisors can provide creditors with the necessary expertise and representation throughout the insolvency process. Lawyers can help creditors understand their rights, evaluate proposals, and take legal action if required. This professional support can enhance the creditor's ability to protect their interests effectively.

INFLUENCING THE OUTCOME OF INSOLVENCY CASES

1. Voting Power

Creditors' voting power is a critical tool in influencing the outcome of insolvency cases. By voting on key decisions, such as the approval of restructuring plans or the appointment of Insolvency Practitioners, creditors can direct the process in a way that maximises their recovery.

2. Proposing Restructuring Plans

Creditors also have the option to propose their own restructuring plans. If the debtor's proposal is deemed inadequate, creditors can develop alternative plans that offer better returns or more viable solutions for the debtor's financial recovery. These plans can then be put to a vote, providing creditors with a direct means to influence the outcome.

3. Leveraging Secured Interests

Secured creditors, in particular, have significant leverage due to their priority in the distribution of assets. By asserting their security interests, these creditors can ensure that their claims are prioritised, giving them a powerful negotiating position in the insolvency proceedings.

4. Collaboration Among Creditors

Collaboration among creditors can amplify their influence. By uniting and coordinating their actions, creditors can present a unified front, making it more challenging for the debtor or the Insolvency Practitioner to overlook their collective demands. This approach can lead to a more favourable outcome for all creditors involved.

Creditors play a crucial role in insolvency proceedings, wielding significant rights and strategies to influence the process and protect their interests. Through active participation, negotiation, and collaboration, creditors can shape the outcome of insolvency cases, ensuring fair treatment and maximising their recovery. Their involvement is crucial for maintaining the integrity and efficiency of the insolvency process, ultimately contributing to a balanced and equitable resolution for all parties involved.

> **"Creditors also have the option to propose their own restructuring plans. If the debtor's proposal is deemed inadequate, creditors can develop alternative plans that offer better returns or more viable solutions for the debtor's financial recovery."**

Alexandra Davies
Senior Manager
adavies@menzies.co.uk
+44 (0)33 0912 9577

WATCH OUT FOR THE ZOMBIES!

Although it may seem like a concept straight out of a horror movie, zombie companies may present hazards for credit managers.

A zombie company is defined by the Organisation for Economic Cooperation and Development (OECD) as one that cannot pay the interest on its borrowing from operating profit for three years in a row. These are businesses that are at risk of insolvency, and could be pushed over the edge by a sudden unexpected event.

Zombie companies will be put under significant financial pressure when inflation rises above the 2% target and interest rates rise in an attempt to combat it. Indeed, the impact of high interest rates was felt with a 15% increase in corporate insolvency figures during the first half of 2023 compared to the same period in 2022. This follows the sharp increase in interest rates in response to the sharper rise in inflation through 2022. Whilst insolvencies are still on the rise, when compared to the first half of 2024 there is only a small 0.5% increase.

The increase in inflation has resulted in hikes in prices for various goods and services and has presented a challenge for zombie companies. When prices go up, consumer purchasing power decreases, which can affect the demand for goods and services. For zombie companies, who are already struggling with small margins, it may be difficult to transfer increased costs to consumers. This squeeze on profitability restricts their investment capacity in research and development or necessary upgrades, which means they start to stagnate and are unable to expand.

For companies with significant outstanding debt, the burden of repayment becomes heavier in an inflationary environment because central banks typically increase interest rates in a bid to control it. Zombie companies struggling to cover the interest on their borrowing will feel the pinch and this can ultimately lead to insolvency.

Whilst an increase in insolvencies may be seen in a negative light, if these entities are failing to contribute to economic growth, there is an argument that their failure might make room for those who do contribute instead?

I appreciate that there can be a domino effect on a supply chain and those whose livelihoods are impacted will certainly not appreciate being collateral damage, but this is where caution should be taken when choosing who to trade with. Accounts departments, procurement officers and credit managers will be well versed in mitigating risk in the supply chain, however supply is key and there are only so many mitigation measures that can be adopted. A competitive market will assist corporate resilience though, and in making room for new entities and by freeing up funding opportunities, industries will progress and ultimately contribute to UK plc in a positive way.

Bethan Evans
Partner
bevans@menzies.co.uk
+44 (0)33 0912 9578

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What are the key differences between a Liquidation and an Administration?

How can Insolvency Practitioners advise on a Creditors' Voluntary Liquidation?

MEET THE EXPERTS

The Menzies Creditor Services team can advise on the best way for you to protect your position when one of your debtors enters, or is approaching, insolvency proceedings. Utilising our extensive experience and expert insights, we work in collaboration with you, drawing upon our industry and insolvency sector knowledge, to improve your financial outcome.

For further information on our creditor services offering, please get in touch.

BETHAN EVANS
PARTNER
bevans@menzies.co.uk
+44 (0)33 0912 9578

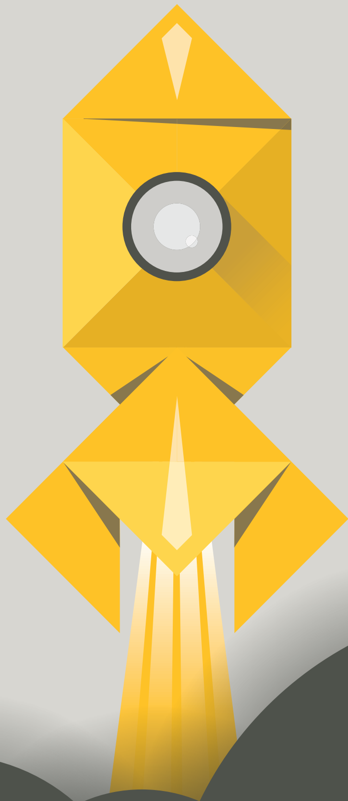
SIMON UNDERWOOD
PARTNER
sunderwood@menzies.co.uk
+44 (0)20 7465 1932

GIUSEPPE PARLA
DIRECTOR
gparla@menzies.co.uk
+44 (0)20 7465 1919

ALEXANDRA DAVIES
SENIOR MANAGER
adavies@menzies.co.uk
+44 (0)33 0912 9577

LIAM JONES
SENIOR ADMINISTRATOR
ljones@menzies.co.uk
+44 (0)33 0912 9186

HARRY BURKE
ADMINISTRATOR
hburke@menzies.co.uk
+44 (0)20 7387 5868



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