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English restructuring tools for non-UK companies

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Non-UK companies have started to use English restructuring procedures. Here we consider the recognised criteria for restructuring in England and the legal mechanisms available under European and other legislation.

The English law restructuring environment

English law provides a very flexible restructuring environment. As a result, it is often easier to deliver a restructuring solution in the UK than in many other jurisdictions. The three key procedures - administrations (including pre-packs), schemes, and CVAs (see box opposite) - each have different advantages which are considered below. Importantly, whilst administrations and CVAs fall within UK insolvency law and the EC Insolvency Regulation, schemes fall within UK companies legislation (they can be used in solvent and insolvent scenarios) and do not fall within the EC Insolvency Regulation.

Migrating to England: issues to consider

Administrations and CVAs will only be considered main insolvency proceedings under the EC Insolvency Regulation if the subject company's 'centre of main interests' ('**COMI**') is in the UK at the time insolvency proceedings are opened. The presumption that a company's COMI is the location of its registered office can be rebutted by 'objective', 'ascertainable' evidence to the contrary (*Eurofood*). This test was recently applied in an English case, *In the matter of Hellas Telecommunications (Luxembourg) II SCA* ('**Hellas II**').

In Hellas II, the company argued successfully that it had moved its COMI from Luxembourg (where it was registered and was tax resident) to England, where it wished to restructure, using an administration and pre-pack. The case demonstrates some of the key factors the court takes into account in determining COMI, which included:

- opening a new head office in London and notifying creditors of the change of address;
- holding board meetings and sending correspondence from London;
- conducting creditor negotiations in London;
- issuing a press release advertising the transfer; and
- registering the company as a foreign company and as a UK establishment of an overseas company.

English law restructuring - key procedures

Administration This is a statutory procedure under which a company that is, or is likely to become, unable to pay its debts can be reorganised or have its assets realised for the benefit of creditors. Upon insolvency, an insolvency practitioner ('**IP**') takes control of the company's affairs from its directors to achieve either a rescue of the company as a going concern or, if that is not achievable, a better result for the company's creditors as a whole than would be likely if the company were put into liquidation. Administration can be initiated by the company or its directors, or by creditors. It can also be used as a means of enforcement by lenders who hold a specific type of floating charge.

Pre-packaged disposal ('pre-pack') This is used to implement a restructuring through a sale by an administrator, often to lender-owned newcos, on terms which have been agreed before the administration. The consideration for the sale of the company's assets may include the assumption of debt by the purchaser. It is implemented immediately after the administrator's appointment.

Scheme of arrangement ('scheme') This is an agreement involving a compromise or arrangement between a company and its creditors (or any class of them). A scheme requires approval by a majority in number representing 75% in value of each class of voting creditors affected by the scheme proposal. Once approved and sanctioned by the court, it is binding on all affected creditors and the company.

Company voluntary arrangement ('CVA') This is a contract between a company and its unsecured creditors. If 75% by value of voting creditors approve the proposal it binds all unsecured creditors (provided that more than 50% of 'unconnected' creditors do not reject the proposal).

The location of creditor negotiations was deemed to be critical to the successful transfer of COMI. It should be noted, however, that the case involved the migration of a holding company which was a financing vehicle, whose creditors were well-aware of the restructuring. Migrating the COMI of an operating company with employees and physical assets would present substantial additional challenges.

English restructuring procedures: key issues and recent developments

There are a number of issues to consider when determining whether an English restructuring procedure would be appropriate, and which of a CVA, scheme or administration (or a combination) may be most useful, in any particular restructuring scenario.

Initial considerations

Before entering any process that requires creditor consent, it will normally be necessary to demonstrate to creditors that a real and immediate risk of insolvency exists - a so-called 'burning platform' - to encourage creditor engagement in the restructuring process. Ultimately, creditors are only likely to support a compromise of their claims if it offers a better return than they would expect to receive in an administration or liquidation.

Valuation

In both a pre-pack and a scheme, an accurate valuation is crucial to correctly identify 'out of the money' creditors. In the case of *IMO Carwash* the court confirmed it is appropriate to apply a valuation reflecting current market conditions rather than incorporating a premium for a potential improvement in the market.

Cram down: imposing a restructuring through a CVA or scheme

In a scheme or a CVA, non-consenting creditors are bound by the restructuring provided that the requisite majorities support the proposal and, in the case of a scheme, that the court sanctions the arrangement.

Unlike a scheme, a CVA can only bind secured creditors with their consent. CVAs are therefore frequently used to compromise unsecured creditors (e.g. trade creditors such as commercial landlords).

Once approved and implemented, a scheme will bind all affected creditors. This may include dissenting senior secured creditors where, for example, unanimous consent is otherwise required under the finance documentation. It is also possible to implement a scheme without the consent of 'out of the money' junior secured creditors who have no economic interest in the outcome of the transaction (although the scheme may need to be combined with a security enforcement and the use of a intercreditor release clause in order to conclude the restructuring free of the claims of such creditors).

Cram down: imposing a restructuring through a pre-pack

In a pre-pack, provided the administrator is confident that he is receiving the best price reasonably obtainable in all the circumstances, he is not required to obtain the consent of junior creditors if he concludes that there is no realistic possibility that they will receive a return on a sale in any circumstances. As a result, pre-pack disposals are often delivered without the consent of, and potentially without input from, junior or unsecured creditors.

The necessity for speed and confidentiality when conducting pre-packs has given rise to concerns that the best price is not always obtained. This led to the introduction of Statement of Insolvency Practice 16 ('**SIP 16**'), guidance with which IPs are required to comply, which stipulates the types of information to be given to creditors and reiterates to IPs their duty to all creditors in the context of a pre-pack sale.

In practice, a prospective administrator may communicate with junior creditors ahead of a pre-pack to comply with SIP 16 and to deal with any objections to the proposed transaction. An administrator may also give junior creditors an opportunity to submit a bid higher than the proposed sale price. However, any sale is likely to require the support of the senior creditors. As was seen in Hellas II, an offer which is not supported by the senior creditors may not be deliverable and may therefore not be accepted by the administrator.

Class Issues

A scheme requires the consent of the requisite majority of each class of creditors affected by the scheme. The members of each class must be treated in the same manner. Defining the members of each class of creditor is a key aspect of the scheme procedure. A 'class' has been defined by the court as constituting 'those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest'. It is particularly important to correctly identify creditor classes in highly leveraged structures with multiple classes of debt.

The court, in considering whether to approve a scheme, must be satisfied that each class was fairly represented by those who attended the meeting and that the statutory majority were bona fide and were not coercing the minority in order to promote interests that the majority have in another capacity. Those creditors that do have such "special interests" may have their votes discounted by the court.

In contrast, a CVA only requires the approval by the requisite majority of the creditors as a whole, and different creditors can be treated differently provided the proposal is not 'unfairly prejudicial' to a creditor (which is unlikely if the CVA proposal is offering compromised creditors a better outcome than the alternatives of administration or liquidation).

Moratorium

If creditor pressure is intense, the company may need the protection of a moratorium while it promotes a restructuring. When a company enters administration, a moratorium on creditor action will apply from the time appointed by the court (when the appointment of the administrator is made by the court) or the date of filing (when appointment is made out of court). A moratorium is only available for administrations (and CVAs involving small companies). It is therefore common to see companies which intend to restructure using a CVA or scheme enter administration in order to get this key benefit whilst negotiations take place with creditors, although this is not always necessary (see box '*Contractual alternatives*'). A change in the law to provide a moratorium for CVAs involving larger companies is currently under consideration.

A moratorium created by an administration will not automatically have extra-territorial effect in all cases but the recognition of administration as a main proceeding under either the EC Insolvency Regulation or the UNCITRAL Model Law will often be determinative in ensuring foreign court recognition of a moratorium (although its scope may be subject to national laws).

Contractual alternatives

Where the parties need a moratorium but wish to avoid administration, a contractual standstill can be agreed as an alternative. As a result, a CVA or scheme can be implemented on the back of a contractual standstill which is supported by a sufficient proportion of creditors to ensure that no enforcement instruction can be given.

In addition, most intercreditor agreements will contractually impose a standstill period on junior creditors. Such standstill will prohibit junior creditors from taking enforcement action during a pre-determined period so that senior creditors have the opportunity to agree a restructuring.

Intercreditor agreements also frequently allow for the release, by the security agent, of security and guarantee claims of junior creditors upon an enforcement or sale from administration which is supported by the senior creditors. Consequently, an administrator should be in a position to sell the assets of an insolvent company free from the junior lenders' security and guarantee claims.

A junior creditor's debt claim will normally either have to be compromised (by way of scheme) or left behind as a claim against the shell of an insolvent company whose assets are transferred pursuant to a pre-pack, although the current Loan Market Association form of intercreditor agreement provides for the release of debt claims in the event of distressed disposals.

Local court recognition

CVAs and administrations should be recognised in the jurisdiction of the subject company in accordance with the EC Insolvency Regulation. The UNCITRAL Model Law (implemented in the UK as the Cross Border Insolvency Regulations) enables foreign insolvency practitioners to be recognised by local courts and provides access to a separate set of remedies to the EC Insolvency Regulation. The Model Law shares some of the features of the EC Insolvency Regulation (e.g. the use of COMI which, in the recent UK case *In the matter of Stanford International Bank Ltd*, was held to be subject to the same test as that which applied under the EC Insolvency Regulation). In the recent case of *Re Phoenix Kapitaldienst* the English court held that, in circumstances where the usual cross-border gateways are not available, it was open to the UK court to grant recognition to a foreign administrator at common law and for that administrator to exercise all of the rights and powers of an Insolvency Practitioner appointed under UK domestic legislation, notwithstanding that such remedies would not have been available to the administrator in his home state. It should be noted, however, that this finding was highly fact-specific involving allegations of fraud against the company.

Schemes are governed by the Companies Act 2006, rather than the Insolvency Act 1986 (which governs administrations and CVAs). The English court will consider a scheme in relation to an overseas company if the company meets the criteria set out in s.221 of the Insolvency Act 1986. In practice, this will principally require that a 'sufficient connection' with England can be demonstrated. Given that the EC Insolvency Regulation does not apply to schemes, recognition of a scheme by a non-UK court will fall under EC Regulation 44/2001, which deals generally with jurisdiction and the recognition and enforcement of judgments in civil and commercial matters between EC states.

Notable recent UK restructurings

Hellas II The court sanctioned a restructuring through an administration and pre-pack.

IMO Carwash In sanctioning a restructuring by way of scheme, the court confirmed that a scheme could exclude junior layers of debt with no economic interest.

La Seda de Barcelona The English court accepted jurisdiction for the purposes of implementing a scheme proposed by a Spanish company.

Re Rodenstock The court held that the EC Insolvency Regulation did not restrict or exclude the English court's traditional jurisdiction in relation to the sanctioning of schemes of arrangements concerning solvent companies.

Re Uniq plc Where the scheme forms an integral part of a wider restructuring, it is possible to look beyond the terms of the scheme itself to ascertain whether it constitutes a genuine compromise or arrangement between the company and its creditors.

Cortefeil The court held it had scheme jurisdiction over a Spanish company and a Luxembourg company on the basis that the proposed scheme was to amend and extend the terms of a single, English law governed senior facility agreement which contained an English jurisdiction provision.

Seat Pagine Gialle Where the court sanctioned a scheme by an Italian company.

In the recent restructuring of La Seda de Barcelona, the English court accepted jurisdiction for the purpose of approving a scheme because the Spanish company had significant subsidiary operations and a branch in the UK. The English courts have also held in the recent cases of Tele Colombus, Primacom and Seat Pagine Gialle that sufficient connection to the English jurisdiction will be established where the scheme relates to English governed finance documentation containing English jurisdiction clauses, notwithstanding the fact that none of the foreign registered company's creditors may be domiciled in the UK.

However, whilst a company need not have its COMI in England and Wales for the purpose of jurisdiction for a scheme, it would have to do so where the restructuring process also includes an administration.

A recent decision of the German Court of Appeals (OLG Celle) in Equitable Life held that a scheme was not to be recognised in relation to German policyholders as it did not constitute a 'judgment' pursuant to EC Regulation 44/2001. This decision has been upheld on appeal (albeit on more limited insurance specific grounds) and in another recent case, whilst the German Regional Court of Potsdam 2 O 501/07 was prepared to categorise a scheme as falling within EC Regulation 44/2001, it then declined to recognise the scheme on other grounds. It is, therefore, important to note that schemes relating to assets outside the UK may not always be recognised.

How we can help

Travers Smith has a range of experience advising investors, corporates and creditors in relation to a spectrum of UK distressed and restructuring scenarios. Recent transactions have included acting as advisers to:

- Blacks Leisure Group plc in relation to its CVA in 2009 and KPMG as administrators in selling the Blacks and Millets businesses to JD Sports in January 2012.
- Clinton Cards PLC in relation to its administration.
- the Bank of England and BDO on the bank liquidation of Southsea Mortgage and Investment Company Limited, the first use of the UK "bank insolvency procedure".
- Acertec Group on its debt restructuring and the compromise of its pension scheme liabilities.

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Important: This note is intended to provide a brief overview of the criteria for commencing restructuring procedures in England and an introduction to English restructuring mechanisms. It does not constitute legal advice and you are recommended to obtain specific specialist advice in each particular situation.

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