Ways by which a viable business can obtain respite from creditors

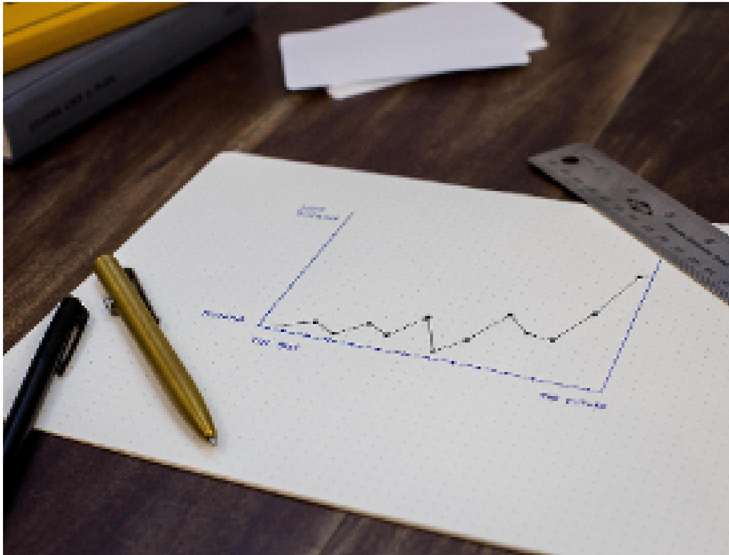
By Geoffrey E. Odongo

The on-going pandemic has resulted in instances where companies are struggling to pay creditors even though their businesses remain viable. In some instances such businesses are already in default having failed to remit repayments to their creditors within the time lines set out in Loan Facility Agreements. This write up highlights legal and contractual debt restructuring mechanisms by which companies in such situations can, with the help of a sound business plan, give their businesses a new lease of life.

The directors of a company whose business seeks to take advantage of debt restructuring mechanisms should be proactive. This means that having taken note of an impending default in meeting obligations the directors should approach the company creditors and honestly explain the challenges they face. This is particularly important where the creditor in question is a bank as most banks appreciate honesty which they consider an important pillar to a long term relationship.

It is also noteworthy that banks prefer restructuring a facility as opposed to selling off assets that borrowers have pledged to them. This is because selling assets tends to be time consuming and in addition to distracting the bank from its core business, most times does not result in an outcome satisfactory to the bank. Moreover, the present post-pandemic economic environment has given rise to an influx of distressed assets that lenders are unable to dispose so as to recover the sums they lent. Given this backdrop, banks will more often than not be happy with repayment even if it means extending more time to the borrower to meet his obligations.

In addition to the foregoing, the directors of a company in distress need to set out a credible strategy the business will be looking to adopt to ensure a turnaround in its fortunes. Such strategy should be elaborately set out and include timelines for its implementation. Once this is established the Creditor can be engaged with the aim of convincing



them that giving the company a respite from its repayment obligations is in their interest given the certainty of getting back the money they lent to the business as compared to the possible outcome in the case of liquidation of the company. Once convinced the Creditor assures the Borrower that it will not exercise any of its enforcement rights for a specified duration hence allowing negotiations on a proposed restructuring between the parties.

Where a company offers a sound business plan clearly setting out its ability to turn around its fortunes based on a credible strategy, its creditors will be readily agreeable to reschedule debt repayment or extending debt maturity dates. During the process stated herein it is prudent to have legal counsel that will guide the process and help in reviewing or preparing the agreements restructuring the debt in addition to robustly engaging the Creditor in discussing available restructuring options and exploring the statutory tools available in effecting the debt restructuring. Proper engagement at this stage ensures that creditors afford the business as much indulgence as possible hence increasing the chances of the company continuing to operate as a going concern and in so doing meeting its financial obligation to creditors in full or at least to the satisfaction of the creditors. The various options available once explored and an agreement reached on which option to utilize then a restructuring agreement is entered into which captures what has been agreed upon between the creditor and the business.

Where negotiations as mentioned above cannot readily be conducted, the law provides other mechanisms that can be used to effect debt restructuring. These include exploring the possibility of placing a company under administration as provided for under the Insolvency Act. Administration is useful for providing a company with some relief even as a turnaround plan is implemented. Under the Insolvency Act, the directors of a company can obtain an interim moratorium upon the lodging of a notice of intention to appoint an administrator. An interim moratorium provides a business with certain protections against creditors by suspending rights held by creditors for some time so as to give the company room to facilitate restructuring such as:

I. Barring the passing of resolutions seeking to liquidate the company
II. Making it a requirement that a person seeking to enforce a security over the company's property seek court approval
III. Making it a requirement that a person seeking to repossess goods in the company's possession seek court approval
IV. Making it a requirement that a landlord seeking to exercise a right of forfeiture in relation to premises let to the company seek court approval.
V. Making it a requirement that a person seeking to continue litigation against the company or its property proceed only after obtaining court approval

During the term of the administration, the administrator is able to reach a compromise with the business creditor and realize the assets of the company in an orderly way. This shields the company from the effects of adverse proceedings such as winding up/liquidation together with litigation for the enforcement of debts.

Administration will normally be effective for 12 months from the date the company enters into administration.

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