Berkshire Hathaway Specialty Insurance

RPC

COVID-19 AND THE IMPACT ON UK CORPORATE INSOLVENCIES

www.bhspecialty.com

www.rpc.co.uk

INTRODUCTION

It has been just over two years since the World Health Organisation first declared Covid-19 a pandemic, and as the UK prepares to transition away from an era of pandemic restrictions and unprecedented government intervention, to a more 'business-as-usual' open economy, it seems timely to consider the possible legacies of this crisis on UK businesses. In doing so, we look to consider:

1. How the impacts of Covid-19 may differ from prior recessionary periods;
2. Whether the downturn will result in a period of heightened corporate insolvencies, and;
3. Whether the government measures discussed in this article, and the scale of the economic shock experienced by the UK economy (and many others), will lead to emerging risks and liability exposures to which company directors (and the providers of directors and officers insurance) should take heed.

To begin to address these questions, we should first remind ourselves of the scale of the COVID-19 impact over the last two years.

ECONOMIC IMPACT OF THE PANDEMIC AND GOVERNMENT RESPONSE

The size of the economic shock caused by the pandemic, and in particular the impact of the Government mandated closure of large swathes of the economy, was huge. The Office for National Statistics records a drop in GDP of 9.4% in 2020, comparing with a 4.2% drop in the fall out of the Global Financial Crisis in 2008. This impact required the Government to provide an unparalleled level of stimulus and support to the economy. At its height, under these arrangements, the Government assumed responsibility for paying the wages of nearly 9 million workers under the Coronavirus Job Retention Scheme at a taxpayer cost of c. £70 billion.[1]

In addition, under the Bounce Back Loan, Coronavirus Business Interruption Loan and Coronavirus Large Business Interruption Loan Schemes approximately £79 billion of liquidity[2] was advanced to businesses impacted by the pandemic, much of which was guaranteed by the Government.

LEGISLATIVE INTERVENTIONS

In addition to these employee protection and fiscal measures, sweeping legislative interventions were introduced under the Corporate Insolvency and Governance Act 2020 (CIGA) and the Coronavirus Act 2020. Under these emergency legislative arrangements, several permanent new insolvency and restructuring regimes were introduced to the UK statute books, and temporary measures imposed, including the suspension of director liability for wrongful trading.

(We discuss, further, the nature and scope of these legislative reforms in the appendix to this article.)

Immediately prior to the pandemic, statistics published by the Insolvency Service for Q4 2019[3] reveal that corporate insolvencies increased to their highest annual level since 2013. Furthermore, as illustrated in the below Insolvency Service graph, the Q4 2019 corporate insolvency statistics form part of a wider trend under which the number of corporate insolvencies had been trending upwards since 2015.

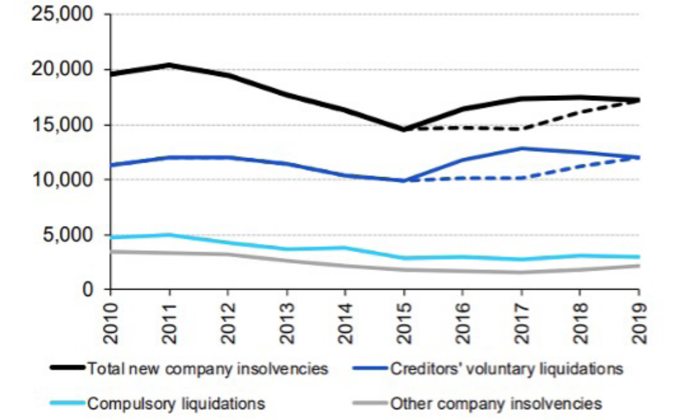
---

[1] https://www.gov.uk/government/statistics/coronavirus-job-retention-scheme-statistics-4-november-2021/coronavirus-job-retention-scheme-statistics-4-november-2021

[2] https://www.gov.uk/government/collections/hm-treasury-coronavirus-covid-19-business-loan-scheme-statistics

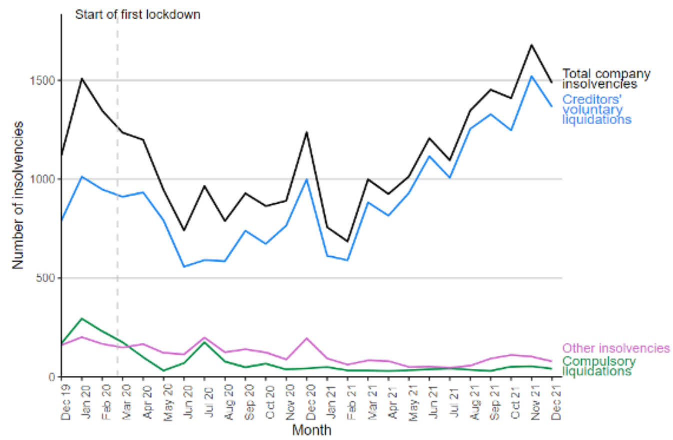
[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/861187/Commentary_-_Company_Insolvency_Statistics_Q4_2019.pdf

Figure 1: Underlying company insolvencies reached their highest annual level for 6 years primarily driven by creditors' voluntary liquidations
England and Wales, dashed lines exclude bulk insolvencies



A review of the data from the UK Insolvency Service, through the course of the pandemic, shows the total number of company insolvencies registered in 2021 was 14,048, which was around 11% higher than the 12,634 in 2020, but remained below pre-pandemic levels. However, what may be a more indicative statistic of what to expect in 2022 is considering how the frequency of company insolvency registration has both evolved over the course of 2021 and how it ended in December 2021, compared to pre-pandemic levels.

Figure 1: The number of registered company insolvencies in December 2021 was similar to pre-pandemic levels, driven by a higher number of CVLs.
England and Wales, December 2019 to December 2021, Not seasonally adjusted



Here, the number of company insolvencies in December 2021 was 33% higher than in the pre-pandemic comparison month (December 2019) and has been trending upwards over the course of 2021. Furthermore, this negative trend can be anticipated to continue through 2022, as evidenced by the latest February 2022 UK Insolvency statistics, which show the number of company insolvencies in February 2022 were more than double February 2021, and 13% higher than February 2020, pre pandemic. All of which are still before government support fully wanes and the effects of a reconfigured economy begin to bite.

All of which leads us to the last of our three questions, and a gaze into the crystal ball.

LOOKING AHEAD: DIRECTOR LIABILITY LANDSCAPE IN 2022

The reforms introduced under CIGA and the Coronavirus Act 2020 provided heightened levels of protections to companies and directors, largely at the expense of creditors' rights. For example, the Government's temporary suspension under CIGA of liability for wrongful trading during the height of the pandemic means that insolvency practitioners will be denied an important ground for challenging directors' conduct, and with the hope that an introduction of two new permanent restructuring regimes could, in the long-term, result in less insolvencies overall, as viable companies are provided with alternative options through which to restructure.

Whilst these reforms have afforded some increased protections to directors, there are other areas of insolvency related risks, beyond wrongful trading liabilities, where protection has not been enhanced. And any adverse impact from Covid-19 on businesses may result in directors facing increased exposure for those additional risks, for example heightened scrutiny on their authorisation of transactions entered into by companies in the period prior to any insolvency, as well as claims for misfeasance and breach of fiduciary duties.

Although untested, it is possible that when assessing directors' conduct during the pandemic, the courts may take some account of the unprecedented challenges faced by directors at a time when the outcome of the pandemic for wide sections of the UK economy was unknown and survival was by no means certain. In these circumstances, except in the most-clear cut cases, it may be harder for claimants to successfully prosecute claims. However, due to the lag between the occurrence of potentially actionable events, a company entering insolvency proceedings (which itself may be delayed due to COVID-related Government interventions), an insolvency practitioner conducting enquiries and finally a claim being brought it may be some time before the courts' approach to these matters becomes apparent.

In addition, the Government's key temporary statutory protections have since expired on 31 March 2022. The relaxation of these protections may result in a sharp uptick in the number of corporate insolvencies, as the pent-up demand of frustrated creditors is released and the viability of businesses post-pandemic will be tested and exposed, without the benefit of Government support. These factors, together with the prospect of further interest rate increases to stave off inflation, the challenges arising from Brexit, increasingly problematic supply chain challenges and employee shortages (exacerbated by the recent war in Ukraine), have led some practitioners to warn that UK businesses are still a long way from returning to prosperity and growth and that the most challenging times for many corporates and their directors lie ahead. This tipping point in Supply Chain challenges has been vocalised by a number of UK industry bodies, with MakeUK, the UK Manufacturing body, warning prices are becoming unmanageable for some manufacturers. "While the pot may not be at the boiling point it has been over the last year, logistics costs remain a big part of the high cost temperature that businesses face," said Verity Davidge, director of policy at MakeUK, adding it was difficult to predict when the costs and disruption would be resolved.

WHERE DOES D&O INSURANCE (AND BHSI) FIT IN?

The environment described in the preceding section involves a level of uncertainty, and potentially increased risk, which may well give cause for concern for directors. Of course, one of the main protections available to company directors and executive officers is provided under directors' and officers' liability insurance. And the engagement of D&O insurance policies often arises when companies enter insolvency. This is because insolvency practitioners have a statutory duty to investigate the circumstances leading up to the insolvency of a company, including examining the conduct of the directors and transactions entered into in the period prior to insolvency.

BHSI is active in providing capacity to financially distressed companies, as evidenced by the specific solutions we provided for a number of our customers who utilised the UK government's new restructuring plan. We have a market leading management liability portfolio in London, with a team of underwriters and claims handlers experienced in handling these complex and evolving exposures. And equally important, a claims offering that provides certainty and support when a customer most needs it, all supported by a platform with a long-term focus on providing sustainable and consistent solutions for our customers, with the backing of the Berkshire Hathaway Specialty Insurance's unmatched financial strength.

FINANCIAL STRENGTH & COMMITMENT

BHSI offers our customers a wide range of coverages on a worldwide basis, all backed by BHSI's market commitment, underwriting and claims expertise and financial strength.

A.M. Best	Standard & Poor's
A++	**AA+**
(Superior) Stable	(Very Strong) Stable

Berkshire Hathaway's National Indemnity group of insurance companies hold financial strength ratings of A++ from AM Best and AA+ from Standard & Poor's with $411.6 billion in total admitted assets and $250.6 billion in policyholder surplus*.

* Source: Balance sheets as of 30/09/2021 for the Berkshire Hathaway National Indemnity group of insurance companies.

APPENDIX

WINDING-UP PETITIONS AND WRONGFUL TRADING

The reforms introduced under CIGA and the Coronavirus Act 2020 provided unprecedented levels of protections to companies and directors, largely at the expense of creditors' rights. Under CIGA creditors were initially prohibited from presenting a winding-up petition against a company based on either: (i) a statutory demand that was served between 1 March 2020 and 30 September 2021 or (ii) during the same period, based on a company's inability to pay its debts (including rent), unless the creditor has reasonable grounds for believing COVID-19 has not had a financial effect on the company, or that the company's debt issues would have arisen in any event.

With effect from 1 October 2021 until 31 March 2022 certain creditor restrictions remained in place. Under these legacy measures, winding-up petitions may not be made in respect of debts: (i) relating to unpaid rent or other sums due under a lease of premises used for business purposes where the debt is unpaid by reason of a financial effect of COVID-19; or (ii) of a value of less than £10,000. In addition, creditors are required to give 21 days' notice to the debtor of its intention to present a winding up petition and invite creditors to make a debt payment proposal.

Under the wrongful trading provisions contained in the Insolvency Act 1986, where a director of a company knows, or ought to conclude that there is no reasonable prospect that the company will avoid insolvency, they must take every step that a reasonably diligent person having the knowledge, skill and experience that may reasonably be expected of a person carrying out the director's functions, and their own knowledge, skill, and experience, would take with a view to minimising the potential loss to the company's creditors. If the director fails to take such steps, and the company becomes insolvent, then the director may be ordered to make such contribution to the company's assets as the court considers appropriate. Such contributions are often assessed as equating to the amount that the director's actions contributed to the company's net balance sheet deficiency.

Initially under CIGA, and subsequently extended by statutory instruments, the Government suspended liability for wrongful trading between 1 March 2020 to 30 September 2020 and 26 November 2020 to 30 June 2021. These temporary measures brought about a profound change in the risk profile to directors for breach of fiduciary and/or directors' duties during the pandemic.

NEW INSOLVENCY REGIMES

In addition to making temporary amendments to existing insolvency rules and procedures, CIGA also introduced permanent new insolvency regimes to bolster the UK restructuring toolkit. These permanent reforms included the introduction of the restructuring plan and a freestanding moratorium procedure.

The restructuring plan develops and extends principles and procedures of schemes of arrangement under Part 26 of the Companies Act 2006 with the purpose of assisting viable companies struggling with debt obligations through a court sanctioned process that binds creditors if it is "fair and equitable" and can be imposed on dissenting creditors under a cross-class cram down mechanism.

The moratorium procedure is a new "debtor-in-possession" procedure which provides UK companies with breathing space in which to pursue a rescue or restructuring plan. During this moratorium no creditor action can be taken against the company without the court's permission. The moratorium is overseen by a monitor (an insolvency practitioner) but responsibility for the day-to-day running of the company remains with the directors.

AUTHORS

BEN BARKER

Head of Executive and Professional Lines Claims, UK, BHSI

Ben.Barker@bhspecialty.com

Ben Barker is Head of Executive and Professional Lines claims for Berkshire Hathaway Specialty Insurance, UK. In nearly 20 years as an insurance professional Ben has acquired a market leading expertise in all Financial Lines products, managing claims teams dealing with large, complex and high-profile losses across multiple product lines.

THOMAS HARRIS

Senior Underwriter, Commercial Management Liability, UK, BHSI

Thomas.Harris@bhspecialty.com

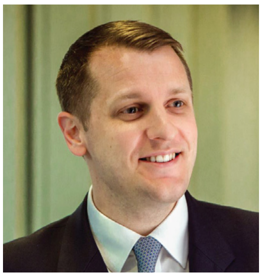
Thomas Harris is a Senior Underwriter in the Commercial Management Liability team for Berkshire Hathaway Specialty Insurance, UK. In nearly 14 years as an insurance professional, Thomas has worked in both broking and underwriting capacities, acquiring significant expertise in underwriting large, complex Directors & Officers Liability placements, and the broader Management Liability suite of products.

PAUL BAGON

Partner, RPC

Paul.Bagon@rpc.co.uk

Paul Bagon is a partner at international law firm RPC and advises stakeholders in all aspects of cross-border and domestic insolvencies, financial restructurings, corporate turnarounds, group reorganisations complex workouts and distressed M&A and financings. In recent years, Paul has advised boards of directors of financially distressed multinational groups and insureds and worked on restructurings in the retail, leisure, oil and gas and financial services sectors. He is a member of the R3 Association of Business Recovery Professionals, the Insolvency Lawyers Association and INSOL.



JAMES WICKES

Partner, RPC

James.Wickes@rpc.co.uk

James Wickes is a partner at international law firm RPC that specialises in advising insurers and reinsurers in respect of claims under FI, PI, D&O, W&I and Crime / Fidelity insurance.

James also regularly defends claims against financial institutions/professionals and directors & officers, often with an offshore or international dimension, including cross-border disputes.

James has been recognised as a Leading Individual for Insurance and Reinsurance Litigation and a Next Generation Partner for Professional Negligence by The Legal 500 UK (2022). He has also been recognised as a Notable Practitioner for Insurance: Contentious Claims & Reinsurance in Chambers UK (2022).