# Solutions within the legal and operational toolkit for businesses in Retail (and the supply-chain) to enhance resilience

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The Government's roadmap out of lockdown signals a return to trading for a number of businesses hard-hit by the COVID-19 pandemic. There is however potential for heightened financial distress in the coming period as existing support measures are withdrawn and currently deferred liabilities become payable, bringing the challenges faced by this sector into sharp focus. Businesses saddled with debts accrued throughout the pandemic are protected by the various Government support measures and moratoria (repeatedly extended and currently in place until 30 June 2021), but will soon be exposed to increased creditor pressure.

The onset of COVID-19 and the Government mandated lockdown signaled immediate cash flow impacts for non-essential retailers forced to shut their stores and re-position for remote outlet channels which, in turn, has a 'knock-on'effect for businesses in the supply chain. However, the full impact of the Pandemic has been mitigated (or rather, deferred) in part by the UK Government implementing various laws containing temporary measures that significantly limit certain creditor remedies and options, particularly in relation to non-payment of rent.

Certain businesses have adopted a variety of measures to address levels of accrued debt and liquidity shortfall and mitigate the effects of the pending withdrawal of Government support measures, ranging from early engagement with lenders to formal restructuring procedures compromising creditors, such as Company Voluntary Arrangements or the new Restructuring Plan. **The key takeaway is that early action is vital; businesses across the sector that fail to prepare for the end of the Government support measures may find themselves in a vulnerable position.**

In addition, UK legislation (the *Corporate Insolvency and Governance Act 2020*) brought into force in June 2020 renders ineffective the operation of a range of contractual clauses (in both new and existing supply contracts) which a supplier would commonly expect to rely on in a customer insolvency/restructuring scenario. There remains significant opportunities for well positioned businesses to enhance value by implementing effective protections against disruption from supply chain shock and the potential to seize strategic opportunities to enhance their offerings and implement operational efficiency by being alert to competitors and supply chain businesses facing insolvency in the coming months.

## Galvanizing your business against supply chain disruption and customer insolvency risk

Businesses in the sector stand to protect substantial value by: (i) taking early action to assess critically their potential exposure to supplier and customer insolvencies; (ii) reviewing whether legal protections in supply contracts may be ineffective in light of new legislation; and (iii) implementing enhanced legal and operational protections. Specific legal and operational planning and on-going monitoring processes, tailored to the jurisdictions in which the operations/exposure may arise, will significantly mitigate the risk and effect of customer or key supplier insolvency, increase optionality from an early stage and thereby enable resulting business costs to be minimised.

## Warning signs of supplier/customer financial distress

### WARNING SIGNS

- Delayed payment/stretching of supplier credit.
- Re-negotiated payment terms sought/requests for deposits and upfront payments.
- Store/office premises closures.
- Deteriorating service levels.
- Spurious/unjustifiable claims.
- CCJs, late accounts filing, withdrawal of credit insurance, pending winding up proceedings.
- Auditor's report subject to qualifications.
- New/additional security being granted to an alternative funding provider.
- Market rumour/industry specific challenge/external shock.
- Over-leveraged business.
- Management exits/changes.

### CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020

The Corporate Insolvency and Governance Act 2020 impacts a number of *typical* rights and protections of suppliers. The legislation:

- precludes the operation of a range of supplier contractual rights where they arise by reference to a customer entering an applicable insolvency process (e.g. a right to terminate supply (amongst others)); and
- applies to supply contracts irrespective of when they were entered into (i.e. it applies retrospectively to existing contracts) and the changes are relevant to all businesses (including those of financial good standing) having UK supply operations to customers.

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## Options to protect your goods/exposure

### CUSTOMER RISK

- Review supply terms in light of new UK legislation.
- Retain title to goods supplied until payment received.
- Periodic on-going monitoring:
  - customer accounts filed on time?
  - CCJs/winding up proceedings commenced?
  - audit of stock segregation conditions at customer premises for goods supplied which are not yet paid.
  - credit insurance available?
- Review of financial position and payment terms.
- Monitor/review level of credit exposure.

### SUPPLIER RISK

- Is the supplier key to your supply/ production operations?
- If the supplier ceased trading, what alternatives would be available, at what cost and within what time frame?
- Monitor potential knock on impact on your ability to deliver on onward supply contracts.
- Would supplier distress provide an opportunity to acquire assets/bring part of production required for your business in-house?

### REACTING TO SUPPLIER/CUSTOMER DISTRESS: EARLY ACTION TO RECOVER ASSETS/OBTAIN PAYMENT

Where concern is identified with regard to customer or supplier financial distress, early action is key to avoiding potentially large exposure as an unsecured creditor upon an insolvency.

- At an early stage key steps can be taken, including:
  - contingency plan continued alternate supply of key goods and services;
  - audit and inventory of stock held by customer where title has been retained;
  - recovery action in respect of stock/ suspension of credit terms absent payment of debts being made;
  - written reminders of directors' duties and/ or threat of early enforcement action/ commencement of insolvency proceedings;
  - procuring payment on account/guarantee from third party for continued supply;
  - taking security/guarantees to elevate and enhance creditor rights;
  - securing provision of pertinent financial information; and
  - early engagement with a key supplier in financial distress.

Early monitoring of warning signs and maintaining connection with market intelligence to identify potential insolvency of businesses in the industry and/or supply chain can present significant opportunity for dynamic action to acquire strategic operations, whilst protecting continuity of supply arising from financial distress.