Implications of COVID-19 Restrictions on Restaurant Businesses in the UK

by Simon Thomas, Oonagh Steel

The COVID-19 pandemic and associated restrictions have dramatically altered the operating model of restaurants. In this article, we consider what happens where there is not enough income to meet all liabilities. We recommend that restaurants should address the cash shortfalls in their business models and share information with key stakeholders in order to seek to reach compromises in respect of historic and future liabilities. There is a shared interest between stakeholders in developing sustainable business models in order to enable restaurant businesses to trade through and out of the current crisis. Given the falls in revenue, all stakeholders will be asked to consider compromises in order to achieve this.

CHALLENGES FACING RESTAURANT BUSINESSES

Despite having high fixed costs, restaurant businesses have experienced weeks of little or no income. Whilst payments to suppliers have been cut, and the Government furlough scheme has significantly helped with paying employees, businesses are still responsible for all of the liabilities which have accrued during lockdown.

The initial response of many businesses has been to take the benefit of the Government grants and tax breaks alongside a strategy of mothballing businesses. The enforced pause on landlords' enforcement rights has provided further breathing space.

Meanwhile, backed by dedicated chefs and delivery drivers - who are prepared to put their personal well-being on the line to keep restaurants trading and customers fed, many operators have demonstrated incredible agility to transform operations that have focused on the eat-at-home market.

We are now at the stage where many businesses are making plans to come out of lockdown. Were it possible for businesses to return immediately to pre-COVID-19 trading conditions then this may only require a restructuring of unpaid lockdown debts. However, these debts need to be addressed at the same time restaurants are facing reduced and uncertain turnover during a protracted recovery period. As lockdown measures are relaxed, operators are having to re-assess their future business plans without any certainty as to how long social distancing measures will be enforced and when a vaccine will be available. Indeed, the Government has suggested that lockdown measures could be reimposed on a regional basis where spikes in COVID-19 cases occur.

In addition, the Government's guidance published on 11 May 2020, > *Working safely during coronavirus (COVID-19)* (https://www.gov.uk/guidance/working-safely-during-coronavirus-covid-19/restaurants-offering-takeaway-or-delivery) will have adverse financial consequences for operators. It will reduce turnover due to restrictions on capacity and will increase costs. For example, in respect of cleaning and providing personal protective equipment for workers.

Many businesses will be concerned about returning too quickly to their previous model. It is not uncommon for businesses to fail coming out of a recession as they gear up operations too quickly. This may particularly be the case where restaurant customer responses to the easing of restrictions is unpredictable.

A group of leading restaurateurs wrote to the Chancellor on April 21 2020 seeking a #NationalTimeOut, which includes a nine-month #NationalRentFree period for hospitality businesses, combined with a matching loan and interest payment postponement for landlords, as well as protection for landlords from covenant breach and debt security enforcement. However, in the absence of further measures from the Government, individual businesses will need to seek their own compromises with their creditors.

HOW SHOULD RESTAURANTS RESPOND?

Lower turnover means less cash to pay liabilities. It is therefore likely, given the fall in revenue, that many businesses are currently insolvent on a cashflow basis. However, this does not mean that directors need to file for insolvency of their companies. In order to support a period of acute trading uncertainty, the Government has confirmed that the wrongful trading legislation shall not apply from 1 March 2020 to 30 June 2020 (which can be extended). The aim of the suspension is to deter directors (concerned about potential wrongful trading liability) from commencing insolvency procedures and to encourage businesses to continue to trade (or simply exist) through the COVID-19 crisis. It also encourages directors to take out loans on behalf of companies, including those available under the various Government schemes.

SEEKING COMPROMISES

Whilst the ‘breathing space’ measures are in force, there is an opportunity for a period of negotiation with stakeholders to address historic and future liabilities. We recommend that restaurants should proactively engage and build consensus with their key stakeholders including suppliers, employees, landlords, HMRC and lenders. Where possible, operators may provide increased transparency to stakeholders in respect of turnover performance, in order to seek consensus towards achieving a sustainable business model and avoiding liquidation.

The consequences for all stakeholders of businesses being liquidated would be to crystallise losses. Insolvency Practitioners are very well placed to assist stakeholders in reaching compromises with creditors by explaining the outcomes of the potential scenarios available. Importantly, more value may be available where stakeholders can agree to a consensual restructuring of liabilities and a liquidation process is avoided.

Compromises of liabilities can take various forms. These include:

- Company Voluntary Arrangements (CVAs – a formal agreement with creditors supervised by an Insolvency Practitioner);
- Schemes of Arrangement (a Court based process used for a multitude of purposes including agreeing compromises with creditors);
- Standstills (often used by lenders in order to provide borrowers with breathing space to pursue a restructuring plan);
- Time to Pay agreements with HMRC (in respect of tax liabilities); and
- Other bespoke agreements (including ad hoc and settlement agreements)

WHAT OTHER RESTRUCTURING OPTIONS ARE AVAILABLE?

There are many existing restructuring solutions available to help businesses.

Available solutions include:

- Pre-pack administration – allowing the sustainable parts of the business to be rescued;
- Light touch administration – where existing management teams remain in place in order to execute a rescue business plan and in an attempt to save the company with protection from creditor action; and
- Debt for equity swaps – used to deal with an unsustainable debt mountain.

In addition, the following restructuring tools are due to come into law shortly:

- A pre-insolvency moratorium – to try and effect a rescue of the company, monitored by an Insolvency Practitioner whilst the directors remain in charge; and
- A 'restructuring plan' – requiring approval by creditors and sanction by the Court, it provides an ability to bind classes of dissenting creditors.

As a result of the unique circumstances arising in response to the pandemic, we may also see more innovative solutions used. These potentially include:

- Government equity stakes – used in the Future Fund and may be extended to include debt for equity swaps in respect of BBLs, CBILs and CLBILs;
- Government providing credit guarantees for suppliers; and
- Employees taking equity in companies in lieu of salaries.

CONCLUSION

Restaurants should address the cash shortfalls in their business models and share information with key stakeholders in order to seek to reach compromises in respect of historic and future liabilities. There is a shared interest between stakeholders in developing sustainable business models in order to enable restaurant businesses to trade through and out of the current crisis. Given the falls in revenue, all stakeholders will be asked to consider compromises in order to achieve this.

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