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UK Debt Restructuring Techniques

In this article we consider the key potential elements of a debt restructuring in England. Generally speaking, a restructuring will be needed where the existing equity and debt capital structure is broken. The operating business is also likely to be underperforming and in need of an operational turnaround. The business may need fresh capital, as well as some relief in respect of its current debt burden. Without remedial action, the business may be facing insolvency.

INTRODUCTION

Ideally a solution will be agreed and implemented consensually. However, this may not be practical, especially if there are multiple stakeholders, with competing interests and differing agendas.

English law provides a number of tools which can be used (or which can credibly be threatened) to enable a restructuring to be achieved. They are:

- amendment mechanisms in existing finance documents;
- release mechanisms in intercreditor documentation;
- administration (including pre-packaged disposals of businesses, assets or shares);
- shift of an overseas company's centre of main interests ("**COMI**") to England;
- scheme of arrangement; and
- company voluntary arrangement ("**CVA**").

The key point to note is that there is no "one size fits all" solution – a debt restructuring could include one or more (conceivably all) of such techniques. But every case is different. It is also vital to understand that the restructuring tools mentioned above are methods of implementing a commercial deal; they are not an end in themselves. Moreover, some of these processes can be cumbersome and expensive, and their suitability should be assessed on a case-by-case basis.

One of the first steps in any proposed restructuring, from a legal perspective, is to understand fully the existing capital structure – in particular which entities within a group of companies owes which types of liabilities and to which type(s) of creditor, as well as understanding which companies own which assets and how the various liabilities rank, contractually and/or structurally.

As a general rule, in a modern restructuring, there is a presumption that, given the potential damage to the business and the possible termination of key contracts or licences, operating companies should be kept out of any formal restructuring process (except, perhaps, a CVA) and that any necessary surgery should take place only at the holding company level.

Please note that the information in this document is intended to be of a general nature and is not a substitute for detailed legal advice.

BACKGROUND CONCEPTS AND ISSUES TO KEEP UNDER REVIEW WHILST NEGOTIATING AND IMPLEMENTING A RESTRUCTURING

When considering the options of stakeholders in the context of a debt restructuring, then, in addition to understanding the current capital structure (and taking account of other deal specific factors, for example, tax, pensions and regulation), there are some key concepts to keep in mind. They are:

- Subordination/Ranking;
- "Value Break";
- Moratorium;
- Debt Trading;
- The role of the Security Agent;
- Issues affecting Listed Companies; and
- "COMI".

We shall look at each of these in turn.

Subordination/Ranking

An understanding of the current ranking of creditor claims is vital in designing a restructuring.

Broadly speaking, secured claims will rank ahead of unsecured claims in the event of insolvency or enforcement of security, in each case as regards the application of the proceeds of realisation of the assets which are subject to the security (subject to certain preferred claims and expenses where the security is not "fixed" security).

In addition, transactions comprising secured debt will typically be governed by an intercreditor agreement pursuant to which the various classes of secured creditors (e.g. senior, second lien and mezzanine) and core unsecured creditors (such as intra group lenders and, possibly, bondholders) agree contractually on the ranking of payments and on rules for the enforcement of security. Intercreditor agreements commonly follow the form of templates published by the Loan Market Association ("**LMA**").

In addition to, or as an alternative to, contractual subordination, a creditor's claim may be "structurally subordinated". This applies, for example, where such creditor's claim is owed by a holding company of an operating subsidiary. In that case the creditor's claim is structurally subordinated to the claims of the subsidiary's direct creditors, unless the subsidiary has given the creditor of the holding company a guarantee (the holding company creditor will still have an indirect, but potentially limited, claim against the subsidiary in circumstances where the holding company is, in its own right, a creditor of the subsidiary).

Where does the value "break"?

At the outset of any restructuring, lenders and other stakeholders will analyse the outstanding debt alongside the value remaining in the business, to determine where the value "breaks" taking into account the rankings of the respective liabilities. Valuations will help determine the amount of debt that can realistically be repaid and there are often disputes as to the most appropriate valuation methodology. In practice, there might well be a marketing and sale process in parallel with restructuring discussions.

In a simple debt structure comprising a senior and a junior tranche, the value might "break" in the junior tranche. In such a case, the restructuring might be centred on a compromise of the junior debt, with the senior debt remaining largely untouched. If, however, the company's problems are very serious, such that the value "breaks" in the senior debt, the holders of the junior debt are likely to have no economic interest in the outcome and the restructuring would be centred on a compromise of the senior debt, with the junior debt either eliminated or made redundant as a result of changes to the structure.

However some deals will comprise multiple layers of debt instruments or tranches, ranking one after the other. In such cases, the issue quickly becomes one of which tranche should the restructuring be centred on, with successive classes of debt jostling for position. Assuming the equity owner(s) are no longer in a position to support the business, it would be open to the most junior debt tranche to make a proposal to the more senior debt tranches to refinance them and provide fresh capital to the company (effectively purchasing the company for the total of the full value of the more senior tranches, plus the amount of new capital to be injected). In the absence of such a proposal, the restructuring would centre on the next most senior creditor. The business would effectively be up for sale; it would come down to the creditor class which is prepared to pay the most for the company. Alternatively the business may be sold to a third party following a sales process, which could offer creditors better returns than following a restructuring.

Moratorium

Stability during the course of negotiations will be key to achieving a successful restructuring. Of the English law restructuring tools available, only administration provides a legal moratorium against creditor action, although the court may agree to stay particular proceedings whilst a scheme of arrangement is promoted. A moratorium may also be available whilst a CVA is promoted, but only in relation to "small" companies. In general, this means that in practice, in order to avoid legal or insolvency proceedings, ordinary unsecured creditors of the operating companies will continue to be paid in full whilst restructuring negotiations continue.

Stability can also be maintained, at least for a period, at the holding company level through the way the finance documents usually work. Acceleration and enforcement of security in respect of senior debt in a multi lender situation in the leveraged loan market usually requires action by a Facility Agent and Security Agent, acting on the instructions of the "Majority Lenders", being more than 66⅔ per cent. of the lenders by value where there is a continuing event of default; as such, lenders holding at least one third of the senior debt by value can block any proposed acceleration or security enforcement, although care needs to be taken to avoid a non-payment event of default, as insolvency proceedings could be initiated by any single senior lender, based on its own unpaid debt. Acceleration or security enforcement by mezzanine lenders again needs an instruction from the majority mezzanine lenders (usually more than 66⅔ per cent. by value), but is also subject to further restrictions in the intercreditor agreement for the benefit of the senior lenders.

In the high yield bond market the thresholds are usually lower for acceleration (25 per cent.) and enforcement (50.1 per cent.).

The general position regarding creditor action may also be extended in practice by means of deal specific forbearance or standstill agreements. There will often be a need for waivers of defaults whilst restructuring negotiations continue; even if a majority lender instruction to accelerate appears unlikely, the existence of a default may need to be waived in order to avoid causing a "cross-default" under other finance documents.

Debt Trading

It is a regular feature of a debt restructuring that debt held by creditors, in all parts of the capital structure, will be sold to incoming debt investors, who may either wish to further trade the debt at a profit as events unfold, or to build up a strategic stake which might be used to influence the terms of a restructuring and, possibly, converted into an ownership interest. The ability to trade can provide an exit for an unwilling existing lender and an investment opportunity for another investor. Debt trading does however affect the dynamics of any proposed restructuring, as the composition of the creditor constituencies fluctuate from time to time. In particular, a par lender may be concerned primarily with trying to recover its loan in full, whereas a sub-par lender will have bought into the capital structure with a view to making more money.

Role of the Security Agent

Whilst guarantees and borrowing obligations are usually owed or given directly to the lenders, security is often granted in favour of a Security Agent (or Security Trustee), to be held on trust for the financial creditors (such as the senior, hedging and mezzanine creditors). As we shall see below, in order to give effect to a restructuring, the Security Agent may be instructed to enforce such security and/or use its powers under the intercreditor agreement to release parts of the Group from certain liabilities in connection with the enforcement of security or a "distressed disposal". The Security Agent will be concerned to ensure it does not incur liability by doing so, and will want to minimise the extent to which it may have to exercise any discretion (which might be open to challenge). Intercreditor agreements will usually contain extensive exclusions of liability and indemnities in favour of the Security Agent, but, as a practical matter, it will be important to ensure at an early stage that the Security Agent (advised by separate counsel) will co-operate with the restructuring process.

Listed Companies

Naturally, listed companies are subject to additional and stringent requirements on disclosure and approvals, amongst other things, and this can add an additional layer of complexity when dealing with restructurings of listed companies.

In particular, a listed company is obliged to disclose inside information that directly concerns it as soon as possible via a Regulatory Information Service (RIS). Inside information is information that is precise, has not been made public or generally available, relates directly or indirectly to the company and, if made public, would be likely to have a significant effect on the price of the company's financial instruments. A listed company, as its restructuring evolves, may be required to release information to the market on an ongoing basis. Such disclosures may of course exacerbate the company's financial difficulties and challenges, particularly if the information scares employees and suppliers, possibly leading to defections of key staff and an increased working capital requirement if suppliers tighten their trading terms. There are some (limited) exceptions where a company might be permitted to delay making disclosure, in particular around negotiations with creditors – but not the fact of financial difficulty or worsening financial condition. Conversely, listed companies need to be careful not to overstate the severity of financial difficulties (e.g. to help negotiation with landlords).

Persons in possession of inside information are prohibited, again, subject to limited exceptions, from dealing with, or encouraging others to deal with, price affected securities. "Insider dealing", as this is known, is a criminal offence under the Criminal Justice Act 1993 and is mirrored under the civil offences of market abuse.

Investors who trade in debt are very concerned to avoid having inside information which could restrict their ability to trade their debt. They will often, therefore, be keen that the company issue announcements, thereby "cleansing" the information they may have. Again, having to make such disclosures may make the company's financial position more difficult.

As part of any restructuring a listed company will have to consider whether the transaction(s) is/are sufficiently substantial to require shareholder approval. The Listing Rules set out a series of tests (known as "class tests") which should be complied with before effecting any relevant transaction. Depending on the nature and size of a transaction, different requirements must be complied with; some might require just an announcement, others a full shareholder approval. The AIM Rules are more flexible but still need to be checked for additional disclosure requirements. This can, against what may be a challenging timetable, cause additional delay, and this should be factored into the planning process.

COMI

In designing a restructuring, it will be important to understand where a company's COMI (or centre of main interests) is. COMI is a term that describes the jurisdiction with which a company is most closely associated for the purposes of cross-border insolvency law. The term is used in the Regulation on Insolvency Proceedings (EC) 1346/2000 (the "**Insolvency Regulation**") and the UNCITRAL Model Law on Cross-Border Insolvency (the "**Model Law**"). The Insolvency Regulation uses the concept of COMI to determine which insolvency procedure takes precedence if competing insolvency procedures are commenced in different member states, and to ensure recognition and co-operation for those proceedings. The Model Law uses the concept of COMI to determine the degree to which the courts of one jurisdiction are obliged to recognise and assist insolvency proceedings commenced in a different jurisdiction. COMI is not defined in the Insolvency Regulation or the Model Law, although the preamble to the Insolvency Regulation states that it should correspond to the place where the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties. There is a rebuttable presumption that a company's COMI is the location of its registered office.

A company's COMI is malleable, and it has become increasingly common for debtors to effect a COMI "shift" or "migration" to utilise insolvency procedures and tools in other jurisdictions that are not available to them in their home jurisdiction. The English courts and advisors practising insolvency and restructuring law in England, in particular, have benefitted from this trend (see below regarding schemes and foreign companies). A COMI shift could, it seems, be achieved by a company moving its head office functions, notifying all of the suppliers, creditors and counterparties of the move, moving bank accounts, and holding board meetings in the target member state. In some cases, even minor connections with the UK have proved sufficient. However, given the practicalities involved in shifting a COMI, a COMI shift is in practice generally limited to holding companies.

If an administration proceeding or CVA (company voluntary arrangement – see below) is needed to implement a restructuring, or for the recognition of a restructuring, it will be important that the relevant company's COMI is, or is moved to be, in England.

A company's COMI may not, in and of itself, need to be in England in order to do a scheme of arrangement (see below) but there may nonetheless be good reasons why it may be desirable that the COMI is, or is moved to be, in England.

DIRECTORS' DUTIES AND AVOIDANCE OF ANTECEDENT TRANSACTIONS

In addition, consideration should be given to some of the legal risks to avoid, which could otherwise result in criminal and civil liability for key individuals and may also result in the subsequent invalidity of core elements of the restructuring transaction:

- Directors' duties; and
- Avoidance of antecedent transactions.

Directors; general duties

The directors of an English company are subject to a number of statutory duties (codified in section 171 – 177 Companies Act 2006). The Companies Act 2006 ("**CA 2006**") duties include the requirement for a director to act within his powers, to promote the success of the company and to avoid conflicts of interest. However additional duties and responsibilities apply to the directors of a company in financial difficulties.

Duty to creditors

Section 172 CA 2006 states that the duty to promote the success of the company has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interest of creditors of the company. In effect, this means that where the company is insolvent the directors' primary duty is to act in the best interests of the company's creditors, not its shareholders. This perspective shift is critically important. Unless directors appreciate this point and act accordingly they are at risk of breaching the duties that apply to them in a distress situation.

Who is a "director"? These legal duties apply to all directors of the distressed company. This means (i) formally-appointed directors (including non-executive directors); (ii) "de facto directors"; and (iii) "shadow directors". A "de facto director" is someone who claims to be a director, acts as a director and is held out by the company as being a director, notwithstanding that he has not been formally appointed. A "shadow director" is someone in accordance with whose directions or instructions the directors of the company are accustomed to act. However, if advice is given to the directors by an adviser in a professional capacity, that alone will not make the adviser a shadow director. The shadow director concept extends the wrongful trading and disqualification provisions (discussed below) to those who "pull the strings" of a company's board. For instance, shadow directorship can arise where a parent company dominates and directs the operations of a subsidiary which regularly carries out the requirements of the parent; both the parent and the directors of the parent could be shadow directors of the subsidiary. Alternatively, where an investor dictates what actions the investee company's board should take and the board complies on a regular basis, that investor is likely to be a shadow director.

Misfeasance and malpractice

Section 212 of the Insolvency Act 1986 ("**IA 1986**") provides that the court may order an officer of a company or anyone else who has been involved in the promotion, formation or management of the company to repay, restore or account for money or other property of the company (with interest) or to make a compensation payment if such a person has misapplied, retained or become accountable for any money or property of the company, or been guilty of misfeasance or breach of any fiduciary or other duty to the company. Matters which could be treated as breach of duty would include the directors' involvement in a company granting a preference or entering into a transaction at an undervalue (see below).

Wrongful trading

Sections 214 and 246ZB IA 1986 also provide that the court may make an order in relation to wrongful trading, so that a director or former director of a company in insolvent liquidation or insolvent administration is liable to make such contributions as the court thinks proper to the company's assets. Before any order is made the court must be satisfied that the director or former director was a director of the company at some time before the winding up or administration commenced when he knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration. "Insolvent liquidation" or "insolvent administration" in this context means the company going into liquidation or administration (as applicable) when its assets are insufficient for the payment of its debts, other liabilities and the expenses of the winding up or administration (as applicable) (in other words, in each case, balance sheet insolvency, taking into account contingent and prospective liabilities). Cashflow insolvency does not of itself mean that a company is wrongfully trading. It may however call into question whether the company has a reasonable prospect of ultimately avoiding a balance sheet insolvent liquidation or insolvent administration.

Fraudulent trading

If any business of the company is carried on with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, anyone knowingly a party to the carrying on of the business in this manner commits the criminal offence of fraudulent trading (section 213 IA 1986). The offence applies whether or not the company is in the course of being wound up. The sanction is imprisonment or a fine, or both. In addition, if the company is wound up, or enters administration, any party to fraudulent trading can be made personally liable to make such contributions (if any) to the company's assets as the court thinks proper. The administrator or liquidator of the company may make an application to the court for such an order.

Only directors or shadow directors and former directors or shadow directors can incur liability under the wrongful trading provisions, whereas any party to fraudulent trading can be made liable under IA 1986.

It has been established by case law that fraudulent trading can arise when directors of a company incur credit when they know there is no good reason for thinking that funds will be available to repay the debt when it becomes due or shortly thereafter. No such intent is required to prove wrongful trading. It has been held that one single transaction may constitute fraudulent trading and the provision may apply even if there is only one defrauded creditor provided that the fraud was perpetrated in the ordinary course of business.

The standard of proof required to make a person liable for fraudulent trading is significantly higher than that required for wrongful trading. If the directors avoid taking credit when they believe that the debt which would be incurred will not be paid when it is due (or shortly thereafter) they should avoid liability for fraudulent trading. An important protection for the directors is to ensure that proper advice is obtained and all options are considered at board meetings (and minuted) in order to identify correctly the best course of action and to provide the evidence that the directors have acted in satisfaction of the objective standards required of them.

Other considerations

Pursuant to the Company Directors Disqualification Act 1986, a person may be disqualified from being a director of any company for up to 15 years. IA 1986 also includes restrictions on a director being involved in a company which re-uses the name of an insolvent company of which he/she was previously a director.

Implications for a restructuring

In the light of the duties of the directors, the directors should, in principle, support and seek to assist attempts by the company's stakeholders to progress any restructuring proposal which would enhance the company's prospects of avoiding an insolvent liquidation or administration, or, failing which, would minimise the potential loss to the company's creditors. The directors should regularly monitor and minute the progress of the proposed restructuring. Equally, stakeholders should be conscious that aggressive or ill thought out action (or inaction) on the part of the stakeholders could put the directors in a difficult position and jeopardise their ability to safely continue to progress a restructuring outside of an insolvency process.

Avoidance of Antecedent Transactions

Certain transactions may be set aside by a liquidator or administrator so care should be taken when negotiating a restructuring to avoid or minimise the risk of successful challenge to transactions intended to implement the restructuring.

Of the restructuring tools referred to in this note, only a transaction by an administrator is exempt from possible avoidance (as such, for example, a transaction entered into pursuant to a scheme of arrangement or CVA is not automatically exempt).

A "**transaction at an undervalue**", such as the grant of security or a guarantee, is a transaction entered into for no consideration or for consideration that is significantly less than the consideration provided by the company. Under section 238 IA 1986, a liquidator or administrator can apply to the court for an order restoring the position to that which it would have been in the absence of such a transaction. It is a defence to a claim if the company entered into the transaction in good faith for the purpose of carrying on the business of the company, and there were reasonable grounds for believing that the transaction would benefit the company.

A company grants a "**preference**" (under section 239 IA 1986) where it does something, or allows something to be done, that puts a creditor, surety or guarantor in a better position than it would otherwise have been in if the company went into insolvent liquidation. This could be the case if a company granted security for an existing debt. However the court will only make an order restoring the position to what it would have been if the company was influenced by a desire to put that other person in that better position. This desire to prefer is presumed where the parties are "connected" (as defined in IA 1986).

In addition, certain **floating charges** will also be invalid under section 245 IA 1986, except to the extent of any valuable consideration (being money, goods or services supplied; or a discharge or reduction of any debt or interest). No application to court is required.

The court will not make any order unless, at the time of entering into the transaction at an undervalue, making the preference or granting the floating charge, the company was unable to pay its debts, or became unable to pay its debts as a consequence of the transaction (except in the case of a floating charge made with a connected person). Inability to pay debts is presumed in the case of a transaction at an undervalue in favour of a connected party.

There are time limits on the availability of these remedies. The relevant "hardening periods" prior to the onset of administration or liquidation for the above heads of challenge vary depending on whether the counterparty is a "connected" person (as defined in IA 1986):

IA 1986 →	S238 Undervalue	S239 Preference	S245 Floating charges
Connected person	2 years	2 years	2 years
Not connected	2 years	6 months	1 year

Under section 244 IA 1986, within three years of the transaction an administrator or a liquidator may apply to the court to set aside an extortionate credit transaction, meaning a transaction including terms requiring grossly exorbitant payments to be made in respect of the provision of credit or otherwise grossly contravening ordinary principles of fair dealing. Further, under section 423 IA 1986 a liquidator, administrator or a "victim" of the transaction, may challenge any transaction that is entered into at an undervalue where the purpose of making the transaction was to put assets beyond the reach of a person who is making or may make a claim against the company.

The Financial Collateral Arrangements (No. 2) Regulations 2003 dis-apply certain insolvency challenge risks and the moratorium on enforcement of security in administration in relation to security over financial instruments, credit claims (including claims for repayment of money to and loans made by credit institutions) and cash.

AMENDMENT MECHANISMS IN DEBT DOCUMENTATION

Lender consent thresholds

As mentioned above, ideally a restructuring can be agreed and implemented consensually by the parties amending existing documentation and/or entering into new documentation. In some cases this will require unanimity; in others a majority or super majority approval will suffice.

Accordingly, early in the restructuring process, it will be important to review the company's principal debt documents in order to determine the consents required for actions contemplated. English law governed syndicated loans will typically follow the form of templates published by the LMA, which envisage varying levels of lender consent for amendments and waivers to the loan documentation. Without the approval of lenders (who will usually be the main creditors of the company and have the benefit of security), restructuring will be impractical. Consent threshold requirements will depend on what types of changes need to be made.

When a borrower experiences financial difficulties, a breach of financial covenant ratios (tested quarterly in the case of "maintenance" covenants) will typically be one of the early warning signs for lenders. Unless the borrower is permitted to "cure" a ratio breach (e.g., by equity investors injecting more capital), this will trigger an "event of default" under loan documentation, giving the majority lenders the opportunity to vote to instruct the facility agent to accelerate the debt. In practice it will usually result in a dialogue between borrower and lenders as to amendments required to the terms of the loan.

A borrower will often seek to "amend and extend" an existing facility agreement in order to avoid a forthcoming maturity of its debt, which would otherwise result in a more painful restructuring process. To achieve this, a borrower would typically seek to extend the maturity of some or all of its existing loans, coupled with additional concessions such as a change to the amortisation profile of the loans or more lenient financial covenant ratio tests. This essentially buys time for the company and makes it easier to service its debt in the short term. In a transaction where the existing facilities benefit from upstream and cross-stream guarantees and security from borrowers and guarantors (possibly incorporated in different jurisdictions, meaning that security is subject to a range of governing laws and rules relating to hardening periods), lenders may prefer to keep the existing facilities agreement in place, whilst amending or confirming the existing security and guarantee package with the aim of extending the security and guarantees to cover the amended loan. This may be preferable to taking new security in the context of a wholesale refinancing.

In exchange for agreeing to amend the loan documentation, lenders will wish to see improved terms, additional fees and an increased "margin" (the key component of a floating interest rate). Consent solicitations will be necessary in order to implement such changes.

LMA-style facilities will envisage different consent thresholds, depending on the nature of the waivers and amendments requested. The default position will be that finance documents may be amended or waived only with the consent of "Majority Lenders" (typically, lenders whose commitments aggregate more than 66⅔ per cent. of the total commitments). However the loan document will also itemise matters which will require the consent of all lenders (e.g. items such as extension to a payment date, reduction of the margin or a change in currency of payment) or of a "Super Majority" such as 85 or 90 per cent. (e.g. items such as the release of guarantees and security outside agreed parameters).

In the high yield market, decisions other than modification of key commercial terms will often require a 50.1 per cent. majority, with all remaining decisions, for example, to extend maturity or to write off part of a debt, often requiring a 90 per cent. majority.

If all lender or super majority lender consent is not practical, such changes may be implemented through a scheme of arrangement or (if the debt is unsecured) a CVA (see below).

A credible threat to achieve the amendments through a scheme of arrangement or CVA (see below) may be sufficient to persuade minority lenders to agree to support the changes.

Structural adjustment

Increasingly, a "structural adjustment" clause will allow changes to the structure and size of the loan facilities which would otherwise require all lender consent to be made instead with the consent of (i) all the "affected" lenders plus (ii) a specified majority (sometimes a "super majority" of, say, 85 per cent.) of all the lenders. The LMA structural adjustment clause contains three categories of structural adjustment, allowing the commercial parties to specify different consent thresholds for each category:

- Major Structural Adjustment: an alteration to the facilities, or the insertion of a new facility, where the size of the facilities is increased (subject to an optional cap) or where the currency of a facility or of an amount payable is changed;

- Minor Structural Adjustment: an alteration to the facilities, or insertion of a new facility, which does not result in an increase in the size of the facilities or a change in currency of a facility or of an amount payable; and

- Payables Reduction: an amendment which results in the extension of a payment date or a reduction in any amount payable.

Structural adjustment provisions can be particularly relevant if a syndicate contains a significant number of lenders which are CLOs (collateralised loan obligations; debt securities in the form of bonds or notes which are funded by and secured over a portfolio of loans). CLOs will often be constrained by their constitutions from investing "new money" after the end of their investment periods. It may only therefore be possible for a CLO to participate in an amendment to an existing facility (via a "cashless roll"), rather than in a new facility.

Where it is not possible to achieve the consent of all relevant lenders, sometimes lead banks will purchase and resell loan positions to front the necessary consents to be given.

Snooze and lose

A loan syndicate may comprise a large number of lenders by the time a restructuring is contemplated, which can result in logistical challenges in the handling of consent solicitations. An "Excluded Commitments" clause in a loan agreement (often referred to as "snooze and lose") provides that if a lender fails to respond to a request for a consent, waiver or amendment within a specified time-frame it will not be taken into account in calculating whether the requisite consent level has been reached. This means that lenders actively involved in the voting process are not unduly affected by the inaction of passive investors.

Yank the bank

Another commonly used provision (often referred to as "yank the bank") comes into play when "all lender" or "super majority lender" consent is required. For instance, if unanimous lender consent is required for an amendment, if a high threshold of consents (typically 85 or 90 per cent. of the total commitments) has been achieved, but unanimous lender consent has not been achieved, this clause permits the borrower to replace a dissenting lender. This provision may make it easier for a borrower to meet the necessary lender consent thresholds. However, yank the bank clauses typically only allow the borrower to force a transfer to a replacement lender at par value. This may be unrealistic in a distressed scenario, when the borrower's debt is likely to be trading in the secondary market at substantially below par.

Indeed, as mentioned above there is an active market for distressed debt, with funds buying up debt either to exploit perceived mispricing opportunities, or in order to become actively involved in the restructuring process, in an attempt to create value by strategically influencing decision making.

INTERCREDITOR RELEASE MECHANISMS

Distressed disposals

In order to maximise returns for creditors, the Security Agent will be authorised to release transaction security and other claims against relevant entities in the borrower group when disposals are made in distressed circumstances (i.e. in an enforcement scenario).

The guarantee and security release mechanism is one of the most important provisions for prior ranking creditors. The LMA precedent intercreditor agreement envisages various enforcement scenarios. Commonly, rather than selling individual assets, it will be more efficient (and value may be better preserved) if group companies are sold in their entirety, by way of share sale, free of liabilities under the finance documents. In order to achieve this, in the case of a distressed disposal of shares of a member of the borrower group, the Security Agent will have express powers to release the relevant entities and their subsidiaries from liabilities under the finance documents (including borrowing liabilities, guarantees and security) and from the claims of intra-group lenders and other subordinated creditors.

Such release provisions are essential where senior creditors enforce share security and dispose of the business as a going concern (rather than upon an asset sale). If subordinated creditors were to have continuing claims (e.g. under guarantees) against group companies after a disposal of those companies to a third party, the value of the business on disposal would effectively be reduced by the amount of those subordinated claims, giving the subordinated creditors a de facto right of veto over any such disposal.

Fair value

All stakeholders will have an interest in ensuring that enforcement proceeds are maximised. Subordinated creditors will only receive the excess of the enforcement proceeds that are not applied in satisfying prior ranking claims. Consequently they will often seek contractual protections to prevent the disposal of companies or other assets by the prior ranking secured creditors at too low a price. Under English law, secured creditors are, in any event, under a duty to obtain the best price reasonably obtainable in the circumstances. However, many deals will involve assets in other jurisdictions which apply different tests relating to fair value. Furthermore, the applicable principles of law in any given scenario may only be determined at the time the security is being enforced. To achieve greater certainty for all parties, under the LMA precedent intercreditor agreement the Security Agent will also be subject to an express requirement to take care to obtain a fair market price (or value) in the prevailing market conditions when making a distressed disposal. This requirement may be satisfied, for instance, if (i) the disposal is made pursuant to a court-sanctioned process; (ii) the disposal is effected by (or at the instruction of) an insolvency officer; (iii) the disposal is made pursuant to an auction or similar competitive sales process; or (iv) a financial adviser delivers an opinion that the proceeds received in connection with the disposal are fair in the circumstances. The LMA intercreditor agreement states that this obligation does not oblige the senior creditor or Security Agent to postpone the disposal in order to achieve a higher price (or value).

Cash and non-cash consideration

In adverse market conditions, making a prompt disposal for cash consideration may be impractical or may not represent the best long term value for secured creditors. Since 2012, the LMA intercreditor agreement template has provided a framework to enable the Security Agent to accept non-cash consideration for disposals of assets on enforcement. The valuation of any such non-cash consideration (and the level of liabilities discharged upon a distribution of non-cash consideration to creditors) is determined by an independent financial adviser. Key decisions (such as to whether to instruct the Security Agent to accept non-cash consideration, whether to realise it for cash prior to distribution to creditors and the appointment of any financial adviser to carry out such a valuation) are taken by a specified majority of the then most senior ranking creditors. A mechanism may be included to allow the Security Agent to hold non-cash consideration (and to realise it for cash) for creditors for whom it is illegal (or otherwise contrary to their constitution) to accept non-cash consideration. The Security Agent has an overriding right to decline to accept non-cash consideration, or to immediately realise for cash any non-cash consideration that it has received, if it has reasonable grounds for believing that accepting, or continuing to hold, the non-cash consideration would have an adverse effect on it.

PRE-PACKAGED ADMINISTRATION

Administration

Administration is procedure under IA 1986 where a company may be reorganised or its assets realised under the protection of a statutory moratorium. A company may be put into administration by court order or by an out-of-court procedure available to the company itself, its directors or the holder of a qualifying floating charge. Broadly, the aim of administration is to facilitate the survival of companies which are in financial difficulties. It is also a method of enforcement by secured creditors.

There are a number of reasons why an administration may form part of a restructuring:

- The value may "break" in the senior debt and, for whatever reason, the junior debt owed by the company which owns the assets cannot be eliminated or compromised, at all or on acceptable terms. As such, those assets may need to be transferred to a new company which might be owned by some or all of the senior creditors, or by a third party (or a combination). Administration is a very effective means to deliver such change of ownership;

- A sale by an administrator will also insulate the directors and the purchaser against the deal being subsequently challenged as a transaction at an undervalue (see above), because the "relevant time" for the review of such transactions ends upon appointment of the administrator (section 240(3) IA 1986);

- As mentioned above, the mechanism in the intercreditor agreement for the release of borrowing, guarantee and other liabilities normally only applies where there is a "distressed disposal", which could include a sale by a company in an administration. Moreover, under usual intercreditor documentation, a sale at the instruction of an insolvency officer would satisfy the "fair value" requirement of the release mechanics;

- An administrator has certain powers to sell assets free of existing security (see below), which may be useful if for any reason it is not possible or practicable for the Security Agent to release such security; and

- The appointment of an administrator may facilitate the obtaining of recognition in certain jurisdictions of an English scheme of arrangement.

Pre-pack sales

A pre-pack is an expedited sale process whereby an "administrator in waiting", having concluded that the purposes of the administration are best served by selling some or all of the business and assets of a distressed company, negotiates with potential buyers and agrees a sale prior to the company going into administration. Once the company goes into administration, the sale assets are purchased by the buyer immediately thereafter. A pre-pack will often be used where there is an absence of funding (e.g. to continue to trade the business in administration). Given that marketing and selling a business is rarely quick or straightforward, a pre-pack offers a viable option where no funding is available for a conventional administration process or where delay would likely damage value/increase claims. In this vein, a pre-pack offers an efficient transfer of business without an erosion in confidence caused by a lengthy insolvency process and, as such, is likely to preserve a company's goodwill.

Sometimes a pre-pack will involve a sale of part only of the assets of the company. However, sale of the business and assets of the company as a going concern will, where it is possible, tend to fetch a higher price than the sale of assets on a break-up basis. More commonly, therefore, the "sale" will occur at holding company level, in order to minimise the impact of the transaction on operating companies. A pre-pack will reduce the liabilities of the company. A pre-pack sale can be structured so that nominal value is attributed to the assets of the company, but the purchaser agrees to take on certain liabilities going forward (such as employee liabilities and continuing contractual obligations).

Administrators ability to sell free of security

An administrator has the ability to sell the assets of a company subject to a floating charge free of security (paragraph 70(1), Sch B1, IA 1986). The court may authorise the administrator to dispose of other charged property (paragraph 71(1)).

Advantages of pre-packs

Pre-packs can facilitate a quick and relatively smooth transfer of a business compared to a normal administration. A pre-pack can also avoid the time and expense of dealing with unsecured creditors. This can reduce the costs of the administration process, which ultimately results in a better return for creditors. Pre-packs can also minimise the erosion of supplier, customer and employee confidence that is inevitably caused by insolvency proceedings. Pre-packs can save more jobs than a normal administration. Employees may feel uneasy at the thought of an administration or liquidation and as such could leave their jobs (which could have catastrophic consequences for small companies with small workforces). In the case of a pre-pack, this risk is reduced.

Criticisms of pre-packs

Nevertheless there is a perceived lack of transparency and accountability in respect of pre-packs. Unsecured creditors may have been expected to lose out in any event but often feel prejudiced by a pre-pack because they do not have the opportunity to protect their interests (unlike secured creditors who will be aware of the administrator's appointment and whose consent is required for the transfer of assets subject to fixed security). Case law has confirmed that although an administrator is generally obliged to convene a meeting of creditors within 10 weeks following his appointment for the purpose of enabling creditors to vote on his proposals, the administrator may dispose of the business and assets of the company in advance of this meeting and without the need for direction from the court.

Whilst a pre-pack would not be effective if it became public knowledge that the business was on the brink of insolvency and up for sale (as this would give rise to problems with customers, suppliers, employees and goodwill), the speed of the process limits the marketing period, which may prevent the maximum price being obtained.

Administrator's duties

An administrator must perform his/her functions in accordance with the following objectives which are ranked in order of priority:

- rescuing the company as a going concern; or
- achieving a better result for the company's creditors as a whole than on a winding up; or
- realising property in order to make a distribution to secured or preferential creditors.

Therefore, the first priority for an administrator is the rescue of the company and it is only if this objective is not reasonably practicable that the administrator can consider purposes (ii) and then (iii). When a pre-pack is to be used, it is likely that the objective will be either (ii) or (iii), as the main purpose of a pre-pack is to extract value from the business and achieve the best outcome for creditors.

When contemplating a sale, the administrator must be mindful of his duty to take reasonable care to obtain a proper price. As a result the administrator will usually seek expert advice on the value of the company's assets. A valuation will help protect the office-holder from subsequent claims that he has not achieved a proper price. This is particularly important in the context of a pre-pack sale, as the office-holder will not have been able to expose the business to the market.

As a consequence of criticisms of pre-packs, highlighted above, the Insolvency Service issued Statement of Insolvency Practice 16 ("**SIP 16**"). SIP 16 is not legally binding, but failure to comply may lead to disciplinary action against an insolvency practitioner. Administrators are now obliged to justify and provide a detailed explanation of why a pre-pack is effected, and what attempts at marketing were made before pursuing the pre-pack strategy. A failure to obtain proper valuation advice and to have regard to the matters in SIP 16 may provide grounds for a potential claim. The Insolvency Service commissioned an independent review of pre-packs in 2013 (the Graham review), as a result of which an amended SIP 16 took effect recently on 1 November 2015.

Perhaps the most significant changes are in the Appendix to the SIP 16, which now lists the "marketing essentials" that an administrator is obliged to consider to ensure he gets the best available consideration on a pre-pack sale. These include:

- **Broadcast:** ensuring that the business is marketed as widely as possible;
- **Justify the strategy:** explaining the marketing and media strategy in the statement to creditors;
- **Independence:** being satisfied as to the adequacy and independence of the marketing strategy, especially where the business is marketed by the company before his appointment;
- **Publicise rather than simply publish:** marketing should be for an appropriate length of time (with creditors informed as to the reasoning behind the timing);
- **Connectivity:** including online media; and

- **Comply or explain:** justify how the marketing strategy has achieved the best outcome for creditors as a whole, especially in sales to connected parties.

In addition, the revised SIP 16 requires the administrator to:

- obtain an independent valuation of the business or, failing that, provide a compelling explanation of why and how he was satisfied as to the value of the assets; and

- deliver a report to creditors no later than seven days following the pre-pack summarising the valuation (and its underlying rationale) and providing detailed information relating to the pre-pack transaction itself, including any divergence from the "marketing essentials", disclosure of the commercial deal and how the consideration has been allocated across asset classes and security interests.

The revised SIP 16 stresses the high level of interest the public and the business community have in pre-pack sales in administration and introduces a new option for connected parties considering a pre-pack purchase to approach a pool of experts with a view of seeking an independent opinion on the proposed sale, thereby enhancing stakeholder confidence in the transaction.

As discussed above, directors also risk liability for wrongful trading when a company is in the zone of insolvency. Directors of a company who are involved in a pre-pack need to ensure that they do everything they can to minimise loss to creditors. Directors should take independent legal advice, especially if they will acquire an interest in the company's business or its assets through the pre-pack.

Where a pre-pack in an administration is contemplated in connection with, but not forming part of, a scheme of arrangement, the administrators must nonetheless exercise their discretion in deciding whether or not to enter into the pre-pack. The fact that, as is likely, entry into the pre-pack is a condition precedent to the effectiveness of the scheme will be a highly relevant factor is exercising that discretions.

COMI requirement and COMI shift

In certain circumstances, the court has jurisdiction to appoint an administrator to a foreign company which means that pre-packs may be a viable option for overseas companies. In order for a foreign company to be put into administration, it will be necessary to show that the insolvent company's COMI is in the UK. By way of example, in the case of *Hellas Telecommunications (Luxembourg) II SCA* the English court decided that the COMI of the company had been effectively transferred from Luxembourg to England to take advantage of an English law administration and pre-pack sale. The COMI moved to England despite the fact that the company's registered office remained in Luxembourg. In order to decide where the COMI was located the court took into consideration the following facts: a new head office was opened in London; the company notified its creditors that it had relocated to England and there was a press release to that effect; it had an active bank account in London; Hellas II was registered at Companies House as a foreign company and as a UK establishment of an overseas company; all negotiations between the company and its creditors were conducted in London; and the company's senior creditors were prepared to approve a pre-pack sale following an English administration order.

Security Enforcement

As an alternative to administration, the Security Agent may itself enforce security, for example, by selling or appropriating shares pursuant to share charges or pledges.

SCHEME OF ARRANGEMENT

What is a scheme of arrangement?

A scheme of arrangement (or "**scheme**") is a statutory procedure under Part 26 of CA 2006 which allows a company to reach an arrangement or compromise with its members and/or creditors (or any class or classes of them)[1]. A scheme could be a compromise or arrangement about anything, subject to certain limits. Insolvency is not a pre-requisite for a scheme. A scheme will bind each class of members and/or creditors irrespective of whether they voted in favour of the scheme, provided the requisite majority of such class of members or creditors approves the scheme and the scheme is sanctioned by the court. A scheme is the only procedure available under English law that enables secured creditor claims to be compromised without their consent (i.e. a cram down). A scheme can be a "member scheme" (affecting shareholders' interests) or a "creditor scheme" (affecting creditors' interests), or a combination of the two (either in a consolidated scheme or by linked (and co-dependent) schemes). Not all creditors have to be made subject to the scheme. The court will sanction a scheme that excludes persons if it can be shown there were commercial reasons for doing so. For example, a company might wish to leave trade creditors' claims unvaried to provide continuity of operations and trading.

A scheme of arrangement can be used, with or without other techniques, to implement a debt restructuring.

It should be noted that many of the reported decisions relating to creditor schemes of arrangement are first instance decisions and ones where the applications were not opposed. It is possible, therefore, that an appeal court might take a different view – for example in relation to the jurisdiction to sanction a scheme in respect of an overseas company or in relation to fees or other incentives offered in order to encourage creditors to support a scheme (see below).

An "arrangement" or "compromise"

There is no statutory definition of "arrangement" or "compromise", but an "arrangement" has been said to have a wider meaning than "compromise" (the ordinary commercial meaning of which is the settlement of a dispute). The court has said that for there to be "compromise" or "arrangement" in the context of a scheme, the scheme must include some element of commercial give and take on each side. The court will refuse to sanction a scheme that removes a creditor's rights without consideration.

Initiating a scheme

Any of the following persons can initiate a scheme:

- the company itself;
- any creditor of the company;
- any member of the company;
- if the company is being wound up, the liquidator of the company; or
- if the company is in administration, the administrator of the company.

Practically (and subject to limited exceptions), if the company does not propose the scheme, it will have to be a party to and support the scheme.

Uses of a scheme

A scheme can be used to:

[1] CA 2006, s.895(1)

- release or compromise secured and unsecured debt or change its ranking;
- effect group reorganisations (*MyTravel Group Plc, Re*)
- effect an amend and extend (*Cortefiel*);
- remove minority share interests;
- effect a share issue;
- effect a debt for equity swap (*Seat, Le Seda de Barcelona, Global Investment House KSC*);
- introduce a new debt tranche or liquidity generally;
- impose a moratorium;
- transfer businesses and assets and/or shares to a new structure (which may be controlled by the existing lenders (a "lender-led pre-pack") (*IMO CarWash*);
- effect changes to finance documents;
- imitate a liquidation distribution (without the company entering an insolvency process) (for example, *Enron Capital & Trade Resources Limited*); and
- deal with contingent and/or unknown or unquantified liabilities (*Re Hawk Insurance Company Limited CA, Re Equitable Life Assurance Society* and *Re Sovereign Marine and General Insurance Co Ltd and other companies*).

Some examples of what a scheme cannot do

- remove a party's rights for no consideration;
- deal with proprietary claims for trust property (where the beneficiary is not a "creditor"); and
- (generally) require creditors to advance new money or indemnify other creditors which provide new money or guarantees (although the point was left open in *Re Apcoa Parking Holdings GmbH and others* as to whether a rollover of existing facilities could be sanctioned).

Most importantly, junior creditors or shareholders will not be bound by a scheme unless they agree or are in a class which has voted in favour of the scheme by the requisite majority. If they are not bound by the scheme, the senior creditors may consider it necessary to move the operating companies or their relevant holding companies out of the existing corporate structure and remove the junior creditors' claims, guarantees and security, using a security enforcement and intercreditor release (see above).

Procedure

Outline

Once the person proposing the scheme has settled its terms (see further below) the next step is to obtain approval. In broad terms, the process is as follows:

- Application to court for permission to convene meeting(s) of creditors and/or members;
- Approval by the required majorities of creditors and/or members; and
- Application to court for sanction.

Commercial deal

A scheme is typically heavily "front-loaded". Before embarking on a scheme in earnest, the person(s) proposing that scheme must, in consultation with the company's key stakeholders, finalise the scheme's terms, consider and determine the proper class composition, and produce draft documentation.

Those stakeholder(s) who hold security and/or have a priority on an enforcement (i.e. those above the "value break") are likely to lead negotiations. The question of the value of a business will, in all probability, be a contentious point and the value (or perceived value) of the business is in any event likely to move during negotiations as the business continues to trade. Creditors below the value break are not necessarily disenfranchised. Those who control the minority vote may be capable of blocking a scheme.

That said, there is the possibility of excluding creditors with "no economic interest", provided compelling evidence can be produced that those persons really are "out of the money". Any uncertainty could trigger challenges to the scheme, and so valuation is absolutely key.

Valuation is usually on a "forced sale" basis (this assumes that this is the only alternative to a scheme) so that members/creditors have a ready comparator. It is however usually advisable to have a second valuation prepared on a "going concern" basis which would help to establish, beyond reasonable doubt, where the value break is and which stakeholders have an economic interest and can therefore vote in the scheme. David Richards J acknowledged the importance of using the correct comparator in *Re T&N Ltd (No. 3)*:

"*In considering the rights of creditors which are to be affected by the scheme it is essential to identify the correct comparator… where the scheme is proposed as an alternative to an insolvent liquidation, it is their rights as creditors in an insolvent liquidation of the company… Those rights may be very different from the creditors' rights against a company which is solvent and will continue in business. In the latter case the creditors' rights against the company as a continuing entity will be the appropriate comparator*."

In the past, the court, when trying to ascertain value break, has looked at trading of the relevant debt in the secondary market. Where this is below par, this is indicative of actual value. The court might also infer, where an intercreditor agreement affords junior creditors the right to buy senior debt, and the junior creditors choose not to exercise that option, that the senior debt must be impaired.

In practice, there may also be a market testing exercise in order to generate offers for the business thereby establishing value.

Letter to creditors

In a creditor scheme it is usual to notify creditors affected by the scheme of, among other things, the composition of any meeting(s). This is encouraged by the Practice Statement (Companies: Scheme of Arrangement) [2002] 3 All ER 96. The issue of the letter is not mandatory, but if the person proposing the scheme does not do so it may be prejudiced later in the process if a fairness issue arises. The court has indicated that issues which may arise as to the constitution or conduct of meetings should be raised at the convening hearing. Disaffected creditors can raise such issues at the sanction hearing, but the court will expect them to show good reason why they did not raise them at an earlier stage (for example, because they did not receive the issues letter).

Convening hearing

Proceedings are initiated by the issue of a Part 8 claim form in the Companies Court. The claim form must be supported by a witness statement, including statutory information, about the company and the terms of the proposed compromise or arrangement. The claim form should seek:

- directions that meeting(s) of members and/or creditors be convened, or both as required;

- the court's sanction of the compromise or arrangement, if it is approved at the meeting(s) and a direction for a further hearing for that purpose; and
- a direction that the claimant files with the court a copy of the report by the chairman of each court-convened meeting.

The witness statement should contain all the relevant facts, including the rationale for the scheme, the proposed location of meetings, the various classes of shareholders or creditors that are to be involved, and any required advertisements. An advanced draft of the scheme's explanatory statement (see below) is usually attached as an exhibit.

Following the hearing the court may order that the meeting(s) be convened, and appoint someone to act as chairman of such meeting(s) and direct them to report the result to the court. It will also direct that any necessary advertisements are made and that the explanatory statement is circulated to creditors and members (as relevant).

The general practice of the court is to require at least 21 days' notice of the creditor meeting(s), and the same notice period as is required for any general meeting of the company for the member meeting(s) (unless members consent to short notice).

Explanatory statement and notice

The creditors and members (as relevant) in each respective class must be sent an explanatory statement explaining the effect of the scheme and disclosing material interests of the company's directors and how the scheme will affect those interests. The explanatory statement is circulated with the notice summoning the relevant court meetings for each respective class.

Class meetings

The scheme is subject to approval at the meeting(s). Approval by each class of creditors and members (as relevant) constituted by both a majority in number and a majority representing 75 per cent. in value of the relevant class of persons present in person or by proxy.

Sanction hearing

At the sanction hearing the court will consider, among other things, whether:

- the various statutory requirements have been complied with;
- the classes were properly identified (although, the court will be loath to dismiss a scheme at the sanction hearing based on composition of classes if those issues had been considered at the convening hearing);
- each class was fairly represented and the statutory majority was acting bona fide in the interests of the class; and
- that the terms of scheme are fair (such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve the scheme).

If a sanction order is made and delivered to the Registrar of Companies it becomes binding on the creditors, members (as the case may be), liquidator, administrator and the company itself. The granting of a sanction order is not merely a "rubber stamping" exercise, but is entirely within the discretion of the court.

Composition of classes

CA 2006 does not provide any guidance on the composition of classes, and so reference must be made to case law. The classic test, set out in *Sovereign Life Assurance Co. v Dodd*, is that a class:

"*must be confined to 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*".

This means that, where the rights of creditors are not sufficiently similar, it will be necessary to have separate meetings for each particular class. A helpful starting point when determining class composition might be to consider what the order of distribution might be on an enforcement. This however may not be determinative if, for example, the appropriate value comparator is a solvent outcome.

By way of example, on a pre-pack scheme, the classes, might be:

- senior secured debt;
- junior secured debt (second lien and mezzanine debt);
- loan note secured debt; and
- unsecured debt.

A member of a class may have a collateral interest that distinguishes it from other members of the same class (for example, because that creditor is also a shareholder). This will not necessarily prevent that creditor from voting in that class (the test looks only at the rights of the creditor before the scheme and how those rights are varied by the scheme), but this may be relevant when the court comes to exercise its discretion to sanction the scheme. In *Re Jax Marine Pty Ltd* Street J noted:

"*Quite frequently it is necessary to discount, even to the point of discarding from consideration, the vote of a creditor who, although a member of the class, may have such personal or special interest as to render his view a self-centred view rather than a class-promoting view*."

Lock-up agreements and fees

A scheme can take months (or years) to formulate, launch and implement. A lock-up agreement can be used to effect a short-term waiver or forbearance of rights to give the company time to implement a scheme, and could require the counterparties to support the scheme (assuming there is no material dilution in the commercial terms offered to them). A fee might be offered as part of a lock up agreement to incentivise creditors to sign up. The court has, so far, upheld the validity of such fees, and said that such fees did not create disparate classes on the basis that the fee had been paid to some and not others. This also assumes that such fees are not a "materially significant amount".

Schemes and foreign companies

The court has the power to sanction a scheme in relation to a "company". A "company" means "any company liable to be wound up under the Insolvency Act 1986". This includes companies formed and registered under CA 2006 and, subject to the following issues, foreign companies. The English courts have in recent years been increasingly called upon to consider whether they should sanction a scheme proposed by a foreign company. Companies that have been schemed include companies from Austria, Bahrain, Belgium, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Kuwait, Luxembourg, Netherlands, Norway, Poland, Singapore, Spain, US (New York and Delaware) and Vietnam.

For a company to be "liable wound up under the Insolvency Act 1986" it merely has to be the 'sort of company' which is capable of being wound up under IA 1986 (if, hypothetically, it was insolvent and if, hypothetically, its COMI was in England).

The English court though will not wind up a company where it has no legitimate interest in doing so. To establish the 'legitimate interest' necessary to assume jurisdiction, the court has established three guidelines for the making of a winding up order in respect of a foreign company, namely whether:

- there is a sufficiently close connection with England;
- there is a reasonable possibility of benefit accruing to creditors from the making of the winding up order; and
- one or more persons interested in the distribution of assets are persons over whom the English court could exercise jurisdiction.

Sufficiently close connection will ordinarily mean that the company has an establishment or place of business or its COMI in England, but sufficient connection has also been found on the basis of an English law governed finance documents (even in circumstances where the governing law of a company's finance documents was changed for the purposes of facilitating an English scheme).

Concerns have latterly arisen regarding the effect of European legislation, namely the Insolvency Regulation and Council Regulation (EC) 44/2001 (now replaced by Regulation (EU) 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast)) on the recognition and enforcement of foreign judgments in civil and commercial matters (the "**Judgments Regulation**") on the court's ability to sanction schemes in respect of foreign companies.

Insolvency Regulation: Article 3 of the Insolvency Regulation gives jurisdiction to open insolvency proceedings in respect of a company to the courts of the Member State in which the company has its COMI or, in respect of territorial or secondary proceedings, to the courts of the Member State where the company has an establishment. An "insolvency proceeding" is a proceeding listed in the Annexes to the Insolvency Regulation and include "a winding up subject to the supervision of the courts". It has been argued that a company is not therefore "liable to be wound up" in a Member State other than the Member State in which the company has its COMI or an establishment.

Judgments Regulation: The Judgments Regulations provides that a person must be sued in the Member State in which they are domiciled (Article 2(1) (and Article 2(1) as recast) of the Judgments Regulation). Further, the Judgments Regulation excludes from its scope "bankruptcy proceedings relating to the winding up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings" (Article 1(2)(b) (and Article 1(2)(b) as recast) of the Judgments Regulation). The Judgments Regulation gives exclusive jurisdiction to the courts of the Member State in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies" (Article 22(2) (and Article 24(2) as recast) of the Judgments Regulation).

In *Rodenstock*, the court held that solvent companies fall within the scope of the Judgments Regulation (there remains some doubt about schemes taking place within the framework of a formal insolvency to which the Insolvency Regulation applies). Briggs J held that the Judgments Regulation and the Insolvency Regulation were "intended to dovetail almost completely with each other", and therefore that the bankruptcy exclusion in the Judgments Regulation extended only to those procedures detailed in the Annexes to the Insolvency Regulation. Schemes are not listed in those Annexes, and therefore, at least as regards solvent companies, schemes are subject to and should be recognised in other Member States (as a civil and commercial matter) under the Judgments Regulation.

If schemes (at least solvent ones) are within the ambit of the Judgments Regulation, the issue arises as to the basis on which the English courts can assume jurisdiction for a scheme for foreign companies, particularly in light of Article 2(1) of the Judgments Regulation. The English courts have interpreted the reference to the person to be sued as referring to the scheme creditors, and not to the company. In *Primacom Holding GmbH and others v Credit Agricole and others*, none of the scheme creditors were domiciled in the UK but the court found that it had jurisdiction on a number of bases. The basis the court favoured most was that schemes are not adversarial processes. Accordingly no person was being "sued" and it therefore followed that the requirements of Article 2 were irrelevant. In *Re Magyar Telecom BV*, the court, as an alternative, concluded that Article 6(1) (now recast in Article 8) of the Judgments Regulation, which provides that a person domiciled in a member state could be sued, where he was one of a number of defendants, in the courts of the place where any of the defendants was domiciled, provided the claims were so closely connected that it was expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings, would apply to provide a further exception to the principle that a person should be sued in the jurisdiction where he was domiciled. This approach was followed in *Re Zlomrex International Finance* and in *Re Van Gansewinkel Groep BV and others*.

Whilst it is accepted that the Insolvency Regulation and the Judgments Regulation have, at least to some extent, narrowed the English courts' jurisdiction to wind up certain overseas companies, that has not affected the English courts' scheme jurisdiction. "Liable to be wound up" is merely a touchstone, and is not the same as "could, here and now, actually be wound up". The essential question, in determining scheme (as supposed to winding up) jurisdiction, is simply whether the company is the "sort of company" which is technically capable of being wound-up, if certain transient circumstances, like its financial position and location of its COMI, were different. Certain circumstances, such as the potential existence of insolvency, which might otherwise trigger the Insolvency Regulation or the Judgments Regulation being engaged, ought to be disregarded in this analysis.

Of course, it is important if the scheme is to be effective that it is recognised in the country where the company is incorporated and/or where its creditors and/or assets are based. The English court will not exercise its discretion to sanction a scheme if there is evidence that the scheme will not be recognised and/or enforced overseas. Practice has been to obtain expert evidence from foreign lawyers, so that the court can be satisfied that there is a reasonable prospect that the relevant foreign court(s) will recognise and enforce the scheme to deliver the desired outcomes.

As we have seen above, there may be deal specific reasons why a scheme should be combined with an administration, in which case, COMI would need to be moved to England.

Potential issues

Third party releases

Problems may arise where a scheme contemplates a business sale for non-cash consideration (for example, where the purchaser assumes liabilities instead). Sometimes (and in particular in pre 2012 LMA intercreditor agreements), security documents will only provide for a release on a sale for cash consideration or as part of a formal enforcement process. The Security Agent, on a syndicated deal, may be reluctant to provide a release in any other circumstances. Hold-out creditors may put pressure on the Security Agent to maintain that position.

Guarantees

Where shares are being transferred, care should be taken to ascertain whether any of the target group has granted guarantees for liabilities that are not being compromised in the scheme. This may be a particular issue if not all senior debts are being assumed, and there are hold-out lenders and, for whatever reason, the release mechanics in the intercreditor agreement are inadequate or cannot be used. Guarantees given by subsidiaries of the target company might also prove problematic if those companies are not also subject to the scheme and/or a linked scheme.

Equalisation and loss sharing

Finance documents typically include equalisation or loss sharing provisions. Care should be taken that payments made pursuant to the scheme are not subject to those provisions.

Validity of security

On a pre-pack scheme inevitably new security will be put in place. Such security (which will replace the existing (and, presumably, hardened) security already in place) is likely to include a floating charge. Typically, the lenders will also be shareholders, and therefore will be "connected" persons for the purposes of IA 1986. To the extent the lenders are not providing "new money" (because the consideration is non-cash) that floating charge might be subject to challenge under section 245 IA 1986 (see above).

Commercially sensitive terms

As part of the scheme process all key documents (including amended and/or new finance documents) will have to be made available for inspection. Thought would have to be given to whether there are any sensitivities about, for example, financial covenants, existing operations or business plans. It is possible to make the application to court in confidence to ensure that the filing of the application does not result in an immediate leak of information.

Scheme Documentation

Scheme Documents require careful drafting, with considerable input from counsel. In a complex case, they should set out clearly the restructuring steps and provide a framework for the entry into substantive finance and corporate documentation which will implement such steps. Clearly the contents will vary on a deal specific basis, but the following items would commonly be included:

- definitions – in particular "Scheme Claims", "Scheme Creditors" and "Effective Date";
- restrictions on debt trading pending effectiveness of the scheme;
- amendments to existing finance documents;
- execution of an agreed form "Restructuring Agreement";
- authorisation to execute, and undertaking to be bound by, the implementation documents;
- allocation/reallocation of consideration;
- compromise of scheme claims;
- instructions to existing Facility Agent and Security Agent;
- scheme creditor and scheme company undertakings (including moratorium and release of claims against individuals and agents);
- appointment of a representative to seek recognition/enforcement in other jurisdictions;
- modification;
- notices;
- governing law.

The Restructuring Agreement will effect the substantive restructuring steps and will exhibit agreed (negotiated) forms of, among other things, debt novations, debt assumptions, new facilities agreements, new intercreditor agreement, notices and instructions to Facility Agents and Security Agents, CP satisfaction notices, share transfers, security documents, etc. (as applicable).

Unitranche

There is a question, as yet unresolved, as to whether an "agreement between lenders" entered into as part of a unitranche facility, and its creation of 'first in, first out' creditors thereunder, could create separate classes of creditors for the purposes of a scheme, notwithstanding that the debtor is not a party to the agreement between lenders? The alternative is that all unitranche creditors form a single class.

Scheme of Arrangement as "Plan B"

As will be apparent from the above, promoting and implementing a scheme of arrangement can be cumbersome and expensive and (as a result of the sanction process) involves at least some execution risk. As such, it could make commercial sense, within reason, to "sweeten" the economic terms of a restructuring to persuade stakeholders to agree to approve the implement the restructuring voluntarily. In a large or complex case this may simply not be practicable however.

COMPANY VOLUNTARY ARRANGEMENT

What is a CVA?

A CVA is a procedure intended to assist a company in financial difficulties. It is a contract between a company and its creditors. A CVA allows a company to agree a "compromise or arrangement" with its creditors in satisfaction of some, or all, of its debts. A CVA is implemented under Part 1 of IA 1986. Its scope and potential utility is more narrow than that of a scheme. In particular, a CVA cannot compromise secured claims without the secured creditor's consent. A CVA is implemented under the supervision of an insolvency practitioner. The insolvency practitioner is known as the "nominee" before the CVA is approved, and the "supervisor" thereafter. While a CVA is implemented under the supervision of an insolvency practitioner and is a procedure under IA 1986, there is no statutory requirement that the company be insolvent or unable to pay its debts. Commonly, however, companies implementing CVAs are distressed or insolvent.

A CVA (unlike a scheme) cannot bind secured or preferential creditors without their consent[2].

Moratorium

The implementation of a CVA does not result in a statutory moratorium. However, it is possible for certain smaller companies to receive the benefit of a 28-day moratorium if they meet certain requirements[3]. A moratorium for other companies can only be achieved if a CVA is combined with an administration (referred to in this context as a "wrapper"), where the moratorium is therefore effected by virtue of the administration, and the company exits the administration into a CVA.

Initiating a CVA

The directors, the administrator or the liquidator of a company may make a proposal to the company and its creditors for a composition or scheme. Neither creditors nor shareholders have standing to propose a CVA[4]. The CVA process begins with the preparation by the directors of a proposal and a statement of affairs containing details of the company's creditors, debts, liabilities and assets.

Consideration of the proposal by the nominee, preparation of the nominee's report and the summoning of meetings

Where the nominee is not a liquidator or an administrator, the nominee will consider the proposal and, within 28 days (or such longer period as the court will allow) of being given notice of the proposal, submit his report to the court. If the nominee recommends to the court that a meeting of shareholders and creditors be held, he may then go ahead and call the meeting. If the nominee is the liquidator or administrator, he/she may simply summon a meeting of shareholders and creditors at any time and place he thinks fit, without the prior need to refer to the court.

[2] Section 4(3) IA 1986
[3] Section 1A IA 1986
[4] Section 1 IA 1986

Announcement of the CVA and notice

The person who calls the creditors' meeting must summon every creditor of the company whose claim and address he is aware of. Notices are to be sent to the creditors at least 14 days before the meeting (excluding the day of sending the notice and the day of the meeting).

"Burning Platform"

Market practice has developed to the effect that when promoting a CVA, the company must be subject to a "burning platform", such that its financial position is so serious that if the CVA is not approved, the company will have to enter liquidation or administration. Examples of a "burning platform" would include financial covenant breaches, accompanied by a standstill pending a restructuring through a CVA, with the secured creditors being in a position to enforce if the CVA is not approved.

Contents of a CVA

Rather like a scheme, the CVA document will be deal specific, subject to the inclusion of a number of items required by statute. By way of example, a number of CVAs in the last few years have sought to compromise landlords' claims. In the case of *Blacks Leisure*, Blacks was struggling under the cost of its store portfolio; specifically there were a large number of underperforming stores. Many of these had been closed but the rent still had to be paid. The main terms of the CVA were:

- the CVA compromised the claims of 101 closed premises landlords and 9 landlords who held guarantees from the parent company. These creditors had a claim for a distribution from a £7.25m fund; and

- the CVA varied the terms of 291 open premises leases from quarterly to monthly rent, service charge and insurance payments for 18 months.

Meetings

The creditors and the shareholders of the company will vote at their respective meetings and decide whether or not to approve the proposal with or without modifications. The nominee will usually be appointed as chairman of the meetings.

To be effective, a CVA requires the approval of the requisite majorities of the creditors and shareholders, being:

- in the case of creditors, a majority in excess of 75 per cent. in value of a company's creditors present in person or by proxy and voting at a meeting to approve the CVA (the resolution will however be invalid if those creditors voting against it include more than half in value of unconnected creditors present in person or by proxy and voting)[5]; and

- in the case of shareholders, more than 50 per cent. in value of the company's shareholders present in person or by proxy and voting at a meeting on the resolution to approve the CVA.

The CVA takes effect if approved at both the creditors' and the shareholders' meetings. If there is a difference of decision between the creditors and the shareholders, the decision of the creditors will prevail, subject to any order of the court. Once the CVA is approved, it binds all the company's unsecured creditors who were entitled to vote at the meeting (regardless of whether or not they voted) or would have been so entitled had they received notice of the meeting.

Challenge

A CVA can be challenged if:

[5] Rule 1.19(3) of the Insolvency Rules 1986

- it unfairly prejudices the interests of a creditor; or
- there has been some material irregularity at or in relation to the meetings called to approve the company voluntary arrangement[6].

Any challenge must be made by a creditor within 28 days[7] of the meeting of creditors or, if the creditor was not given notice of the relevant meeting of creditors, such application must be made within 28 days of the creditor becoming aware that the relevant creditors' meeting had taken place.

This "cooling off" period means that, in practice, at least certain parts of the CVA (and, for example, other documents, such as new financing document, the effectiveness of which depends on the CVA becoming fully effective) will not become unconditional until such period has expired and any challenges have been dealt with or regarded as without merit.

CVAs are recognised in Member States under the Insolvency Regulation. This means that a CVA is afforded automatic recognition in other Member States. Note that, unlike a scheme, a CVA cannot be used in a country that is not a Member State if the CVA is to be a main proceeding, as a CVA cannot be a secondary proceeding.

Material irregularity

There is case-law to the effect that to constitute a material irregularity, the irregularity must be such as to possibly have affected the outcome of the meeting. This could arise from, by example, the valuation placed on creditor claims (see *Re Newlands (Seafood) Educational Trust*).

Unfair prejudice

In assessing unfairness, a number of techniques are used, including the "vertical" and "horizontal" comparisons. A vertical comparison is a comparison between the creditor's entitlement in the CVA and in a hypothetical liquidation. The return in the CVA should exceed the return in the hypothetical liquidation. A horizontal comparison is a comparison between the position of the applicant and the other creditors. Different treatment of creditors is a relevant factor, but will not necessarily render a CVA unfairly prejudicial. It may be possible to justify differential treatment.

In *Prudential Assurance Co Ltd v PRG Powerhouse Ltd*, guarantees given to certain creditors by the parent company of the company in a CVA were made ineffective without anything in return, such that these creditors were in no better position than similar creditors who enjoyed no guarantee. The court held that this was unfairly prejudicial.

In *Mourant & Co Trustees Ltd v Sixty UK Ltd (In Administration)* the facts were similar, save that some compensation was offered to the creditors with the benefit of a guarantee. Despite this, the court found that the CVA was unfairly prejudicial on the ground that, among other things, it was difficult or impossible to determine what sum would adequately compensate the affected creditors for the loss of their guarantees, and, in the absence of compelling justification, those creditors should not be forced to accept the sum offered in the CVA which was based on numerous assumptions which may or may not have been well founded.

Arguably, a CVA can benefit a company's secured creditors and its shareholders and those unsecured creditors whose claims are not compromised, all at the expense of those unsecured creditors whose claims are compromised. In order to minimise the risk of successful challenge on the grounds of unfair prejudice, some CVAs have also included arrangements (for example warrants or similar instruments) by which compromised creditors can share in any "equity upside". Also, insolvency practitioners are keen to encourage a high level of support for the CVA amongst creditors whose claims are compromised and, we understand, sometimes choose

[6] Section 6 IA 1986
[7] Section 6(3) IA 1986

to also hold class meetings of the compromised creditors in order to evidence such support and to minimise the risk of successful challenge.

CONCLUSION

English law provides a number of techniques for restructuring the debts of a company, which may assist in achieving a solution where there is financial distress. It is important to bear in mind, however, that there is no "one size fits all solution", and every case is different.

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