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1. Market Panorama

1.1 Market Dynamics

In the period since 2014, the volume of insolvencies in England & Wales has shown a steady decline and this is consistent with the trend since the end of the financial crisis in 2011. According to the UK Insolvency Service Statistics, the number of companies entering into an insolvency process in 2015 totalled 14,629, which was 10% lower than the total in 2014 and the lowest annual total since 1989. However, at the time of writing, the total for Q1 2016 had increased for the first time in the equivalent period since Q1 2014 to 3,694.

In the 12 months ending Q4 2015, the top five sectors with the highest number of new company insolvencies were as follows: construction, wholesale and retail trade; motor vehicle repair and motorcycles; administrative and support service activities; accommodation and food service activities and, lastly, manufacturing. This has been a consistent theme and according to the UK Insolvency Service Statistics, these five sectors have had the highest number of insolvencies each quarter since the 12 months ending Q1 2012.

Although the oil and gas sector has not dominated the insolvency and restructuring landscape by reference to the actual number of cases, some of the most high profile and largest cases have occurred in this sector. This is not surprising given that oil and gas companies and oil services businesses have been so adversely impacted by the unprecedented fall in oil price since the end of 2014. In Q1 2015, EY in its analysis of profit warning issued by UK quoted companies noted that the FTSE Oil & Gas Producers sector had the greatest number of companies issuing profit warnings amongst all quoted companies.

Oil and gas producers in the North Sea such as Enquest plc and Afren plc, an African lifter, were pushed to seek covenant relaxations and support for restructuring proposals respectively, with the latter eventually being put into administration in July 2015 after failing to solicit shareholders’ support for its proposed scheme. Other North Sea firms like First Oil and Iona Energy also resorted to administration amid price and cost-cutting pressure.

As pricing pressure intensified and affected the supply chain, the oilfield services subsector inevitably became another casualty of the wider market malaise. In 2015, the FTSE oil equipment, services and distribution companies topped the profits-warning charts with half of the companies in the sector issuing a profit warning, which was the highest of any FTSE sector according to the EY analysis of profit warnings issued by UK quoted companies for Q4 2015. This has translated into a number of difficult and protracted restructurings of oil services and companies in the UK.

The impact of the declining oil price was initially softened by the low interest rate environment that dominated the credit markets and the benefits of the tail of commodity hedging that benefited players in the sector, but as the sector experi-
enced continuing difficulties, the UK government responded by introducing tax concessions for the North Sea Oil Industry in its 2016 Budget by: (i) reducing the additional rate of corporation tax that North Sea companies pay from 20% to 10% and (ii) cutting petroleum revenue tax that applies to oilfields developed before 1996, to zero. This may be insufficient as the costs of decommissioning may well start to have an impact with the result that more North Sea firms transition into distress.

A further legal and regulatory development that has started to have an impact on the UK's restructuring and insolvency landscape has been the New Living Wage (NLW) which was implemented on 1 April 2016. This is predicted to elevate restructuring and insolvency levels in the short term, particularly in the residential care sector and in other services businesses. Under the new legislation, workers over the age of 25 are entitled to a minimum wage of GBP7.20 per hour (which represents an 11% increase from minimum wage rates). From 2020, this will increase to GBP9 per hour and the NLW is also predicted to hit other sectors with a high labour-to-sale ratio, such as the retail sector. Research conducted by Begbies Traynor (Red Flag Alert Research: Q1 2016) indicates a 20% increase in UK companies most exposed to the NLW ending the first quarter of 2016 being in a state of ‘significant’ financial distress, compared to Q1 2015, retail companies account for 44.6% of the overall increase. Accordingly, the NLW is likely to cause a further deterioration of the financial condition of these retail companies. Reliance on increased consumer spending to confront the challenge may not be viable as disposable income growth is expected to fall – from 2.7% in 2016 to 1.7% in 2017 (Source: EY Analysis of profit warning issued by UK quoted companies (Q1 2016)).

With specific reference to residential care homes, where staff costs on average account for 60% of the cost base, the rise in operating costs as aggravated by the NLW, coupled with the continual payment cuts from local government budgets as part of the UK’s austerity measures, has already had a significant impact on the sector. Insolvencies increased in the sector in Q1 and Q2 and a number of larger groups such as Four Seasons Healthcare have been brought back to the restructuring table, whilst others such as Elli investments have had their bonds downgraded to CCC as a result of the group recently reporting a GBP264m pre-tax loss for the year of 2015, which resulted in the chairman admitting that the company is once again engaging in discussions on solutions for its debt and capital structure after its last restructuring in 2013.

Exchange rates in a sustained period of Sterling’s weakness have also had an impact on the UK restructuring market. Corporates with high dollar denominated costs without appropriate dollar hedging have experienced a decline in performance and in order to avoid any flirtation with a covenant breach in their banking facilities. Certain affected corporates such as Cobham plc have undertaken rights’ issues with the intention of strengthening their balance sheets, reducing gearing and increasing liquidity.

With respect to the UK distressed investing market, there has been a notable influx of funds with a commodities and oil and gas investment mandate. Debtwire’s survey with predominantly UK hedge fund managers, long-only investors and prop desk traders in the final quarter of 2015 highlighted a substantial increase in distressed investing and debt restructuring, with 78% of the respondents anticipating an increase in high yield-related restructurings in the forthcoming 18 months (Source: Debtwire: European Distressed Debt Market Outlook 2016 (January 2016)). Unsurprisingly, the oil and gas sector (94%) is expected to offer the highest number of restructuring opportunities in 2016 with most profitable opportunities coming from the oil services subsector. In terms of investments in distressed debt, 84% of the respondents increased asset allocation to distressed investing in 2015, up from 75% in 2014. Most of them (61%) expect further increase in their distressed allocation in 2016. These investors had a mean capital allocation of 28% to distressed debt in 2015, and they are seeing a rise to 31% in 2016, just 4% per cent less than the most popular investment option – “primary high-yield bond market”

As to distressed M&A activities, the price fall in a number of sectors is likely to incentivise consolidation amongst market players in the oilfield services sector, thereby triggering distressed M&A activity. A survey conducted with senior-level executives from corporates and private equity firms in the UK oilfield services sector shows that 86% of them expect global oilfield services M&A activity to increase over the next 12 months, with 30% expecting a significant increase. (Source: Mergermarket & Pinsent Masons, Ahead of the curve: Challenge and opportunity in the global oilfield services industry, 18 Feb 2016).

At the time of going to press the UK has voted to leave the European Union. This decision immediately resulted in considerable upheaval in the currency markets with a 31-year low against the dollar. This is likely to result in rising fuel prices and more expensive financing for many UK corporates. Post Brexit, the view of most market commentators is that the inherent uncertainty and absence of any contingency planning is likely to erode confidence, disrupt the economy and reduce both UK growth and GDP, thereby increasing the prospect of UK recession and increased restructuring activity. Time will tell whether a political solution can be found to minimise the considerable risks to the UK economy.

An EU Referendum on 23rd June saw the United Kingdom vote to leave the European Union (EU). At the time of going to press the country was navigating both political uncertain-
ty and market instability as a result of the vote. The outcome in London, Scotland and Northern Ireland was notably at odds with that in England and Wales, with the former voting to remain in the EU and raising the prospect of division within the United Kingdom.

2. Debt Trading

2.1 Limitations on Non-Banks and Foreign Institutions

With respect to authorisations under English law, a distinction must be made between the trading of bonds and other debt securities. In relation to debt securities, an authorisation from the UK's Financial Conduct Authority is required on the following basis:

- Financial Services and Markets Act 2000 ("FSMA") s.19(1) generally prohibits carrying on a “regulated activity” in the United Kingdom without either being authorised or exempted;
- FSMA s.22(1) defines a “regulated activity” as an activity that is of a specified kind, which is carried on by way of business and related to an investment of a specified kind;
- FSMA (Regulated Activities) Order 2001 (SI 2001/544, “the RAO”), Part II lists such activities:
  - (a) It includes, in Article 14, “buying, selling, subscribing for or underwriting securities or contractually based investments or offering or agreeing to do so, either as a principal.”
  - (b) Article 21 of the RAO includes “buying, selling, subscribing for or underwriting securities… as agent” as a specified activity.
  - (c) Article 25 further includes “making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a particular investment which is [inter alia] a security….”
  - (d) Article 3 of the RAO defines “security” and its plural as “any investment of the kind specified by any of Articles 76 to 82.”
  - (e) Article 77(1) in turn defines the following as “investments” under FSMA and “security” under the RAO to the extent that they are not issued by an emanation of the State (see Article 78): debentures; debenture stock; loan stock; bonds; certificates of deposit; and any other instruments creating or acknowledging a present or future indebtedness. So in summary, trading bonds and other securities will be a regulated activity for which FCA authorisation will be required.

It is notable that "loans" are not specifically referred to in Article 77 above although debentures are. In the case of Fons Hf (in liquidation) v Corporal Limited (March 2014), the Court of Appeal raised the spectre of the loan markets and loan products being regulated by FSMA and the FCA by deciding that a loan agreement was a “debenture”, for the purposes of interpreting that term in a particular security document. Although the decision was not given in the context of financial services regulation, it raised a temporary uncertainty as to whether it should be regarded as being of general regulatory application, such that loan agreements would be regulated under FSMA. These issues were raised with government and the FCA by the Loan Market Association and the City of London Law Society, amongst others. On 17 July 2014, the LMA published a letter from the FCA in which the FCA confirmed that the decision in Fons had not altered its view of the regulatory perimeter of FSMA. Although the FCA’s response lacked a detailed analysis, the clear implication is that the FCA remains of the opinion that loan agreements are not debentures or, for that matter, regulated products for the purposes of FSMA and that therefore loan trading per se is not a regulated activity. If the only activity a particular person engages in is the investment in a participation in a loan in the secondary market for that loan, then it is reasonably clear that this will not be a regulated activity for the purposes of section 22 FSMA. “Promotion” of taking a participation in a loan will also not come within section 21 of FSMA.

The question of whether a particular person requires authorisation will be very fact-specific, however, and it may well be that funds which invest in participations in loans also do other things which are regulated activities requiring authorisation. A managed debt fund with a designated fund manager will in most cases constitute an alternative investment fund/manager and, accordingly, the manager as a manager of an alternative investment fund will require authorisation under section 22 FSMA and Article 51ZC of the RAO. The definition of alternative investment fund is very wide, and it does not matter what it invests in and whether the “investment is of a specified kind” for the purposes of section 22 FSMA. An alternative investment fund is defined as a collective undertaking that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Therefore, funds/fund managers who invest in the secondary debt market will almost always obtain an FCA authorisation because they are the manager of an alternative investment fund.

2.2 Debt Trading Practice

In most professionally drafted market-based documents, there will typically be a broad permission relating to the transfer of a loan “to another bank or financial institution or a trust, fund or other entity which is regularly engaged in, or established for the purpose of, making, purchasing or investing in loans, securities or other financial assets.” Most funds or credit institutions of substance would ordinarily meet this criterion and so borrowers will ordinarily seek to impose a consent requirement to loan transfers such that the
consent of the borrower is required, but that such consent will not be unreasonably withheld or delayed. Time limits for such consent to be granted might be included. More powerful borrowers may negotiate their own “white list” of approved transferees or a “black list” excluding certain aggressive funds as transferees. It is important to note that most borrowers would not themselves meet the criterion for a permitted transferee (except, say, arguably a treasury company within a group), but a borrower SPV might if it was created by the sponsors, specifically for the purpose of making, purchasing loans, etc, and had appropriate constitutional documents. As a result, lenders and funds in the sponsor-leveraged finance space have tended to limit borrower or affiliated loan repurchases and sponsor transfers, and have purported to disenfranchise the holdings of such parties on any syndicate vote.

With respect to publicly traded bonds that have become distressed, purchasers acquire those bonds in the market in the normal way through the relevant trading platform and clearing systems, albeit at a discount to par. The purchase of distressed bank debt is more interesting from a documentary perspective and although the mechanics of transferring distressed debt are the same as for the transfer of performing debt, the fact that the debt is “distressed” exposes the purchaser to far greater risk than would be the case with the purchase of a performing loan. As a result, the documentation for the sale and purchase of distressed debt has to deal with many more issues than an agreement for the sale of performing debt. In particular, the documentation effectively defines the allocation of risk between the seller and the purchaser.

The three main methods of loan transfer are novation, assignment and participation/sub-participation (either funded or unfunded). A participation may be useful where there are excessive restrictions on transfers of loans. This is because under a participation the legal relationship between the borrower and the lender are unchanged and the selling lender will remain the lender of record.

The buyer will not be able to control the debt in a participation arrangement and this will not be ideal for a buyer that wants to influence a restructuring. Therefore, it is not uncommon for the participation agreement to include a voting provision so that the buyer can direct the voting behaviour of the seller under the facility. Equally, there is likely to be an elevation provision in the participation agreement so that the purchaser can become a full lender of record. This elevation will be vital in a case where the seller becomes insolvent so that the buyer can control and receive the cashflows under the loan directly without them flowing into the seller’s insolvent estate.

To navigate loan transfer issues, it is not uncommon in England and Wales for an economic interest in a facility to be transferred through synthetic means such as a credit default swap, a total return swap, a credit linked note, or by using other trust structures. In synthetic structures, the buyer does not acquire a loan or other receivable directly and there may not be a true sale for accounting purposes so as to remove the asset from the “seller’s” balance sheet. Therefore, the regulatory capital implications will need to be considered on a case-by-case basis. However, the buyer gains risk exposure to the underlying debt by entering into these other types of arrangements.

2.3 Loan Market Guidelines

In order to make trading in distressed loans more efficient, the Loan Market Association (“LMA”) was opened for membership in December 1996 with the objective of fostering an environment in the Euromarkets that would facilitate the constructive development of a secondary market for loans. The LMA was established as a response to market conditions and as part of a perceived willingness on the part of the banking community to bring greater clarity, efficiency and liquidity to the relatively under-developed secondary market that existed at the time.

The LMA website can be found at www.loan-market-assoc.com and on its home page it articulates its five aims in connection with loan trading:

• standardise and simplify the sale of loan assets;
• establish a market standard for settlement procedures;
• establish codes of conduct for market activity;
• establish a loan valuation mechanism; and
• persuade borrowers, banks and other market participants of the merits of a more structured and liquid market.

Over time, the LMA has established customary documentation for documenting secondary market trading. The documents are bespoke and they are a superb resource covering guidance, core trade documentation (including novations, assignments and participations – funded and unfunded), master trade documents, pricing letters, termination letters, netting and confidentiality. The LMA documents are able to transfer the benefit of the underlying guarantees and security, although advice should always be taken with respect to non-English law governed security or with respect to security over assets and interests outside England and Wales.

With reference to bonds, the obvious ethical principle that a holder of debt should not trade on material non-public information that is price sensitive became enshrined in the Criminal Justice Act 1993 which regulates insider trading. As a consequence, it is a criminal offence, under the UK’s insider dealing laws, to trade bonds and other debt securities on the basis of such information. Equally, a person trading debt securities when in possession of inside information will
almost certainly contravene the “market abuse” provisions of FSMA s.118 and the FCA’s Code of Market Conduct.

The loan market, however, is not a regulated market in the strict sense and loans are certainly not securities under the Criminal Justice Act 1993 and are not a qualifying investment under the FSMA market abuse regime, both of which regulate insider trading. As a consequence, it is not a criminal offence under the UK’s insider dealing laws to trade loans on the basis of inside information and it is not market abuse.

To deal with the regulatory and ethical lacuna that participants in the loan markets (as per the bond markets) should not trade on the basis of inside information, the LMA introduced its own guidelines, “Transparency and the Use of Information,” in November 2012 (the LMA Guidelines). Similarly, the Alternative Investment Management Association has issued its own guidelines (the AIMA Guidelines) on loan trading and has endeavoured to identify more accurately what they perceive to be market practice. The LMA Guidelines and the AIMA Guidelines both recognise that participants in the secondary loan market base their trading decisions on information to which they have access in relation to the loans, and to borrowers whose loans are traded and that such market participants are expected to behave with integrity towards the loan market. Both sets of guidelines appear to have been launched because the LMA and AIMA both recognise there are situations (for example through co-ordinator committee membership or an equity holding) where some market participants will have access to information that is not available to other market participants.

Whilst the LMA Guidelines and the AIMA Guidelines do not have force of law, it is widely perceived that a breach of them would probably breach the FCA’s Principles of Business (www.fshandbook.info/FS/html/FCA/PRIN/2/1) a list of principles and standards that firms have endorsed to which a regulated body should adhere. Two of these Principles may be relevant to secondary loan trading and the issue of information disclosure:

- Principle 1 which requires a “firm” to conduct its business with integrity; and
- Principle 5 which requires a “firm” to observe proper standards of market conduct.

Whilst the spirit of both the LMA Guidelines and the AIMA Guidelines is admirable, both frameworks assume, to a certain extent, that disclosure will be made promptly to a syndicate and, ultimately, the loan market, and that a borrower will co-operate in this process so as to enable material information to be made available to the market. Quite often, the level of disclosure is not always satisfactory, with borrowers invariably having the tendency to categorise virtually all information as classified and highly sensitive and resisting any detailed disclosure at every turn, either to manage creditors and suppliers, to protect out-of-the-money shareholders or to control the restructuring. Accordingly, participants in the secondary loan market are increasingly using “big boy” letters as a means of addressing asymmetry of information between seller and buyer, which acknowledge that one party may well have superior information and/or with the relevant party electing not to receive any borrower confidential information (or other information) from a counterparty. A big boy letter or representation will prevent litigation relating to non-disclosure of material non-public information pursuant to a debt trade that is not disclosed by one party to the other.

3. Informal and Consensual Restructuring Framework

3.1 Consensual Restructuring

The overarching approach of market participants in England and Wales is to restructure companies efficiently through a consensual restructuring. Consensual restructurings are invariably the most common outcome and the concept of “consent” encapsulates a process whereby the liabilities of a company in financial difficulties are restructured so that the company, and therefore value, is preserved and its business carried on as a going concern. The fundamental principle is that the company is restructured on a consensual basis either by unanimity, via a relevant majority under a facility agreement or intercreditor agreement, or by means of a cram-down implementation process such as a scheme of arrangement whereby a consent of 75% of creditors by each relevant class and a majority in number of each class is achieved. The principal reason for undertaking an informal consensual restructuring is the potential for improved value recovery, flexibility, lower cost and expediency of the arrangements, both as to how the rescue is planned and how it is implemented.

In order to facilitate consensual restructurings, the majority of market participants (to a lesser or greater extent) will respect informal consensual restructuring frameworks such as the London Approach and the INSOL Principles.

The London Approach is a phrase that has been around since the large restructurings of the early 1990s and, in some ways, it has caused confusion. The spirit, scope and function of the London Approach were, however, helpfully articulated by the British Banking Association in its Policy Bulletin of 16th February 2004 as follows:

“The London Approach can be summarised as a non-statutory and informal framework introduced with the support of the Bank of England for dealing with temporary support operations mounted by banks and other lenders to a com-
pany or group in financial difficulties, pending a possible restructuring.”

The origins of the London Approach go back a long way and it is not surprising that it has evolved throughout a number of economic and financial crises. Indeed, the Bank of England (both in its former role as banking regulator and in its ongoing role as monetary controller) has obvious motives for intervening in corporate restructurings given its inevitable concerns about the systemic implications of substantial bad debts if they are owed by a large corporate with a high profile, and a number of institutions regulated by the Bank of England have exposure to that corporate. The Bank of England has been involved informally in discussions in relation to large restructurings for many years and, during the major recession of the early 1990s, the Bank’s approach to consensual restructuring became even more informal as a “facilitator” and it left the banks to themselves to sort out problems with their borrowers. Its attitude was that it was prepared to discuss the principles, to act as a sounding board for particular cases and to be involved, but it would not tell the banks how to proceed since that was a matter for them to resolve. On an international level, the London Approach purported to work on complex group situations with overseas subsidiaries by encouraging the adoption of similar principles of support by local lenders and bank regulators to facilitate an internationally based solution outside formal insolvency procedures.

With the emergence of the FCA as the key regulator (particularly of debt funds) and the declining regulatory role of the Bank of England, it was the FCA that inevitably emerged as a facilitator of consensual restructurings in the post-millennium decade. As the financial crisis intensified during the period from 2008-2011, the propensity for the Bank of England to become involved in large corporate restructurings re-emerged. As well as being actively involved in the restructuring of regulated institutions such as Northern Rock, it was resolved that the systemic risk posed to the UK economy and regulated financial institutions themselves, by a series of major corporates failing in quick succession, justified a degree of intervention. Since the financial crisis, both the Bank and the FCA have been consulted in a facilitative role on a number of large restructurings.

Although the financial crisis has clearly demonstrated the prevailing relevance of the London Approach today, its effect continues to be felt in much more subtle ways and the principles it enshrines continue to permeate aspects of almost every restructuring on a daily basis. Whilst the London Approach is not prescriptive and it is not formal, it remains the pioneering regime for managing multi-creditor restructuring in England and Wales that articulates a number of high-level general principles that stop short of prescribing specific details and rules as to what should be done in any given context. The tenets of the London Approach are broad-based and can be summarised as: (i) constructive co-operation between lenders; (ii) lenders should remain supportive when they receive bad news; (iii) lenders should strive to make decisions based on accurate information that is shared with other creditors; (iv) lenders should work together to form a collective view; (v) there should be equal treatment for lender claims of an equal ranking; (vi) there should be proper co-ordination amongst lenders; and (vii) there should be priority for new money.

Building on the success of the London Approach and following the Asian debt crisis of the late 1990s, many governments, the IMF, the World Bank and a multitude of financial institutions began to consider an international approach to restructuring increasingly global companies. This resulted in the publication of the INSOL Principles within which many of the tenets of the London Approach are embedded. For the detailed Principles (which are very similar to those constituting the London Approach), see www.insol.org/pdf/Lenders.pdf (2 Oct 2000 - Global Principles for Multi-Creditor Workouts).

Given the Bank of England’s sponsorship and support of the INSOL Principles and the success of the London Approach, financial creditors in England & Wales will, as a minimum, tend to acknowledge the existence and fairness of them even if they will invariably negotiate around them and seek deals which favour their institution’s position – such as questioning the pricing of new money or declining to work actively with other lenders. Despite the existence of hold-out creditors, one positive effect of the INSOL Principles is that funds and more traditional lenders will generally advocate an information gathering exercise, the appointment of advisers and a degree of financial creditor interaction (that will promote and facilitate a degree of transparency and disclosure) pending a more detailed assessment of a debtor’s financial position.

Given the international cache of the INSOL Principles, one interesting development has been the tendency for market participants still to consult the FCA or the Bank of England to facilitate a consensual restructuring, but for the consultation now to cite the INSOL Principles as opposed to the London Approach.

English law does not readily support, interact with, or impact any informal and consensual restructuring procedures other than through the English principle of sanctity of contract, and it certainly does not impose any mandatory consensual restructuring negotiations before filing for a formal “statutory process.” In fact, one of the ongoing criticisms of English restructuring laws is that there is no moratorium or automatic stay as part of any rehabilitation or restructuring proceeding such as a scheme of arrangement. A moratorium
3.2 Consensual Restructuring Process

It is very difficult to ascribe a typical timeline for a restructuring in England and Wales. Restructurings are characterised by uncertainty - every restructuring situation starts with a problem and a pre-contractual phase and, via one or more contractual phases, ends with one or more stakeholders (equity and sometimes one or more levels of debt) losing some or all of their value or protections and/or compromising certain of their rights. It is an inherently uncertain process and environment. The process in the middle is often referred to as the contractual phase and involves a “restructuring,” a “work-out,” a “turnaround” or a “corporate rescue” – and typically involves protracted negotiations between stakeholders trying to preserve value in a distressed situation. The exit from the consensual process is focused on finding a mutually acceptable solution.

The pre-contractual phase of a consensual restructuring involves an assessment of whether stability can be achieved by analysing the group’s current liquidity needs, its current defaults and maturities and its pending defaults and maturities. The parties will each address whether they can “control” the process or at least influence its direction. Information-gathering will take place and advisers will be appointed to manage this. A first all-lenders’ meeting will be convened and this will require careful management on all sides. Coordinators will be appointed by the financial creditors or, in larger cases, a steering committee or an ad hoc committee will be formed by the financial creditors to manage the process on their behalf. The debtor and the financial creditors will then commence their more detailed work streams and will manage disclosure, public relations and other messaging issues.

At this juncture, directors in an English consensual restructuring process will seek to monitor and comply with their directors’ duties and will separately develop a long-term plan and in the shorter term, a strategy for engaging with their financial creditors and preserving liquidity. Inevitably, the company will also consider its options if it cannot get the required waivers for short-term relief.

In practice, this pre-contractual phase can often go on for a very long time before any form of restructuring contract is signed. In many cases, lenders will be reluctant to sign any binding agreement until they have accurate information and an independent business review may itself take up to six weeks, depending on the complexity of the business. The appointment of co-ordinators can also be delayed by negotiations on its scope, role, terms, fees and indemnities. During this initial phase, the most ambitious contractual achievement might be a de facto standstill or, at best, a temporary waiver of a default.

Quite often, the most important aspect of a restructuring for a corporate is the protection from unilateral action by any of the financial creditors pursuant to a long-form temporary waiver letter, standstill agreement or a support agreement and typically this is one of the key contracts that is signed during what is commonly known as the contractual phase. It is a common agreement that is signed in English law-governed restructurings and it enables all of the existing facilities to remain in place. The standstill should cover all relevant facilities required by the group – namely syndicated lines, bilateral lines, asset finance lines, overdrafts and ancillaries, plus any other key facilities that are identified. Some of the key components of a standstill include the maintenance of day-one positions by creditors, waivers, maintenance of credit lines, forbearance and equalisation and loss-sharing so that no creditor is worse off by participating in the standstill and new money priority.

In terms of timeline, the contractual phase is varied and uncertain. In a number of recent English restructurings, agreement on even a short-form interim stabilisation document took six months to negotiate. Criticism is often levelled at restructuring co-ordinators and their advisers when they attempt to put together an elaborate restructuring document which, in reality, is the whole object of the more advanced contractual phase, but which is never actually signed. In one case, there were two years of pre-contractual negotiations and business reviews before any form of document was signed. If the parties co-operate, the pre-contractual phase can be very short. A short-form standstill of a financial institution was executed over a weekend during the financial crisis and co-ordinators were appointed immediately. Similarly, a standstill involving 16 creditors with different recourse to different group companies was executed on Christmas Eve after only three weeks of negotiation – all of which evidences
the fact that the aspirations and objectives of the process and the willingness of the parties to engage in the context of the "default and liquidity" issues affecting the company can be a determinative factor.

Following the initial contractual phase, the parties will work towards the full restructuring solution. Much will depend on the level of distress and the company’s prospects, the capital structure, the composition of the creditors and the ambition and complexity of the solution. In a purely consensual process, the solution is likely to involve an amendment and restatement of existing facilities or a refinancing, a rights issue or other capital raise or a debt for equity swap. In almost every case, new controls for negative covenants will be imposed and new reporting requirements will be instituted. Positive covenants such as disposals, management change and an operational turnaround are also likely to feature. Given that the parties will have been engaged in a detailed information flow from the pre-contractual phase and the business review will have been completed, it is not uncommon for the full contractual solution to be completed within four to eight weeks of the standstill being signed.

The Appointment of a Co-ordinator

In almost all multi-creditor consensual restructurings in England and Wales there will be an appointment of a co-ordinator, a co-ordination committee, a steering committee or an ad hoc committee to represent the creditors or groups of different creditors. Conversely, in some cases where the process is relatively straightforward, there is a limited number of financial creditors and the debt is minimal and structured at the same single level, it is possible to dispense with the appointment of a co-ordinator and the company may deal with the full syndicate simultaneously.

The co-ordinator of a restructuring is usually appointed on consensual restructurings involving a small club of banks or a small syndicate. It is likely to be a financial creditor with the most significant exposure in the debt and typically it will have a reputable restructuring unit employing skilled practitioners with the appropriate restructuring and turnaround experience and expertise. It is also important that the co-ordinator is able to articulate the views of the broader constituency that it represents and that it has a reputation for transparency and veracity.

The co-ordinator is selected and appointed by the company and its position is confirmed by the lenders. The co-ordinator adopts the role of lead financial creditor both during an initial standstill period (if there is one) and the main restructuring process.

It is not unusual for there to be two co-ordinators or even a co-ordinating committee on larger cases where there are two or more financial creditors with similar exposures and one or more of those larger lenders wants to stay close to the process. Typically, one of those financial creditors is the company’s clearing bank and one member may be the facility agent of one or more of the affected facilities.

Where there is a substantial number of lenders to a group or there are different constituencies of lenders providing different facilities of a different type with a different recourse or from different geographies, then, in order to retain a consensus amongst such a large group or such constituencies, it might be necessary to have either two co-ordinators or to form a steering committee of financial creditors to lead and "steer" the restructuring. In the past, certain defined groups of lenders with the requisite resources, availability and experience, (perhaps drawn together by common facility terms, geographic location or regional representation or their recourse to a specific entity or group of entities) have put forward a representative onto a steering committee. By way of example, on one international restructuring, a commercial bank representing the European banks and a US investment bank representing lending interests in the Americas also worked effectively with representatives of an Asian syndicated loan on a tripartite steering committee. In other cases, banks providing project finance debt or bonding have sat on a steering committee with hedging banks, term loan lenders and working capital banks.

Equally, where there is a number of dominant institutions having the majority of the exposure in a large syndicate, it is not uncommon for those banks to form a group that will usually be labelled a steering committee rather than joint co-ordinators. In this respect, the difference between a co-ordinator and a steering committee will be minimal and the label is typically one of mere description as opposed to one of any notable substance. Indeed, it is even possible that the restructuring would still require a co-ordinator or chair of the steering committee with the co-ordinator or chair being the focal point of the steering committee. In a large restructuring of a leveraged credit, for example, the process was managed by a steering committee of three key banks and one hedge fund (effectively representing a number of hedge funds who had bought into the debt in the secondary market) that operated in an identical fashion to joint co-ordinators. As such, the terms of the steering committee appointment will incorporate the same type of terms on which co-ordinators and co-ordinating committees are appointed. The only difference will be modified provisions relating to steering committee voting and the removal of steering committee members.

It is becoming increasingly common for each constituency of financial creditors to form its own committee or to appoint its own co-ordinator. In a recent high-profile English law-leveraged restructuring, a senior co-ordinating committee, a second lien co-ordinator, a mezzanine co-ordinating committee and a junior mezzanine co-ordinator were each
appointed as representatives of each relevant constituency. This was absolutely appropriate and necessary given that the value-break shifted enormously during the protracted restructuring negotiations and it was vital that each stakeholder was properly co-ordinated and properly informed.

An ad hoc restructuring committee is different in a number of respects. It is usually formed from a small group of selected lenders or bondholders who typically liaise with a debtor as a temporary forum ahead of the debtor submitting a detailed refinancing/restructuring proposal to the wider group of lenders or bondholders. The ad hoc committee will usually engage both legal and financial advisers as an initial step in furtherance of this specific objective.

The emphasis is on the ad hoc committee operating as an informal working party to develop a restructuring proposal and it will decline the imposition or assumption of any duties or wider responsibilities to any person. It will typically state that it has no other role or function and, due to the fact that it is not representative of any broader body of lenders and bondholders, it will be able to operate at its discretion. Members of an ad hoc committee may be able to consult with other lenders, bondholders and financial creditors if this is agreed by the debtor, but equally its existence may not actually be disclosed to any other financial creditors in certain cases. It is usually made up of lenders with large exposures or in the case of bonds, holders that manage or own large holdings of the bond.

Increasingly co-ordinators, co-ordination committees and steering committees are appointed on versions of the LMA standard appointment documents in order to minimise negotiation. Most firms do not slavishly follow such forms because there are weaknesses and certain positions adopted (which are beyond the scope of this commentary) that do not always find favour with those taking such roles or their internal and external counsel.

The LMA has released two standard form documents for the appointment of co-ordinating committees:

- a letter of agreement between the co-ordinator/co-ordinating committee (CC) and the signatory lenders (the LMA Lender Letter); and
- a letter of agreement between the CC and the borrower (the LMA Borrower Letter and, together with the LMA Lender Letter, the LMA Letters).

The LMA Letters are supported by the LMA Guidance Notes on the "Role of the co-ordinator and co-ordinating committee" which provide guidance for LMA members on the use of the LMA Letters.

The LMA Letters should not be regarded as sacrosanct and certain of the weaknesses in the documents do justify a departure from their terms. The rationale behind the use of two letters rather than one letter signed by the company, the relevant co-ordinator/committee and the financial creditors is predominantly to expedite the process as it usually takes a degree of time to obtain the signatures of the lender group. The use of two letters will inevitably lead to a certain amount of duplication, but the LMA’s perceived benefit of appointing the committee at an early stage is viewed by them as significant. The reality has proved to be quite different because in practice the lenders invariably want to see the company letter and are keen to agree its terms before locking themselves into the LMA Lender Letter. Conversely, many corporates and their advisers have proven to be very inquisitive and suspicious of the dual LMA Letter process and as a consequence are keen to see the LMA Lender Letter, specifically to examine the basis upon which the co-ordinator will lead the restructuring and deliver confidential information and other updates to the financial creditors. As a result, the process becomes consumed by detailed and protracted negotiation with all parties effectively negotiating two letters rather than one single letter, which was always the conventional approach to documentation. Equally, the co-ordinator will be cautious about signing the LMA Borrower Letter unless it knows that at least a majority of financial creditors will sign the supporting LMA Lender Letter.

An alternative method anticipated by the LMA would be to utilise one letter that the lenders can also accede to. Whichever option is preferred, the co-ordinator and co-ordinating committee will usually wish to know that their appointment is supported by an appropriate majority of the lenders who will sign the single letter in the requested form in due course.

The appointment of an ad hoc committee can be made on a relatively short-form bespoke letter on an expedited basis – which can be hugely advantageous. The committee does not represent other lenders and so a separate lender letter is unlikely to be relevant and indemnity cover will not be sought by an ad hoc committee. As a result of this lack of indemnity cover, the members of the ad hoc committee will typically negotiate full exclusions of liability both amongst themselves and as regards the debtor and will seek considerable latitude to operate in their own interests.

Whichever form of document is used, one of the negotiating hotspots has traditionally been the scope of the indemnity cover granted by other creditors in favour of the co-ordinator or the relevant co-ordination/steering committee. The indemnity provisions are a fundamental part of the appointment documentation and the most likely area for negotiation and dispute. Improvements have been made to the first iteration of the LMA Letters previously published and the versions in existence at the time of publication of this
second edition now cover the issue of indemnities in a more thoughtful way. For example, the LMA Letters now recognise that not all lenders may sign the indemnity provision and that CLO and other funds may not be able to give full indemnities. The Lender Letter does, however, suggest that such funds should be put to proof in this regard.

The footnotes to the LMA document also now promote a consideration as to whether wording should be added to clarify that those lenders who do sign are bound and liable for their rateable proportion, notwithstanding that other lenders do not sign. Moreover, the LMA Letters also now contemplate that liability under the indemnity may be shared, for example, by reference to lenders’ proportions of total commitments overall or shared between only the lenders who sign in the proportions of their respective commitments inter se. What it does not cover is the effect of certain lenders not signing and how the “gap” in the indemnity is shared. There is no “workaround” contemplated where certain lenders refuse to give an indemnity. In terms of allocating the liability for the indemnity, the LMA Lender Letter currently contemplates simple pro rata sharing of liability which may not be appropriate in the context of tiered debt arrangements. It is also worth noting that the LMA letter suggests it might be possible to structure a CLO’s indemnity as limited recourse without rationalising how this fits into a fair and equitable pro rata sharing of the indemnity and what such recourse would actually be limited to. The focus should really be on procuring equality between the lenders in terms of their indemnity risk and exposure and navigating dissentient lenders who are refusing to grant an indemnity.

In summary, it should be noted that, despite a number of improvements adopted by the LMA, the LMA indemnity provisions are less robust from a committee member’s perspective than bespoke documentation and may require further amendment.

In almost all English restructurings, those leading the restructuring effort, whether as a sole co-ordinator, joint co-ordinator or co-ordinating/steering committee member, will legitimately seek to charge a “work fee” or “management fee” for the enormous amount of management time and specialist restructuring and turnaround knowledge that is invested in managing the process and ensuring that the restructuring is conducted in an efficient and orderly manner. In order to manage complex situations effectively, the larger banks that specialise in this arena need to be adequately resourced with professional restructuring bankers of the highest quality and it is inevitable that as the costs of establishing and preserving these teams has increased, “work” fees have similarly increased.

The quantum of such fees remains negotiable but market practice has clearly developed and fees will be paid in almost all circumstances. It is clear that there is a trend developing for the quantum of fees to reflect the complexities and pressures involved in restructuring bulge-bracket LBO deals, and large public companies which operate in a multitude of jurisdictions.

When negotiating restructuring fees, it is not uncommon for borrowers to suggest an aggregate level that they are comfortable with and to leave the co-ordinators/steering committee to allocate this amongst themselves. The assumption (depending on the number of creditors on the committee) is that the lead bank will take a higher proportion of the fee, perhaps at 33.33% or 50% more than the amount paid to committee members. In many cases, it is likely that the fee will have to be backdated, given the usual delays that exist in getting the appointment letters and the accompanying fee letters agreed. Similarly, the fees can be adjusted and phased in over the period during which committee members are added.

In almost all cases, the co-ordinators will seek to protect the disclosure of their fees through a robust confidentiality provision in the separate specific fee letter that accompanies the co-ordinator appointment letter. Similarly, the co-ordinator or committee (in the interests of transparency) will seek to ensure that its fees are not disputed by other lenders by either referring to the co-ordination fee in the LMA Lender Letter or perhaps, more opaquely, inserting a provision in the LMA Lender Letter that expressly entitles them to carry on any business with any member of the group and to retain any profits or remuneration it receives in relation to such business for its own account.

It would be rare for any restructuring plan not to require significant support from a number of financial creditors, not merely in terms of running an efficient restructuring process which justifies a work fee for those involved in managing the process, but also in terms of persuading and delivering those constituencies into the restructuring and getting them credit-approved and over the line – this is often equated with “success” so as to justify a one-off success fee payable only to the co-ordinators. Success for these purposes may be defined as negotiating an extension of facilities, executing a deal with other creditors, including pension trustees, navigating a going-concern issue or an IAS year-end crisis, enabling a disposal to be achieved under the appearance of normal trading as opposed to a fire sale, or facilitating an equity raise or a covenant reset.

Depending on the nature of the lenders’ requests, the extent of the support required from them and the difficulty of achieving this, those committee members supporting and leading a significant transaction, returning substantial value and achieving a successful outcome for the company-side stakeholders will seek to recover a success-based fee for themselves as co-ordinators who have, through their actions and support, provided enhanced value to other parties who
may not have contributed to such an extent. This may be a cash-based success fee, but in public company restructurings it may well be linked to the recovery in the share price and the enhanced shareholder return through some form of warrant or synthetic warrant.

**The Use of Standstills**

As indicated above, the use of a standstill as part of an initial informal and consensual process is very common, particularly in large English law restructurings of investment grade or non-leveraged finance corporates where there may be multiple facilities and credit lines, perhaps syndicated and bilateral, together with, say, privately placed debt or a Eurobond and maybe other ancillary facilities. The standstill is often an intermediate step to achieve stability for such debtors and quite often it will be needed because the capital structure will have evolved over time without an inter-creditor agreement, which would usually have a contractual standstill incorporated in it, being put in place.

In more structured transactions such as leveraged finance transactions or project financings involving a number of multilayered facilities in a more complex capital structure, it is not uncommon to see a contractual standstill already included in an intercreditor agreement that was established at the outset of the financing, regulating the enforcement of the junior layers of debt for periods of between 90 and 180 days, depending on the event that has triggered the standstill. A payment default will typically have a shorter standstill period and a financial covenant breach will have a longer period.

Most debtors and their management teams will not usually have experienced financial distress and, typically, they will have no substantive expectations relating to the process. The situation is different for financial sponsors who may have seen some of their other portfolio companies or assets undergo a financial restructuring. Most borrowers, and even sponsors, usually anticipate that relationship lenders will be supportive, but this may be slightly naïve if the original underwriters have syndicated widely and they only have a minimal holding in the capital structure and the debt has since traded to a number of distressed debt players. Borrowers of all types should usually expect the request for a dialogue and an all-lenders’ meeting and a request for the financial creditors to receive up-to-date financial information and a detailed commentary on the business. This will typically precede an independent review of the business and a request for the borrower to meet the costs of the advisers to the financial creditors. As the process gathers momentum, borrowers should not necessarily expect an easy ride and a waiver or standstill without conditions being imposed by the financial creditors.

The pre-contractual phase is, in large part, an information-gathering stage during which a strategy needs to be developed. It is a time when the size of the problem is ascertained, the lending, asset and group structure charts are being prepared, the strategy of the business is re-evaluated, recent trading is assessed, cashflow is analysed, a schedule of banking facilities is prepared, the recourse of creditors and the maturity of their credit lines are established, other non-bank creditors are contacted and intra-group positions are analysed.

As soon as a debtor approaches its financial creditors for a waiver, a standstill or some other kind of relief, it risks losing control of the process. Anything can drive the company into the zone of uncertainty once the waiver is requested and the group as a whole needs to be prepared for any eventuality. The debtor and its advisers will typically do all they can to try to influence the process, in the meantime. This will include keeping a constant dialogue with its creditors and sanctioning the commission of a business review. Business reviews have tended to be more structured and focused in recent times and debtors will normally strive to instruct their own advisers to prepare significant parts of it with a duty of care being granted to the lenders. This gives the company more influence on the scope, content and timing of information to be released to its financial creditors.

The typical scope in relation to information flow will almost always include rolling short-term and long-term cashflow forecasts, but may also include, by way of example, one or more of the following items: profit and loss accounts, balance sheets on a group and subsidiary basis, comparisons of actual performance against budget, tables of capital expenditure and investments made and management commentary. There may also be a need to include margin ratchet and cash sweep calculations and compliance certificates in this management information, as well as any relevant key performance indicators (KPIs) such as gross sales, margins, customer-retention data and contract wins and losses, etc. An updated annual budget may also be required, setting out full projections and covenant compliance, capital expenditure and investments and a management commentary. Regular information meetings and access to management may also be required and a whole raft of other miscellaneous information relating to the group and its business including, without limitation, information on a disposals process, information technology updates, recovery plans, management change, and litigation. The list is only limited by the imagination and requirements of those involved and advising and the circumstances of the case.

**Contractual Priority**

In capital structure where there is a pre-existing intercreditor or subordination agreement that ranks and/or subordinates relative layers of the capital structure, this contractual relationship (as it relates to ranking and subordination) will be respected under English law. In Re Maxwell Communica-
Contractual subordination in its various forms is respected and in its simplest form, a junior creditor who gives an undertaking not to collect the junior debt until the senior debt has been paid in full, will, via such a covenant, give the senior creditor a personal right against the junior creditor, not a proprietary right against the junior debt. A junior creditor should appreciate that, if the debtor becomes insolvent, under a simple contractual subordination it will be subordinated not only to the senior creditor, but to all other creditors ranking equally with the senior creditor. This is because these creditors must be paid on a pari passu basis.

Contingent debt subordination whereby the junior creditor agrees that its debt is contingent on the senior debt being paid will also be observed under English law. Under this method of subordination, the junior debt is not a liability of the debtor until the specified contingency (the payment of the senior debt) has occurred.

Turnover subordination will also be observed under English law. Here, the senior creditor and junior creditor will agree contractually that the junior creditor shall, in the event of the insolvency of the debtor, pay sums received in respect of the junior debt to the senior creditor up to a specified amount or the total amount due to the senior creditor. This normally requires the junior creditor to prove in any winding up of the debtor, so that any distributions received by the junior creditor become available (under the turnover arrangement) to the senior creditor. The advantage of turnover subordination for the junior creditor is that it is only subordinated to the senior creditor and not to other creditors ranking pari passu unless it is subordinated or subject to contractual or security ranking. Indebtedness with contractual or security ranking will also be respected in an English law liquidation.

Trust subordination is also recognised under English law and pursuant to this technique, a trust is created with respect to the proceeds, dividends and other payments receivable by the junior creditor on the debtor’s winding up (a creditor trust) and this is augmented by the junior creditor’s promise to pay sums received on the debtor’s winding up to the senior creditor (a debtor trust). Where the junior creditor wishes to ensure that it is subordinated only to the senior creditor and otherwise ranks equally with other creditors, trust subordination will work as an alternative to turnover subordination.

Trust subordination provides the senior creditor with a proprietary interest in the proceeds received by the junior creditor. As such, it offers more protection to the senior creditor than a turnover subordination in the event of the junior creditor becoming insolvent. It also achieves the objective of the senior creditor getting the benefit of both its and the junior creditor’s claim in the winding up of the debtor. The trust involves the junior creditor declaring itself a trustee of any sums received in respect of the junior debt up to the specified amount. The terms of the trust will provide that any sums received must be applied first to the senior creditor for the discharge of the senior debt, and then to the junior creditor.

Similarly, the priority of security will be respected unless such security is vulnerable as a preference or a transaction at an undervalue or as a voidable floating charge under the Insolvency Act 1986, or is otherwise vulnerable on the basis that there was insufficient corporate benefit at common law. There is no concept of equitable subordination in English law and shareholder or affiliate indebtedness will rank pari passu unless it is subordinated or subject to contractual or security ranking. Indebtedness with contractual or security priority will also be respected in an English law liquidation.

### 3.3 New Money

It is common for new money to be accorded priority outside of a statutory process and this is best achieved by identifying spare unencumbered assets and providing security over them. This is preferable because if the company is authorised to grant such security contractually through a negative pledge exemption, providing that the security is granted for good consideration and is in the corporate benefit of the grantor, it will be validly created without the need to obtain contractual priority.

The other means by which priority for new money can be provided is contractually through a ranking and subordination agreement, but the disadvantage here is that the priority will only bind those other financial creditors willing to grant it and if the new money is not secured, then it will not bind other creditors ranking pari passu with the new money who did not consent.
Financial creditors always seek to minimise the quantum of new money due to its dilutive effect on their claims and the quantum of new money can be minimised and the urgency of the requirement can be controlled, by ensuring that the details of the restructuring remain confidential so that the broader body of creditors are not aware of the company’s distress.

In a small club of lenders, new money is typically provided by each institution in proportion to its original exposure at the commencement of the restructuring process (also known as their Day 1 position). Alternatively, in larger deals it may be made available by those financial creditors having undrawn commitments making them available. Equally, in larger, more complex transactions, and given the problems faced by certain CDOs and insurance company investors active in the private placement markets in being permitted to make further investments in impaired credits, the entirety of the new money requirement is, in many cases, provided by the members of the steering committee or, more likely, by the lead bank co-ordinator exclusively. Delays in making the new money available can sometimes emerge because even those not providing the new money will require credit approval for ceding priority to, or underwriting, those providing it.

The new money required by the group can often be injected by means of an additional overdraft, revolving credit, bonding, guarantee and hedging facilities. Quite often, new money is made available by the relevant institutions permitting their existing facilities which are “draw-stopped” to be utilised above their current drawn position. This reinstatement of the original commitment (so as to create headroom) will be afforded priority both pre- and post-enforcement. Similarly, under derivative facilities provided to the group, the current “mark to market position” will be calculated so that any increase in that mark to market position during the restructuring will also rank as priority new money. This is a useful device because it means that strategic and economically important hedging previously implemented by the group can be maintained.

3.4 Duties of the Parties
The case of National Westminster Bank plc v Rabobank Nederland [2007] EWHC 1056 (Comm) is the leading authority on the mutual duties and obligations of banks involved in restructurings. The case is of critical importance to restructuring practice and the conduct of workouts in England and Wales because the High Court held that in the absence of an express agreement to the contrary there are only very limited duties (particularly as regards disclosure) owed between banks engaged in a restructuring.

This case is a helpful clarification of the current market position in England and Wales in that it confirms there are no obvious duties between banks involved in a restructuring in the absence of express contractual obligations, such that banks will vote or take other decisions based on their own subjective assessment of what is important. The case does, however, highlight the risks of purposely withholding information that a financial creditor participating in a restructuring might expect to have disclosed to it. It is also important to perceive the case with a degree of caution, because it is submitted that the provision of information on a reckless or negligent basis might be sufficient to invoke liability to another creditor. For this reason, co-ordinators and steering committees, in their appointment letters, seek to exclude a duty of care and any form of liability to the company and other financial creditors, and expressly state that they shall not be responsible for the adequacy, accuracy and/or completeness of any advice obtained by the co-ordinators in connection with the transactions contemplated by the restructuring.

When confronted by a credit of declining quality or when navigating a restructuring, financial institutions inevitably identify and protect their own interests by voting in a manner consistent with this. Despite a number of clarifications by the courts in the Redwood case (Redwood Master Fund Ltd v TBD Bank Europe Ltd [2002] EWHC 2703 (Ch)), and the Assénagon case (Assénagon Asset Management S.A. v Irish Bank Resolution Corporation Limited (Formerly Anglo Irish Bank Corporation Limited) [2012] EWHC 2090 (Ch)), the starting point for the courts in assessing the validity of the exercise of any voting powers was to assess by reference to the available evidence, whether the voting power was being exercised in good faith for the purpose for which it was conferred. The courts have elaborated by suggesting that merely because a minority might be able to adduce evidence that it had been relatively disadvantaged as compared with the majority, it was not axiomatic that the voting power had been exercised improperly by the majority. Accordingly, the exercise of their voting powers could only be successfully challenged in very limited circumstances. As far as minorities are concerned, they should perhaps note that in the absence of discrimination and bad faith by a majority, where a vote is being exercised for an improper purpose, they will be bound by majority decisions in a restructuring.

In Assénagon, the voting resolution was clearly oppressive and discriminatory to the minority and an abuse of the power of the majority as it expropriated their economic value for a nominal consideration and was completely incapable of benefiting the minority, unlike Redwood where it could be legitimately argued that the resolution potentially benefited each creditor and was not being exercised for an improper purpose. Redwood can be distinguished because the lenders had not acted in bad faith. They had simply made a commercial decision to approve a restructuring package which potentially benefited each creditor. It should still, therefore,
be possible for lenders, under a facility agreement, to vote in furtherance of their own economic interests where the vote is potentially capable of benefiting all creditors, is not wholly discriminatory and oppressive and is designed to expropriate the economic interests of the minority.

3.5 Consensually Agreed Restructuring

Informal consensual restructurings are regularly executed in England and Wales and this is certainly the norm and the expectation. It may, of course, take time to execute such a deal, but a consensual contractual transaction is certainly the aspiration and the objective. Much will depend on the level of distress and where the value breaks in the overall capital structure. If the restructuring comprises a re-pricing, an amendment and restatement or extension or refinancing of existing facilities, this is typically achievable in a consensual process, as financial creditors and other equity stakeholders will not be disenfranchised and/or will not experience a substantial erosion of their value. Stakeholders will, therefore, more readily support such a deal consensually. If the terms of the restructuring have a more fundamental economic effect and/or require unanimity of a specific stakeholder then all parties or creditors in that stakeholder constituency will need to agree the deal. If the existing contracts (for example, a facility agreement, indenture, trust deed or intercreditor agreement with respect to financial creditors) or constitutional documents with respect to the company (a shareholders’ agreement and/or articles of association) require a lower consent threshold, unanimity will obviously not be required.

Where the restructuring affects the substantial value of a creditor or substantially impairs their economic interests such that it is not possible to garner support from a given constituency in the capital structure, or if the transaction requires unanimity and there are “hold-outs,” then it will be necessary to invoke a cram-down to deal with dissentient creditors. English law has credible cram-down devices pursuant to a scheme of arrangement under Part 26 of the Companies Act 2006 (a Scheme) and a company voluntary arrangement under the Insolvency Act 1986 (a CVA). A Scheme can cram down classes of creditor in a capital structure and can be used to cram down secured and unsecured creditors. It will be necessary for 75% of each class and a majority in number of that class present and voting to support the restructuring under a Scheme. In a CVA there are no separate classes of creditors but it is typically only used to cram down unsecured creditors (usually landlords) because secured and preferential creditors cannot be compromised without their consent under a CVA. In a CVA, the other limitation is that the restructuring proposal must be agreed by more than 50% of the company’s shareholders and 75% of the creditors present and voting, and whilst the creditors can prevail, the shareholders have a residual right to apply to court to contest the CVA.

To be precise, a Scheme or a CVA is not used to augment an already consensual restructuring, but instead it will be used to execute a restructuring that has momentum and a broad consensus, but which cannot be implemented because the terms of the restructuring require unanimity of one or more classes of creditors that cannot be procured without a cram-down. In many cases, the broad consensus under a Scheme or a CVA will be recorded in a binding lock-up agreement by as many creditors as possible (ideally 75% and in a Scheme that percentage in each class). The broad consensus will then be used to procure the necessary execution of the transaction through the Scheme or the CVA which will be used to cram down the minority.

4. Legislative Regime Applicable to Restructuring and Insolvency

4.1 General Overview

The principal legislation dealing with insolvency in England and Wales is the Insolvency Act 1986, which has been amended over time by a number of subsequent legislative measures, such as the Insolvency Act 2000 and the Enterprise Act 2002. The Insolvency Act has also been augmented by subordinate legislation such as the Insolvency Rules 1986, which set out key procedures and procedural requirements with respect to insolvency processes in England and Wales.

Insolvent partnerships (generic unlimited liability partnerships) are dealt with by subordinate legislation made under the Insolvency Act 1986 s.420 (as subsequently amended), namely, the Insolvent Partnerships Order 1994 and for limited liability partnerships, the Limited Liability Partnerships Regulations 2001 (SI 2001/1090) was enacted.

With reference to corporate reorganisations using Schemes (which incidentally are not an insolvency procedure), the procedure is set out in the Companies Act 2006. These procedures do not apply to partnerships.

With reference to directors, the relevant directors’ duties as they approach a restructuring and insolvency process are set out in Chapter 2 of Part 1 of the Companies Act 2006 which purported to codify English common law on this issue. The position, liability and possible disqualification of directors in an insolvent company are set out in the Insolvency Act 1986 and the Company Directors Disqualification Act 1996.

Where a restructuring process affects a defined benefit pension scheme, the Pensions Act 2004 and the subordinate legislation made thereunder will be relevant and, to a significant extent, can shape the restructuring.

With respect to cross-border cases in the EU, the EC Regulation on Insolvency Proceedings 2000 (Council regulation
(EC) No 1346/2000) will be relevant. The UK is also a party to the UNCITRAL Model Law on Cross-Border Insolvency and this was incorporated into English law by the Cross-Border Insolvency Regulations (SI 2006/1030).

Separate provisions in the Insolvency Act 1986 deal with unregistered companies and unincorporated associations, friendly societies and foreign companies.

4.2 Restructuring and Solvency Regimes
In the Banking Act 2009, the UK government legislated for the rescue or wind-down of banks and other similar financial institutions including institutions authorised under FSMA to accept deposits (including building societies with certain modifications, but excluding credit unions), large investment firms of systemic importance (having an initial capital requirement of GBP730,000), UK clearing and payment houses and banking group companies. The regime aims to create stability in the financial system by creating a framework for a private sector acquisition, transfer to a solvent bridge bank or temporary nationalisation. There is a number of special resolution objectives that are implemented by HM Treasury, the Bank of England and other regulators and a code of practice exists to provide guidance on how the special resolution tools will be used.

Two bespoke insolvency regimes form part of the special resolution regime – bank insolvency is designed to facilitate an orderly winding-up of a failed institution and is similar to English law liquidation provisions, and administration is designed to deal with the legacy business of an institution where parts of the business have been dealt with under other special resolution procedures. The administration procedure is based on conventional administration procedures under the Insolvency Rules 1986.

A further special resolution option of “bail-in” was adopted by The Financial Services (Banking Reform) Act 2013. This is a tool that can be used to absorb the losses of a failed firm, and recapitalise that bank (or its successor) using the bank's own resources. The shareholders' and unsecured creditors' claims are written down or converted (or both) into equity to restore solvency in a manner that respects the hierarchy of claims in insolvency. The resolution approach document contains information on how the Bank of England envisages using the bail-in tool in practice and Chapter 9 of the revised code of practice contains details of the governance arrangements that apply to firms subject to bail-in.

It should be noted that the Banking Act 2009 excludes investment banks from the bank insolvency regimes and the administration regimes referred to above. Instead, a separate regime is established by the Investment Bank Special Administration Regulations 2011 (SI2011/245) and the Investment Bank Special Administration (England and Wales) Rules 2011 (SI2011/1301).

Special regimes for insurance companies exist under English law. FSMA includes a number of provisions that restrict an insurance company’s ability to enter into voluntary liquidation without prior consultation with the Prudential Regulation Authority (the PRA) and the FCA. The PRA is also entitled to attend creditors’ meetings and court hearings. For long-term insurers carrying out contracts of long-term insurance, the consent of the PRA is required before they can be wound up. Furthermore, if a liquidator is appointed, section 376(2) of FSMA requires the liquidator to carry on the insurer’s long-term insurance business with a view to it being transferred as a going concern to a person who can lawfully carry out those contracts.

Section 360 of FSMA contains an enabling power which now allows insurance companies to be placed into administration. This was not previously possible under the Insolvency Act 1986. The administration option for insurers was implemented by subordinate legislation pursuant to the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010, which provides that the administration order must be made by the court as opposed to an out-of-court appointment of administrators which is available for other companies. As with a liquidation of a long-term insurer, the administrator must carry on the insurer’s business to achieve a transfer of that business as a going concern. The Administrator must also assist the Financial Services Compensation Scheme in discharging its function of compensating policyholders.

The Insurers (Reorganisation and Winding Up) Regulations 2004 accords priority to claims by an insurer’s own policyholders over other unsecured debts (except for preferential employee remuneration and pension contributions) and FSMA provides additional provisions relating to insolvent insurance companies.

In addition to the Banking Act 2009, which regulates a multitude of financial services entities in relation to their insolvency, detailed legislation exists to protect the integrity of the financial markets and the financial system in the event of corporate insolvencies of market participants that affects market contracts. This is a complex area of financial regulation and is set out in Part VII of the Companies Act 1989. Notably, Part VII does not provide a standalone UK insolvency regime that regulates insolvency proceedings for participants in the financial markets (to the extent that such participants are subject to UK regulation). Instead, it changes the way that UK insolvency law under the Insolvency Act 1986 would and, in particular, it is important to note that under FSMA, the PRA and the FCA have specific
powers to apply for, and participate in, the application for the insolvency of a regulated entity.

Under English law, special regimes exist for, inter alia, air traffic transport (Transport Act 200), railway companies (Railways Act 1993), utilities and energy companies (Energy Act 2004 and Energy Act 2011), water companies (Water Industry Act 1991) and healthcare companies (National Health Service Act 2006 and Health and Social Care Act 2012).

5. Remedies Available to Unsecured Creditors

5.1 Unsecured Creditors
In most financial restructurings in England and Wales the rights of trade creditors are generally preserved and kept whole and it is only in exceptional cases where there is a small number of influential and easily identifiable creditors that a “trade creditor conference” will be instituted to socialise a compromise of their claim. The readiness of trade creditors to agree a compromise, even in the exceptional circumstances where they are approached, is rare. Given that trade creditors tend to be working capital creditors and the business franchise is dependent on trade creditors and their ongoing goodwill, and given that their compromise is infrequently determinative to the continuation of a company as a going concern, it is often felt to be inappropriate and too difficult to compromise them.

It is possible to structure a CVA to deal with unsecured creditors and this has been an approach that has been utilised in connection with landlord claims on a number of English restructurings.

5.2 Rights and Remedies
There is a multitude of remedies that can be exercised by unsecured creditors in addition to liens on assets in the possession of an unsecured creditor which can create repayment pressure, and an unsecured creditor can always commence debt recovery proceedings and, in the absence of a defence, proceed for summary judgment. This can take up to three months. Suppliers of goods typically include retention of title of clauses to enable goods to be recovered as a matter of contract if payment is not made by a specified date.

A more aggressive tactic would be for a creditor (especially an unsecured creditor) to issue a statutory demand for an unpaid debt and to use this as evidence that a debtor is insolvent and cannot meet its liabilities as they fall due. If repayment is not made within the 21 days specified in the demand, the creditor can quickly move to issue a winding-up petition, which is a very inconvenient development for a debtor. Where the debtor is negotiating a consensual restructuring with its creditors, this step may procure payment because if the winding-up petition is not discharged, any dispositions of a company’s property that occur after the date of presentation of the petition are potentially void if the company is ultimately wound up by the court. The company’s bank will freeze its accounts to protect the bank in the event that a winding-up order is made against the company. A bank may freeze a company’s accounts at any time after presentation of the petition, although it usually does so only after the petition has been advertised in the London Gazette. Once its accounts have been frozen, the company may find itself unable to pay its employees and suppliers, and so may be forced to cease trading.

Caution must be exercised here because if a debt is genuinely disputed, this remedy should not be used to claim a contested debt and an award for damages and full indemnity costs may be awarded against the creditor. Unsecured creditors can also make an application to court for the appointment of an administrator.

Unless the company is in administration or compulsory liquidation a moratorium or stay on unsecured claims is not possible under English law. In a creditor’s or member’s voluntary liquidation, a stay may be granted by the court on the application of a member, creditor or the liquidator.

If a company is undertaking a restructuring, it may be possible temporarily to defer the hearing of an administration or winding-up petition. The English courts have also shown a willingness to enable a company in the process of restructuring to continue in business despite the fact that a winding-up petition was outstanding against it, by granting orders under the Insolvency Act 1986 s.127 prospectively to validate payments which it needed to make to implement the restructuring.

More recently, the Courts have used their case management powers under Civil Procedure Rules to stay dissenting creditor actions. Under CPR 3.1(2)(f), the court has power to stay the whole or part of any proceedings or judgment either generally or until a specified date or event. This is a useful development as it means that a company proposing a scheme of arrangement may indirectly obtain the benefits of a moratorium, which is not provided for in Parts 26 and 27 of the Companies Act 2006 in relation to a Scheme.

5.3 Pre-Judgment Attachments
Pre-judgment attachments are available if the unsecured creditor can adduce sufficient evidence that the debtor is likely to dissipate its assets. In this scenario, the unsecured creditor will seek a court order freezing assets (usually a bank account) with a value equal to the claim. The unsecured creditor may be required to give a cross-undertaking for damages. Once a judgment is obtained, it becomes easier to attach assets and a further remedy would be to send a
court officer to the debtor's business address to seize goods, or to seek an order diverting a source of income such as a bank account or a receivable to the unsecured creditor.

5.4 Timeline for Enforcing an Unsecured Claim
As intimated, a lien can be exercised at any time when a debt is unpaid. A summary judgment can take three months to obtain if the debt is not disputed and this usually follows the issue giving 21 days to pay. A winding-up petition will be heard within 21 to 28 days of issue following advertisement of the petition in the London Gazette. Steps must be taken to prevent advertisement by a debtor within seven days by contesting the debt and making an application to court to prevent its advertisement.

5.5 Rights and Remedies for Landlords
Landlords have statutory rights to enforce claims as they have a right to sell the possessions of the debtor tenant on the leased premises to pay up to six months arrears of rent.

5.6 Special Procedures for Foreign Unsecured Creditors
Save for a potential requirement to provide security for a debtor's costs there are no special procedures or requirements that have to be satisfied by a foreign unsecured creditor. All unsecured creditors may be obliged to satisfy such bonding for costs, but this is more likely for a foreign debtor with no assets in the jurisdiction of England and Wales.

6. Secured Creditors: Security and Enforcement

6.1 Types of Security
A legal mortgage is the most common means of securing real estate and it has the effect of transferring the debtor's interest in the real estate to the lender, subject to the security and the "equity of redemption", which is the right to repay the debt and to procure a release of the security. An equitable mortgage has the effect of charging the property with the debt, but does not convey any legal interest to the lender. A lender holding an equitable mortgage or charge made by deed may sue the borrower under the covenant to pay. If a lender holding this type of security wishes to enforce its security, it will generally apply to the court for an order for sale of the property or the appointment of a receiver (see 6.2), unless express powers have been granted to the lender in the security document allowing it to take these actions without applying to court until foreclosure. Foreclosure is the process by which the borrower's rights in the property are extinguished (that is, the borrower's equity of redemption is extinguished) and that property becomes vested in the lender. The lender becomes the absolute owner of the property and may then sell it free of the borrower's rights (including its equity of redemption).

A fixed charge is an agreement between the lender and the borrower by which a particular asset can be appropriated by the lender, to the satisfaction of a debt owed to the lender. A fixed charge does not transfer a legal or beneficial interest in the asset to the lender, nor does it confer a right to possession, but it does attach the lender's remedies to the real estate on creation. The lender will have a right to sell the asset to realise it so as to pay off the debt or to take possession or appoint a receiver. The key characteristic of a fixed charge is that it gives the lender control over the charged asset.

Lenders may also take an assignment of rents as a further security interest in connection with real estate. This will usually be accompanied by a charge over a relevant rent proceeds account.

Security over shares in England and Wales may take the form of a legal mortgage whereby the debtor transfers legal title to the shares. The lender becomes the registered owner of the shares and the debtor will be prevented from dealing with the shares whilst they are subject to the mortgage (unless the mortgagee agrees otherwise). It is possible to take a legal mortgage over bearer shares and registered shares in both public and private companies.

A charge over shares is an agreement under which the shares are appropriated to the satisfaction of a liability or obligation. Unlike a mortgage over shares, a charge does not transfer a legal or equitable interest in the asset to the lender. It merely creates an encumbrance in favour of the chargee.

A fixed charge can also be taken over credit claims (loans made by financial institutions), financial instruments and cash if there is sufficient control over the assets. With respect to security over cash, this will require control over the account and the proceeds thereof.

Share security and security over cash, credit claims and financial instruments now benefit from the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226), which simplify the process of taking security over financial collateral. The Financial Collateral Arrangements (No 2) Regulations 2003 apply to financial collateral arrangements which include security arrangements. A security financial collateral arrangement is defined as one where a security interest (a mortgage, charge (fixed or floating), pledge or lien) is created over financial collateral where ownership of the collateral is transferred on the understanding that it will be transferred back on repayment of the debt. Security granted under the Financial Collateral Arrangements (No 2) Regulations 2003 has the benefit of removing burdensome formalities of execution, registration and enforcement.

It is also possible to create fixed and floating security over movable property such as stock, cash and debts. In order to
constitute a fixed charge, high levels of control have to be exerted over the relevant assets by the lender, which is invariably impractical for the company. Accordingly, it is more likely that a floating charge will be created over such asset classes, both present and future. As a general point, a floating charge is often created over the entire assets and undertaking of a debtor. Such security floats over the assets until an event of default or acceleration of the debt occurs, at which point the floating charge will crystallise such that it converts to a fixed charge over all of the debtor’s assets at that time with the effect that the debtor can no longer deal with the assets.

6.2 Enforcing Security
Subject to contractual restrictions between creditors (in, for example, an existing intercreditor agreement or a standstill or waiver letter) a party can enforce security in accordance with its terms. Such terms typically permit enforcement upon the occurrence of an event of default that is continuing unremedied or unwaived, or in more professionally drafted borrower-friendly documents following an acceleration.

Unless the company is in administration or compulsory liquidation, a moratorium or stay on enforcement is not available under English law when a company is undergoing a consensual restructuring or a Scheme or CVA. In a creditor’s or member’s voluntary liquidation, a stay may be granted by the court on the application of a member, creditor or the liquidator.

This is far from ideal because the vast majority of restructurings are negotiated outside of any formal insolvency proceedings. One recent development to manage a potential winding-up petition that is threatening a consensual restructuring process, has been the readiness of the courts to use their case-management powers under Civil Procedure Rules to stay dissenting creditor actions. Under CPR 3.1(2) (f), the court has power to stay the whole or part of any proceedings or judgment, either generally or until a specified date or event. This is a useful development as it means that a company proposing a scheme of arrangement may indirectly obtain the benefits of a moratorium, which is not provided for in Parts 26 and 27 of the Companies Act 2006 in relation to a Scheme.

In a compulsory liquidation, leave of the court is required to take any action or proceedings and leave will not be granted if the action raises issues that could be dealt with more appropriately in the liquidation.

In administration, there is an interim moratorium upon filing the application at court and a final moratorium when the order is made. Unless the administrators consent or a court order permits, secured creditors cannot enforce security over the company’s property and no party can take any step to repossess goods in the company’s possession under a hire purchase agreement. “Security” in this context is given a broad definition. It includes “any mortgage, charge, lien or other security” but does not include the exercise of a right of set-off. The definition of “hire purchase agreement” for this purpose includes a contract that incorporates retention of title provisions, conditional sale agreements and chattel leasing agreements. It is important to note that the administration moratorium does not apply to any security interest created or otherwise arising under a financial collateral arrangement within the meaning of the Financial Collateral Arrangements (No 2) Regulations 2003.

It should also be noted that secured creditors can potentially enforce their security (assuming the contractual enforcement triggers in the underlying finance and security documents have occurred) during a consensual restructuring where an insolvency has not been commenced by: (i) appointing a receiver with respect to a fixed charge or a mortgage over specified assets such as real estate or a charge over shares; or (ii) appointing an administrative receiver if the secured creditor has floating charge over the whole or substantially the whole of the company’s assets and undertaking.

Historically, the administrative receiver would be appointed over all of the company’s assets and would operate the company as its agent, despite having a primary duty to the appointing secured creditor. Following the Enterprise Act 2002, it is no longer possible to appoint an administrative receiver unless the floating charge pre-dates 15 September 2003 or it relates to certain exempt financing transactions such as a narrowly defined capital markets or project finance transaction. Although the original purpose of having a floating charge has been removed by the enactment of the Enterprise Act 2002, four advantages of a floating charge now exist:

- The floating charge still has priority over unsecured claims;
- The floating charge holder must be given a notice of an intention to appoint an administrator by the company or the directors if they elect to pursue an application for an administration;
- The floating charge holder can appoint its own choice of administrator in preference to the administrator selected by the company or the directors; and
- The floating charge holder can appoint an administrator out of court.

A fixed charge receiver, by way of contrast, is an individual appointed by a creditor that holds only a fixed charge over the relevant asset of a debtor, who is able to take custody of that charged asset, manage that asset, receive the income from it and sell it to discharge the underlying debt. Clearly, the appointment of a fixed charge receiver or the threat of such an appointment gives the relevant secured creditor hav-
ing that right, a significant degree of leverage in restructuring negotiations.

A mortgagee may also itself take physical possession of a mortgaged asset and without appointing a receiver may sell the asset to discharge the debt owed to it – however, this is extremely rare in practice. Similarly, with respect to security over cash or securities constituting financial collateral under the Financial Collateral Arrangements (No 2) Regulations 2003, the lender has a right to sell, “use and dispose of the financial collateral as if it were the owner of it” and can “appropriate” the financial collateral so as to enable it to become the absolute owner of the collateral should the security become enforceable.

6.3 Timeline for Enforcing Security
The timeline for enforcing security over cash collateral is immediate once the right to enforcement has been reached and the necessary formalities under the security document have been observed. Pursuant to the Financial Collateral Arrangements (No 2) Regulations 2003, the lender, under a security financial collateral arrangement securing cash or shares, may be given the right to sell and use and dispose of the financial collateral as if it were the owner of it, providing that such rights are exercised in accordance with the provisions of the agreement. The parties may also have agreed that the lender can “appropriate” the financial collateral – this means that the collateral-taker has the right to become the absolute owner of the collateral should the security become enforceable.

6.4 Foreign Secured Creditors
There are no procedures or other impediments that hinder or discriminate against foreign secured creditors.

7. The Importance of Valuations in the Restructuring and Insolvency Process

7.1 Purpose and Importance of Valuations
In a restructuring and insolvency context, valuation is a fundamental and guiding principle and it has numerous functions. In the first instance, where a company has a balance sheet insolvency event of default test based on its liabilities exceeding the value of its assets, value becomes an important principle. Similarly, in the context of contingency planning for an insolvency as part of a restructuring process, the value of the group, its assets and constituent businesses will inform that planning process. Equally, when votes and classes in a Scheme are being considered, a company formulating its scheme classes may dispense with a scheme of a creditor constituency that has no “economic interest” in the company based on a valuation analysis. In England and Wales, a statutory compromise under a Scheme or a CVA will not be sanctioned by the court if the value of a creditor’s return under an insolvency plan is worse than the value of its return under a liquidation. More recently, when those promoting a Scheme are using insolvency and liquidation as a barometer to demonstrate that creditors would have the same economic outcome and should, therefore, be in the same Scheme class, the courts will require valuation evidence to this effect.

Intercreditor agreements often contain sophisticated release provisions enabling the security agent to release junior claims, guarantees and security rights if those junior classes are out-of-the-money following an independent valuation and/or the issue of a fairness opinion by an investment bank or other internationally recognised valuation firm. Valuation also obviously comes to the fore when insolvency office holders, such as an administrator, are selling an asset and they are concerned with obtaining the best available value in all of the circumstances. Equally, where antecedent transactions are being challenged in an insolvency by an office holder on the basis that the transaction was a preference or conducted at an undervalue, the court will need to be satisfied that the company was insolvent at the time (which triggers a need for a valuation) and that the asset or transaction itself was not conducted at fair value.

The most common debate amongst stakeholders will be conducted in the early stages of a transaction to establish whether those who hold equity, junior debt or senior debt in the enterprise have any economic interest in it. One of the first questions asked by all stakeholders will be: “Where does the value break” (ie which creditors’ claims are likely to remain unpaid based on the current value of the business if there was an enforcement). Creditors with claims below the point at which the value breaks or who have an impaired claim which would not be discharged in full will argue that the value breaks with them and that they are the so-called fulcrum creditor. Given the fundamental impact of this debate on the entire course of a restructuring, it is not surprising that those stakeholders purporting to have an economic interest in a company and its estate will conduct their own detailed valuation analysis.

7.2 Initiating the Valuation
There are no consistent patterns in England and Wales, but investors buying into the debt of a company will most typically undertake their own desktop valuations and may engage an adviser to undertake preliminary work to validate that. As a restructuring intensifies and develops, the directors may well undertake a discreet valuation to guide their conduct and to establish where their duties might specifically lie, notwithstanding their general duty to all creditors at that point. The directors may also want to determine asset prices for parts of the business that they might sell or which they might secure to raise new money. A valuation might alleviate challenges at the time of the disposal or grant of security or subsequently by an office-holder.
During the course of the restructuring and most probably during the course of an independent business review commissioned by the relevant creditors, those creditors will have more detailed valuation work undertaken on their behalf. This is much more likely to be accurate than the original desktop valuations, since the relevant advisers will have access to comprehensive and up-to-date company data. Given their exposure to an adverse valuation and the risks of this dictating the entire shape and terms of the restructuring, junior creditors may conduct a defensive valuation of their own to establish that they are still in the money and are very much a fulcrum creditor.

At the point of enforcement, it is not uncommon for the company to update its valuation so that it remains a fair arbiter of value allocation and properly discharges its duties to its creditors (see 7.3). At this juncture, a security agent asked to release security may well undertake its own independent valuation that could potentially morph into a fairness opinion. If a Scheme or a CVA is contemplated, then the company and its financial advisers will also seek to have a valuation that can support the proposals and formations of classes in connection with the Scheme. If the restructuring involves the use of an insolvency process for implementation purposes or if a formal insolvency process is the likely outcome, then an insolvency office-holder is likely to conduct its own valuation and commission an independent valuation in advance of the appointment. This will be imperative.

7.3 Jurisprudence Related to Valuations

Since the financial crisis, there has been much more scrutiny on the “value break” and the identification of the stakeholders that are economically disenfranchised, the stakeholders that have an impaired interest and the creditor group that is unimpaired. Valuation has therefore been elevated more than ever as the fundamental battleground in a restructuring and, as a consequence, the jurisprudence relating to valuations of distressed companies has developed to an extremely sophisticated level in England and Wales.

The starting point under English law will be a going-concern valuation because in most restructurings the company will be in the middle ground: where it is neither beyond economic redemption and incapable of generating any return on capital, nor a stable entity with good fundamentals merely requiring temporary support in order to maximise value via a “soft” amendment of its credit facilities. The middle ground is often occupied by a “good company with a bad balance sheet”.

The valuation of a company on a going-concern basis usually takes into account four business cases which will drive the cash flows of a business: (i) the base case which is aligned to the core business plan used by the debtor to formulate the restructuring plan; (ii) the downside case which incorporates the adverse effect of certain business risks so that the business can still survive without another round of restructuring; (iii) a best case which purports to estimate an optimum outcome applying certain upside opportunities; and (iv) a sensitised case may also be produced which is a combination of both the downside case and the base case. Whilst the four cases will be relevant in terms of reaching a valuation or a valuation range, specific valuation techniques will also need to be applied rigorously. In the IMO case (IMO Carwash (In the matter of Bluebrook Ltd and in the Matter of IMO (UK) Ltd and in the Matter of Spirecove Ltd and in the Matter of the Companies Act 2006 [2009] EWHC 2114 (Ch)), which is one of the leading valuation authorities under English law, Mann J at para 12 of his judgment was supportive of a valuation process that embraced a number of going-concern valuation techniques and it is clear that in the future it will be necessary for restructurings valuations under English law to be multifaceted in order to be credible. There are six key going-concern techniques that have been adopted by the English courts:

- Comparable multiples – comparable multiples of companies operating in a similar sector and geographical location by reference to comparable variables such as EBITDA, gross revenues or net income or some other industry-specific barometer such as tonnes mined or even subscribers to a business.
- A discounted cash flow method - this technique (taking into account the four cases above) derives a going-concern valuation by calculating the net present value of all future cash flows over an initial period of 5-10 years. These cash flows are then discounted back to a present value using “weighted average cost of capital” formulae. A “terminal value” of the business into perpetuity at the end of the initial period is then established by applying a perpetual growth rate to the final year of cash flows. The last step is to discount this terminal value back to a present value using the weighted average cost of capital formulae and this amount is added to the present value of the projected near-term cash flows to obtain the company’s DCF enterprise value.
- An LBO (Leveraged Buy-Out) Analysis - many investment banker fairness opinions and the valuations provided by restructuring professionals have included an LBO financial buyout model as a further component of a valuation. This method determines the amount that a financial buyer (effectively private equity firms) would pay for the business, given assumptions as to how much debt capacity the business would have in current market conditions. Any such debt capacity calculation assumes that part of the company’s cash flows would be required to provide shareholders with what they would see as a reasonable return on their equity investment. The relevance of this restructuring tool is due, in large part, to the importance of financial buyers (PE firms) in the M&A process and capital markets today.
• Secondary Debt Market Pricing - the capital markets provide many fixed income investors with a secondary market price for a loan or debt security. Whilst debt pricing is only one approach to indicate value and may not be determinative, determining a yield to maturity of a debt security is useful as an input for computing a company's cost of capital in the DCF analysis as well as the implied recovery rate (where the debt breaks) by debt investors.

• "Market Testing" Valuations - based on bid interest and potential supply and demand. The existence of historical bids for the company can provide useful valuation guidance, although greater certainty is provided by bids made with greater proximity to the execution of a restructuring, especially where they were supported by an investment banking adviser that had conducted thorough market testing and invited interest from trade buyers, financial investors and potential private equity acquirers and such interested parties had been able to conduct detailed due diligence through a properly organised process.

• Real Estate Valuations - in restructurings where the group owns a significant amount of real estate assets as a proportion of its asset base, such as nursing home businesses, it will not be unusual for the protagonists to conduct a real estate valuation both on a full market value basis taking into account the restricted usage of the property and the continuation of the core operations, but also contemplating a separate value based on vacant possession.

If a company is listed and has access to the capital markets, there may also be a so-called "liquidity premium" and for valuation purposes this may well distinguish a listed company from an unlisted company operating in the same sector.

Another form of valuation technique is a Liquidation Valuation. This technique assumes that the company is not viable as a going concern because the value of its business as a going concern is worth less than the break-up value of its assets and that any prolonged operation of the business will compound the losses of the stakeholders such that it is logical in such circumstances that assets would be sold piecemeal on an expedited basis. Any valuation on a liquidation basis will require an assessment of the value of each asset class on a balance sheet and will take into account a raft of factors such as asset type, liquidity, condition, encumbrances, degree and purpose of annexation in the case of fixtures and the level of marketing required. There is inevitably a degree of due diligence and verification conducted by the insolvency office-holder and prospective purchasers as to ownership, perishability, demand existence and location of the relevant assets, taxation and base costs of the asset, the range of prospective purchasers, the degree of competitive tension and the impact of insolvency laws and procedures.

For more specialised or intangible assets such as brands, trademarks and intellectual property, and fixed assets such as real estate, fixtures and plant, the assistance of surveyors and other professional valuers is required. The spectrum will typically range from nominal value on "fire-sale" to market value or possibly even premium value in the case of vital intellectual property or key component tools or parts.

Valuation for Office-holders

If an office-holder is undertaking a sale, it will be necessary to undertake a valuation both for legal reasons to avoid a challenge and, by implication, as a risk-management tool. In the EMI case (In the Matter of Maltby Investments Ltd (in Administration) between: Maltby Holdings Ltd and (1) Peter Norman Spratt and (2) Anthony Victor Lomas [2012] EWHC 4 (Ch)), the plaintiffs challenged a valuation undertaken by the joint administrators of Maltby Investments Ltd prior to selling that company's assets in a pre-packaged administration sale and the utility and foresight of undertaking an extensive valuation in that case is clearly evident from the judgment.

For administrators undertaking a pre-packaged transaction there is a requirement under Statement of Insolvency Practice 16 (SIP 16) that a valuation process is properly conducted and an explanation as to why the assets were not exposed to a competitive process. SIP 16 also imposes compliance standards on the preparatory work that the putative administrator must undertake before executing such a sale.

With respect to an administrative receiver, the obligation is to obtain the best prices reasonably obtainable in all of the circumstances at the time of the exercise of the power of sale. The case law does not require that an administrative receiver conduct a competitive sale process or a sale by auction to discharge this duty, but given the risks of personal liability and the risks of challenge, it is rare for an administrative receiver not to undertake a full valuation process and to expose the assets to the market. Indeed, it is likely that both administrative receivers and liquidators will observe the integrity of SIP 16 as a risk-management tool.

Valuation Challenges

In the landmark Stabilus valuation case (Salto III Limited (Claimant) –v- (1) MD Mezzanine SA Sicar (as Mezzanine Facility Agent), (2) JP Morgan Europe Limited (As Security Trustee), (3) MD Mezzanine SA Sicar, (4) Quintus European Mezzanine Fund Sarl (5) ECAS Sarl (6) Lloyds TSB bank plc (7) Contego CLO I BV (8) Gresham Capital CLO IV BV (together the Defendants) –and- Servus Holdco Sarl (Third party) and Blitz F-10 – Acht-drei-drei GMBH & Co KG (Fourth Party) [2012] EWHC 3025)) where Eder J gave an incredibly well-considered and admirable decision of the highest quality, this issue was considered. From his judgement it appears that it is not strictly necessary to undertake an M&A process if the company was on the verge of insolvency and all of the other value techniques applied provided...
indisputable evidence that the value break was in a particular point in the capital structure. In such circumstances, and where the senior creditors were effectively impaired to the extent of over 50% of their exposure, it was acknowledged by the court that it was wholly impractical and unnecessary at this juncture to run what would have been an elongated sales and marketing process that would have made no difference to the valuation outcome.

In cases where there is a legitimate valuation tension between competing creditors, it was acknowledged by Eder J that it will be necessary to undertake a valid M&A process and in his judgment he provided a number of helpful indications as to how such a process should be conducted. He indicated that where value is not polarised and is indeed disputable, an M&A process will need to have much greater proximity to the execution of the restructuring and the enforcement process. In addition, the M&A process should be specifically commissioned by the security trustee for the clear purposes of finding a potential purchaser for the business and, of course, ascertaining what a potential purchaser would pay. It will need to be more than a mere market-testing process because where value is much more debatable, a comprehensive “market and sales process” will be required. It would also appear that a limited process cannot be undertaken merely out of an anxiety on the part of certain stakeholders that an extended process will damage the business when this might result in the business not being marketed adequately so as to create a challenge by those opposing the restructuring. It is also possible to conclude from the case that in order for a sales process to be fit for the purpose of a security trustee enforcement, the process cannot be undertaken in a vacuum and there has to be some understanding of the enforcement strategy on the part of the valuer providing reliance on his independent valuation. Tight timetables based only on indicative bids were also perceived negatively by Eder J and, ideally, such processes should benefit from a “competitive tension” which would, or at least might, have arisen if the process had progressed to a final round of bids via a final phase.

Credible Valuations
It is apparent from the Stabilus case that a valuation need not look out so far into the future that it benefits from the impact of substantial but albeit prospective predictions of recovery. In this regard, it is notable in the Stabilus case that there had been an improvement in the automotive markets within which Stabilus operated by the end of 2010 at the time of enforcement. However, Eder J noted that a significant forward-looking valuation not based on current performance and prospects over the short-term made the competing mezzanine valuation, in some respects at least, somewhat theoretical because as a matter of timing a valuation depended on an assessment as to when and how quickly the world would recover from the downturn after 2008 and what part the Stabilus group would or might play in such recovery. By significantly shifting the entire projected revenue curve upwards for five years, the mezzanine valuation became speculative in nature in the eyes of Eder J, and lacked realism.

In the judge’s view, the competing mezzanine valuation suffered considerably because it was, in significant respects, based on hindsight or a rosy outlook, not based on the evidence and outlook at the time of enforcement. The case is, therefore, a good precedent for the proposition that a valuation exercise should be carried out on the basis of information available at the time, with only a conservative and short-term perspective on the projected performance of the business being applied. In assessing the position at the time of the valuation, it was highly relevant to Eder J that the management, who knew the business best, did not consider at the time of the final valuation and the time of enforcement that the Stabilus group had “turned a corner” nor that the improvements in results demonstrated a continuing “trend” that could be relied upon to continue in the future so as to bridge a valuation gap where the senior debt was 50% and some EUR200 million impaired.

Sole Value Comparator
In the case of Re MyTravel Group plc, the English courts had the opportunity to assess the basis upon which a highly distressed company on the verge of an unplanned insolvent liquidation should be valued. MyTravel was an international travel business and tour operator selling holidays and part of its capital structure was constituted by convertible notes expressed to be fully subordinated in the event of a liquidation, such that at that time they had the characteristics of an equity claim since they would be subject to a deemed conversion on the day immediately preceding the date of the winding-up.

Attempts at a consensual restructuring had failed and the regulator of the UK travel sector was on the verge of terminating MyTravel’s operating licences and, as a consequence, an insolvent liquidation was a real and imminent possibility. The litigation in the case focused on MyTravel’s contention that the convertible bondholders were effectively disenfranchised from voting on, and participating in, the scheme on the basis that the bondholders had no economic interest in the company and that the only alternative to the scheme was a liquidation and in a liquidation their subordinated status and the deficiency of assets meant that they had no prospect at all of recovering any of the sums due under the bonds.

Mann J who heard the case, did not have to consider the “economic interest” argument for other reasons and so his judgment is only obiter dicta, but he did accept on the evidence that the only viable option for MyTravel in the absence of the consensual restructuring was an immediate insolvency filing. In this regard, it is important to point out
that because the regulator was on the verge of revoking the licence, the company would not survive an administration and would be liquidated.

Under the proposed scheme, no compromise or arrangement was proposed with the bondholders. As intimated, their debt was simply to be left in the company without any assets to satisfy it and there would be no recovery for the bondholders. The company had made the correct decision, in Mann J’s view, that a consultation with the bondholders was unnecessary because they had no economic interest in the company; the only alternative to the scheme was a liquidation and in a liquidation their subordinated status and the deficiency of assets meant that they had no prospect at all of recovering any of the sums due under the bonds.

Whilst the case does demonstrate that liquidation and a liquidation value can be used as the sole value comparator so as to justify an assertion of “no economic interest” in relation to a specific creditor class, it is clear from the case that this will require the company to present clear and incontrovertible evidence to that effect. It is also clear that this question in every case will be decided on the factual evidence and what it shows on the correct standard of proof. However, where the company is on the cusp of liquidation, it seems clear that fanciful or theoretical possibilities of sufficiency of assets and value should be excluded. In MyTravel, the company asserted that the context of the valuation should be a winding-up because without the restructuring through the scheme by those having an economic interest in a liquidation, the compelling expert evidence was that the company would be insolvent and that the only alternative would be an insolvent liquidation where the bondholders would have no economic value in their claims.

In My Travel, the court also effectively rejected the argument that there must be inherent value in the company if certain creditors perceive this by being prepared to convert their debt claims into equity. On the facts of the case, however, where the company was hopelessly insolvent and a value deficit of some GBP435 million would have to be bridged in order to return value to the bondholders, this was an unrealistic premise on which to accord the bondholders any value. In MyTravel, Mann J effectively dismissed this notion and held that impaired creditors whose claims have some value in a liquidation are entitled to weigh up the potential realisations in a liquidation. If such creditors conclude that a restructuring and a continuation of the business as a going concern is a better way of them recovering more value for their debts at some point in the future, then they are clearly entitled to pursue such a restructuring. Mann J concluded on this point by stating that for the bondholders (on the facts of MyTravel) to perceive the restructuring efforts of others as proof that “the present company presently has a value which exceeds the amount of the unsubordinated debt is an enormous leap. [He asked] Where is that value to come from? The hopes of the other creditors as to the future prospects for another company (newco) do not generate extra value in the present company.”

MyTravel should not, however, be interpreted as the norm, and in the vast majority of cases a liquidation valuation will not be adopted as the core valuation technique. Indeed, where there is no immediate burning platform posed by the need for a prompt insolvency filing driven either by extraneous factors (such as the loss of a regulatory licence as in MyTravel or the loss of a fundamental contract) or an acute liquidity crisis in the company that is being restructured, a going-concern valuation will be the norm. This principle was endorsed by Mann J in the IMO case where he correctly held that for the purposes of that case, and in order to assess the fairness of the IMO schemes, a going concern value was appropriate because there was a standstill in place and no pending obligation on the directors to file for insolvency.

8. Directors’ Duties and Personal Liability

8.1 Duties of Directors in a Distressed Company

The duties of directors under English law are set out in Chapter 2 of Part 1 of the Companies Act 2006 although it is expressly acknowledged in the relevant provisions that reference can also be made to the common law so that the general duties shall be interpreted and applied in the same way as common law rules or equitable principles. The aim of the Companies Act 2006, which is a codifying statute, is to make the law in the area of directors’ duties more consistent, certain, accessible and comprehensible. The Companies Act 2006 introduces a statutory statement of directors’ duties described as “general duties” and these include the following duties: a duty to act within the constitutional powers of the company and only for the purposes that the powers were conferred; a duty to promote the success of the company; a duty to exercise independent judgment; a duty to exercise reasonable care, skill and diligence; a duty to avoid conflicts of interest; a duty not to accept benefits from third parties; and a duty to declare interests in proposed transactions and arrangements.

The starting point is that these general duties are expressed to be owed to the company and that codification does not open the prospect of the duties being enforced by other parties such as members, creditors or suppliers. Whilst the Companies Act 2006 creates a new duty to promote the interests of the company which is supported by certain statutory matters set forth in s.172 (1) that the directors should take into consideration, it should be noted that pursuant to s.172 (3), this duty to promote the interests of the company is expressed to be “subject to any enactment or rule of law re-
quiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.” The reference to creditor interests effectively means that as the company becomes distressed and there is a risk of insolvency, the duty to promote the success of the company for the benefit of the shareholders transitions, thereby requiring the directors to consider and act in the interests of creditors of the company.

The Companies Act 2006 does not, however, expressly deal with the actual detail of the obligations of directors to creditors when a company is approaching insolvency and how they should specifically act, because the decision was taken to leave the courts to develop the law in this area. If one refers to the pre-Companies Act 2006 case law, the legitimate conclusion would be that the point in time at which the duties to the members transition to the interests of creditors is prior to actual insolvency, at the point “where a company is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors’ money which is at risk.” Other cases have held that the duty to creditors intrudes prior to insolvency when the company is in a “dangerous financial position,” in a “parlous financial state,” “financially unstable” and in “financial difficulties.” Although there is no clear judicial guidance and there is no obvious difference between financially unstable and a parlous financial state, the trend in the English courts is for directors to be fixed with a duty to their creditors in advance of the point of actual insolvency.

Whilst the interests of the creditors have been stated by the courts to be “paramount,” one could possibly frame an argument that prior to the point of insolvency, the cases (technically) do not entirely remove the flexibility for the directors to also partially promote the success of the company taking into account the statutory factors, where this is possible without prejudicing creditor interests. The rationale for this more “shareholder-friendly” interpretation of the current law is that insolvency is the only certain test for intrusion of creditor interests and “paramount” does not necessarily mean exclusive.

It is important to note that the case law has also clearly articulated that whilst creditor interests “intrude,” the fiduciary duties are not actually owed by the directors to the creditors themselves, but to the company itself for disregarding the interests of the creditors that had clearly intruded. This will enable the company or its liquidator to bring actions against the company for the breach of these duties, but not a third-party creditor who is not directly owed a duty.

In terms of the standard of care to be adopted in relation to creditors, the English case law would suggest that where the director against whom proceedings have been initiated had actually failed to consider whether the action that is the subject of complaint would be in the interests of the company, the court had to ask whether an intelligent and honest man in the position of a director of the company involved, could, in the whole of the circumstances, have reasonably believed that the transaction or a particular course of conduct was for the benefit of the company.

Another interesting question relates to the identity of the creditors that the directors should be cognisant of. Is it the creditors who are most likely to be affected by a given decision or is it the general body of creditors? This is a difficult question to resolve and the case law would appear to conflict. One first instance judgment has suggested that where the company is insolvent, the human equivalent of the company for the purposes of the directors’ fiduciary duties is the company’s creditors as a whole, ie its general creditors. It follows that if the directors act consistently with the interests of the general creditors, but inconsistently with the interest of a creditor or section of creditors with special rights in a winding-up, they do not act in breach of duty to the company.

In cases where the directors are contemplating incurring additional credit under a bank facility to discharge their maturing trading or other financial liabilities, it is submitted that despite the above cases which indicate that a director owes a duty to the creditors generally, the directors cannot ignore the interests of a specific lender that is being asked to increase its liabilities, when the directors have no understanding of how they will repay that lender – they cannot simply hope that something will turn up or trading will improve. Despite the position adopted in the above cases, it is inconceivable that the directors can recklessly discharge the liabilities of unsecured creditors at the expense of a lender (especially a secured lender that would expect to have priority in a liquidation) when they have no visibility on how the lender increasing its exposure will be repaid.

In another first instance judgment of Mann J in the IMO Carwash (In the matter of Bluebrook Ltd and in the Matter of IMO (UK) Ltd and in the Matter of Spirecove Ltd and in the Matter of the Companies Act 2006 [2009] EWHC 2114 (Ch)), the specific allegation was that the directors ought to have bargained for something to be provided to the mezzanine lenders, but Mann J correctly pointed out that if this was correct, then even those creditors ranking behind the mezzanine lenders were owed a duty and this had not been suggested by the mezzanine creditors or indeed any other person in the litigation. Moreover, he noted that the mezzanine lenders were at all material times “fighting their own corner” and in no way expected the directors to deliver any value to them. He also noted that the valuation materials did not make it obvious that the directors should be taking it upon themselves to negotiate an interest for a body of creditors who had not managed themselves to negotiate an interest in direct negotiations with other stakeholders. Mann J makes it clear in his judgment, that where the value clearly breaks in a specific creditor constituency, the direc-
tors act properly if they engage with the major creditors in that constituency (and any others ranking in priority to it) in restructuring discussions.

Personal Liability

The directors (or a shadow director or de facto director) can be liable for wrongful trading under the Insolvency Act 1986, s.214 in circumstances where the company has gone into insolvent liquidation and at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. The court will not declare a director liable for wrongful trading if it is satisfied that, after he knew or should have concluded that there was no reasonable prospect of avoiding an insolvent winding up, the director took every step with a view to minimising the potential loss to the company's creditors that he ought to have taken.

The Insolvency Act 1986, s.213 sets out the fraudulent trading provision under English law. Any person (not just the directors) can be liable if, in the course of the winding up of a company, it appears that any business of the company has been carried on by that person with the intent to defraud creditors of a company or creditors of any other person, or for any fraudulent purpose. The relevant persons must have knowingly been parties to the carrying on of the business in such a manner.

It should be noted that originally it was only on the application of a liquidator that the court could declare the director liable under s.213 and s.214 to make such contribution (if any) to the company's assets, as the court thinks proper. Pursuant to the Small Business, Enterprise and Employment Act 2015, administrators will now be allowed to bring such actions. In addition, administrators and liquidators can now assign these actions to third parties.

The courts have confirmed that the remedies under the fraudulent and wrongful trading provisions aim to be compensatory (to the company's creditors) rather than penal. Whilst it is important to bear in mind that the required contribution from the directors is left entirely to the court's discretion, it appears that the contribution will normally be the amount of loss suffered by the company.

The directors can also be liable for a breach of fiduciary duty and in this regard members can indirectly enforce the duties by acting on behalf of the company pursuant to the derivative action procedures pursuant to sections 260-264 Companies Act 2006. Alternatively, a claim may be brought by a liquidator in the event of a winding up of the company.

Apart from liability for wrongful trading and fraudulent trading, there is no specific liability related to a deepening of the insolvency of an English company.

Sanctions

Directors can commit an offence if they are found to have acted fraudulently under Insolvency Act 1986 s.206-207. Liability can also be imposed under the Insolvency Act 1986 s.208-211 for misconduct in the course of a winding up, falsifying the company's books and making false representations to creditors in the course of a winding up.

The Company Directors Disqualification Act 1986 (CDDA 1986) enables a court to impose a “disqualification order” upon a person, usually a director. Such an order would prevent that person, without leave of the court, inter alia, for a period of up to 15 years, from being a director of a company or from, in any way, whether directly or indirectly, being concerned or taking part in the promotion, formation or management of a company (which has been widely interpreted to include being a management consultant or giving advice on the financial management or reconstruction of a company). Given the impact on professional directors of a disqualification order, experience has shown that the risks posed by the legislation do occasionally affect the conduct of directors in a restructuring. Both economically and from the perspective of their reputation, directors will want to avoid any prospect of proceedings under the CCDA 1986. Convocation of a disqualification order involves a criminal offence and can render the person liable for the debts of the company.

8.2 Chief Restructuring Officer

There has been an increasing trend for distressed companies in England and Wales to appoint specialist turnaround professionals (CROs) to implement both financial and operational restructurings. There has been a much greater tendency for lenders to push for substantial management improvement in the form of a CRO and for lenders to condition the continuation of their facilities on the appointment of a CRO. Lenders adopting such a stance will not be shadow directors without crossing the line and ensuring that CROs become accustomed to act in accordance with their instructions; experience has shown that lenders need to proceed with caution and to socialise the concept of a CRO discreetly and objectively.

CROs must possess proven levels of business and financial experience and must be highly credible with outstanding project management and communication skills and the confidence to take difficult decisions and devise, drive and execute significant change through a holistic restructuring. The CRO will, inevitably, therefore be a key executive appointment and even if not formally appointed as director, may well become a de facto director of the company with...
all the attendant duties and responsibilities that arise under English law. Taking on such a role at what can often be a precarious juncture does expose the CRO to considerable personal risk. Accordingly, well-advised CROs will have carefully scrutinised the company’s director and officer insurance policy (D&O Policy) before accepting such roles and will have carefully negotiated their terms.

8.3 Shadow Directorship
Under English law, both de facto directors (who are persons operating and acting as directors without having been validly or formally appointed at all) and shadow directors (who are effectively persons in accordance with whose directions or instructions the directors of a company are accustomed to act), can attract liability.

In large English-law restructurings, where the influence of shareholders and creditor constituencies is strongly felt and those stakeholders strive to manage and direct both the negotiations and the restructuring outcome in a manner that promotes their economic interests, there are inevitably going to be situations where such stakeholders are actively involved in the future direction of a company’s business. Caution and care need to be exercised, however, in order to ensure that the promotion of those interests does not transform and manifest itself as real influence over a company’s board such that the stakeholder becomes a “shadow” director. In identifying shadow directors, the courts have focused on persons who exercise real influence over a board of directors. This ‘real influence’ may be over just one area of a company’s business, and need not be over all of the corporate affairs of the company. Generally, there must be a pattern of real influence and a single act is not sufficient. The potential shadow director can be an individual person or a company, and can be located outside England. Shadow directorship has been characterised as a “pattern of behaviour in which the board did not exercise any discretion or judgement of its own, but acted in accordance with the directions of others.

The directors’ duties acted in the Companies Act 2006 apply to shadow directors in a qualified manner because s.70(5) provides that “[t]he general duties [in sections 171-177] apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.” This of course requires a reference back to the common law with respect to shadow directors and the case of Ultraframe (UK) Ltd v Fielding and others [1998] 1 BCLC 333, which held the mere fact that a person falls within the statutory definition of a shadow director is not enough to impose on him the same fiduciary duties as are owed by de jure and de facto directors unless such shadow activity extends to specific assets in which case there may be a fiduciary duty on the part of the shadow in relation to that asset. Liability for wrongful and fraudulent trading applies equally to shadow directors.

9. Solvent Restructuring/Reorganisation and Rescue Procedures

9.1 Statutory Mechanisms
There are two forms of solvent restructuring and reorganisation proceedings in England and Wales which can be used outside of insolvency as a solvent rescue procedure, but also within a formal insolvency procedure: (i) (company voluntary arrangements (CVAs); and (ii) schemes of arrangement (Schemes). The above questions will be posed in relation to each proceeding.

CVAs
A CVA is an agreement reached between a company, its shareholders and its unsecured creditors which is initiated by the directors, the liquidator or administrator. A CVA is a voluntary reorganisation plan that is designed to allow companies to avoid insolvency by coming to an informal, but binding, agreement with its creditors with the support of its shareholders. Typically, the plan will involve delayed or reduced debt payments and may well be drafted under the umbrella of a trust. It is possible, however, for more complex reorganisation plans to be agreed such as an unsecured debt for equity swap and even the transfer of the company’s business to a new company, leaving behind certain onerous obligations with the insolvent legacy company. There are no limits on the agreement, compromise or reorganisation that can be achieved under such a procedure subject to achieving the necessary approval threshold and it is possible for debt such as connected pari passu shareholder debt to be subordinated and re-prioritised under a CVA plan.

A CVA is a voluntary procedure that can only be initiated by the company or its office-holders and it cannot be commenced involuntarily by the creditors. A CVA is implemented under the supervision of an insolvency practitioner. The insolvency practitioner is known as the nominee before the CVA proposals are approved, and as the supervisor afterwards. It is a reorganisation plan that is implemented under Part I of the Insolvency Act 1986. During the process, the directors remain in full control of the company, although the nominee/supervisor has an ongoing monitoring role.

In terms of approval thresholds, a CVA requires support of more than 50% of the shareholders in value and 75% in value of the company’s unsecured creditors present and voting. The company’s shareholders can approve the proposals by a simple majority in value, although if they do not approve the proposals and the creditors do, the CVA will still be implemented, subject to the right of a shareholder to apply to court to reverse or modify the plan approved by the creditors. 50% in value of the creditors that are “unconnected” with the company must also approve the CVA. The concept of “connected” under the Insolvency Act is crafted in a broad way...
and will include officers, shareholders, holding companies and subsidiaries.

A CVA can bind both present liquidated debt and also unliquidated and unascertained contingent unsecured debt which, in the absence of agreement from the nominee, will be GBP1. The nominee, however, has a degree of discretion in valuing such claims and the case law demonstrates that the court is unlikely to allow challenges to estimates made in good faith of the value of the creditors' debts. The approved CVA will bind creditors who were entitled to vote at the creditors' meeting and creditors who would have been entitled to vote had they received notice of the meeting with the effect that it is binding on both known and unknown creditors.

Challenges to a CVA can be made on the basis of unfair prejudice which is a question of fact, determined on a case-by-case basis. A CVA that treats different unsecured creditors in different ways may be prejudicial to those creditors, but the question of fairness and prejudice depends on the overall effect of the CVA. “Material irregularity” may also be a source of challenge and, by way of example, can be claimed by a person who was entitled to vote at either the creditors’ or shareholders’ meeting, but was not permitted to do so or who was wilfully not notified. If an unknown creditor is bound by the CVA without having received notice of the meeting and that creditor does not receive any payments under the CVA, the company will, inter alia, be liable to pay that creditor the amount they should have received under the CVA.

A CVA cannot affect the right of a secured creditor to enforce their security, except with their consent. Secured creditors cannot vote on a CVA, unless they also have unsecured debt, which votes in a conventional way with all other unsecured debt. Secured creditors cannot be compromised under a CVA with respect to their secured debt and must be dealt with directly or discharged in full. Any proposal must also provide for the payment of any preferential debts in priority to other unsecured creditors.

The financial position of the company does not affect its ability to pursue such a proceeding and both solvent and insolvent companies can enter into such a procedure. It should be noted that a CVA does not benefit from a moratorium or a stay unlike an administration, so there is nothing to protect the company from creditors taking action to recover their debts during the CVA process. For this reason, if the company is illiquid, it may also need to file for administration in order to benefit from the administration moratorium. Only smaller companies (with a turnover no greater than GBP10.2 million) can opt to take the benefit of a 28-day moratorium.

As intimated, a CVA can be used in conjunction with other voluntary procedures like a Scheme and can also be used to avoid or augment a formal administration procedure. All three procedures could be used in the same restructuring depending on the purposes and objectives of the stakeholders and the constituencies of creditors. The Scheme could compromise secured debt, the CVA unsecured debt and the administration could be used to obtain a moratorium and/or sell the assets of the company to a new entity pursuant to a pre-pack thereby navigating hold-out shareholders.

In terms of procedure, the directors initially submit a written proposal to the nominee. This must include a statement of affairs containing details of the company’s creditors, debts, other liabilities and assets to enable the nominee to prepare the report and file it at court. The nominee must file a report at court within 28 days of being given notice of the proposal for a CVA (or such longer period as the court may allow). The report will express the nominee’s opinion as to whether meetings of the shareholders of the company and of its creditors should be summoned to consider the proposal and its viability, and if this is positive, the date, time and place of such meetings. Creditors must be given 14 days’ notice of the meeting. Although the report is filed at court, there is no hearing or judicial examination of it. Meetings of the shareholders and the creditors will then be convened. A CVA may be advertised and, as indicated, it will be filed at court. There are no mechanisms for preserving its confidentiality and in higher-profile cases the terms become known.

The approved CVA takes effect from the date of the creditors’ meeting that approves it and following such approval the nominee is redesignated as the supervisor of the CVA and is empowered to implement its terms. Once bound by a CVA, a creditor cannot take any step against the company to recover any debt that falls within the scope of the CVA, or to enforce rights against the company that arise from the company’s failure to pay the debt in question in full. On approval of the CVA, the supervisor must send a final report on the implementation of the proposal to all shareholders and creditors who are bound by the CVA, within 28 days of its approval.

The authority of the supervisor is derived from the terms of the CVA and the supervisor will deal with any assets in accordance with its terms. The supervisor is entitled to apply to the court for directions in carrying out this role.

**Schemes**

A Scheme is a statutory procedure under the Companies Act 2006 that enables a company to agree an arrangement or compromise with its members or creditors (or indeed any class of them). The Scheme will bind each class of members or creditors regardless of whether an individual member or creditor in that class does not vote in favour of it, provid-
ing that the requisite majority of that class of members or creditors approve the Scheme and it is sanctioned by the court. The purpose or objective of the Scheme is to execute a restructuring, recapitalisation or modification of debt terms by the relevant majorities of the affected classes of creditor when the relevant transactions would ordinarily require unanimity.

A recent trend is for Schemes to be used in an international context to restructure companies incorporated and trading in other jurisdictions. The developing jurisdictional case law in England and Wales clearly demonstrates the readiness of the English courts to permit overseas companies to utilise the English law scheme procedure to cram down their local and international creditors and implement a restructuring, especially where the company has an English law-governed financing, has shifted its centre of main interest to England and Wales or has significant assets in the jurisdiction such that in each case it is a company capable of being wound up in England and Wales by reason of a “sufficient connection” with the jurisdiction.

Significantly, a Scheme is not a formal insolvency process executed under the Insolvency Act 1986, but it is a voluntary company law procedure. This can remove the “rancour” associated with insolvency and can alleviate the sensitivities of certain boards of directors of undertaking an insolvency process. It should be noted, however, that a Scheme is a public court process and that confidentiality of key economic terms will not be maintained.

Unanimity is not required and the Scheme can achieve a cram down in the sense that it will bind each class of members or creditors regardless of whether an individual member or creditor in that class does not vote in favour of it, providing that a majority in number representing three fourths in value of the creditors or class of creditors or members or class of members, present either in person or by proxy agree to the compromise or arrangement, and it is also sanctioned by the court.

Whilst a scheme of arrangement may be commenced on the application of a creditor or a class of them or, in the case of a company in liquidation, its liquidator, the company must still be a party to the application. Indeed, it was held in Re Savoy Hotel Ltd ([1981] Ch 351, [1981] 3 All ER 646) that the court has no jurisdiction to sanction a scheme that does not have the company’s approval. Accordingly, a scheme cannot be used as a mechanism to implement an arrangement between the creditors merely as between themselves. In these circumstances, the company will be a respondent with respect to the creditor’s application.

A creditor scheme includes all persons in the same class having pecuniary claims against the company, notwithstanding that they are often difficult to quantify and irrespective of whether such claims are actual, contingent, unliquidated or prospective. By way of example, secured and unsecured creditors will be in different classes and creditors with a different outcome in a liquidation may also be put in different classes such that a separate senior, second-lien and mezzanine class is feasible. In order to vote at the meeting, the creditor must still have such a pecuniary claim at the time of the meeting. The Scheme will ordinarily establish a valid claims’ calculation process and this will be described in the Explanatory Statement relating to the Scheme which is circulated to creditors. There is, of course, considerable scope for abuse in terms of valuation methodology (particularly in relation to contingent claims) although discriminatory valuation provisions in the scheme may persuade the court not to grant final sanction.

A Scheme can be used for any proposal that can be regarded as a “compromise” or an “arrangement” between a company and its creditors or members. The scope of a scheme is effectively unlimited and complex reorganisations have been accomplished using Schemes. Providing there is an element of commercial “give and take” and accommodation on each side, and the scheme is not simply removing a party’s rights for no consideration or for consideration that is of questionable value, then, for all intents and purposes, the company and its members or creditors (or any class of them) may agree a diverse range of matters between themselves. Whilst a compromise might have a connotation of insolvency, a company proposing or undertaking a Scheme does not have to prove solvency or either actual or prospective insolvency.

The process is court-supervised, but commenced by the company circulating a “creditors’ issues letter.” The purpose of this letter is to inform relevant creditors to be affected by the Scheme and who are to be subject to the compromise or arrangement, on a confidential basis, that the company is proposing to apply to court to seek an order convening meetings of the relevant Scheme creditors for the purpose of considering and, if thought fit, approving a proposed scheme of arrangement between the company and those scheme creditors pursuant to Part 26 of the Companies Act 2006. There is no set rule as to how many days before the convening hearing the creditors’ issues letter should be sent, but it is a procedural notification requirement.

The letter will set out the proposed terms of the restructuring and the sequential steps. It will also highlight the steps that will be implemented consensually and those to be implemented by other means such as via an insolvency or enforcement process. The letter also sets out the voting mechanics and thresholds and the constitution of the classes. It will also highlight how and when creditors can raise issues by attending court and, in particular, that creditor class issues should be raised at the convening hearing.
Once the creditors’ issues letter has been circulated, an application to court is made via a claim form for an order that a meeting of creditors be convened. The function of the court at this stage is “emphatically not” to consider the merits or fairness of the proposed Scheme, which are reserved for the sanction hearing.

The claim form must be supported by evidence and because most applications are made ex parte, an affidavit will usually be used. Additional witness statements may support this, but in totality, the evidence must contain sufficient detail on the composition of the Scheme classes. It is the responsibility of the applicant to identify correctly the classes of creditor and whether or not more than one meeting of creditors should be convened. The evidence should also explain the reasons for the scheme and the structure and objectives of the scheme. All aspects of the company’s statutory information must be specified, in particular, details of its share capital.

Issues relating to the composition of the classes of creditors and the summoning of the relevant class meetings is now dealt with at the convening hearing to avoid the time and costs’ wastage associated with the court determining that the classes have not been properly identified at the subsequent final hearing to sanction the scheme.

An Explanatory Statement providing detailed information about the background, reasons, objectives and terms of the scheme must be sent out with the notice to the creditors of the meeting. Specifically, the Explanatory Statement must explain the background, scope and effect of the scheme. If the notice to creditors summoning the meeting is given by advertisement, it is essential that the advertisement states where and how creditors entitled to attend the meeting may obtain copies of such an Explanatory Statement for free. The notice to creditors will also include forms of proxies for voting at the meeting. At the creditors’ meeting, the Scheme is approved if 75% in value and a majority in number of the creditors present and voting vote in favour.

Following the requisitioning of the meetings of the relevant class(es) of creditors, and members if necessary, and the passing of the relevant resolutions by each class, the company may apply to the court for a sanction of the Scheme. Court sanction of the Scheme is the all-important second phase of the process and the application for sanction is made by means of a claim form which must provide all relevant administrative information in relation to the company and particulars of the Scheme by reference to its objectives and effect. The claim form should also attach a detailed witness statement from the chairman of the relevant meetings confirming the results of the meetings and any relevant issues relating to the voting and the receipt of proxies. Copies of all proxies, evidence of proof of posting the notices, a copy of the explanatory statement and scheme document and a copy of a draft order sanctioning the scheme should also be attached to the claim form.

The sanction of the court is not a formality and dissenting creditors can raise objections at the sanction hearing as to why the scheme should not be sanctioned. The court’s function is not merely to rubber-stamp the scheme or to provide a cursory check that the majority have been acting bona fide. The court will examine the Scheme, and the court’s sanctioning discretion is unfettered, but in exercising this discretion the court will take into account whether all of the statutory conditions under the Companies Act 2006 s.895-900 have been observed and, in particular, whether the meetings were properly convened and conducted, whether the class(es) summoned to the meeting(s) was fairly represented by those who attended and whether those voting acted legitimately and in a bona fide manner without coercing a minority in order to promote interests that are adverse to the class that they purport to form part of. The final consideration is whether the arrangement could be considered by an intelligent and honest businessperson acting in their own interest to be one, which they could reasonably approve.

Once a sanction order of the court is issued it must be delivered to the Registrar of Companies, at which point it will be binding on all creditors in each class irrespective of whether they dissented or abstained. It is worth noting that if challenges to the Scheme are to occur, it will be at the convening hearing on the basis of class formation, jurisdiction and valuation of claims, and at the sanction hearing on the basis of procedural and substantive unfairness.

9.2 Position of Company During Procedure

As indicated there is no stay with respect to a CVA and the company is exposed to enforcement action by both secured and unsecured creditors. Where a CVA is in progress, the court can decide to stay or sist all winding-up proceedings but not before the end of 28 days beginning with the first day that reports are required under the Insolvency Act 1986 s.4(6).

The directors can continue to operate the business in a CVA subject to limits imposed by the terms and a monitoring role of the nominee pre-approval. On approval of the CVA, the supervisor will continue to have a monitoring role.

As with a CVA, there is no moratorium or stay with a Scheme and this remains an inherent weakness in the Scheme procedure. It should be noted that more recently the courts have used their case management powers under Civil Procedure Rules to stay dissenting creditor action when a Scheme is already before the court.
9.3 Position of Creditors During Procedure
In a CVA there are no classes, but there are separate unsecured creditors’ and shareholders’ votes. Unsecured creditors can be treated differently if this does not constitute an unfair prejudice or a material irregularity.

In a CVA, creditors form a single unsecured class with their votes weighted and valued by the nominee. It is possible for an informal committee of creditors to be formed to liaise with the nominee.

The nominee in a CVA prepares a report based on the statement of affairs prepared by the creditors which will also set out the terms of the CVA plan.

A Scheme places creditors with differing interests into separate classes and each class of creditors whose interests are affected by the Scheme must approve its terms as they affect that class. The Companies Act 2006 does not provide any guidance on the formulation of classes. Those establishing the relevant classes of creditors must therefore continue to have reference to the extensive body of case law. Establishing the classes accurately is of course crucial because creditors in specific classes are required to vote on the Scheme at separate class meetings.

In terms of class composition, the courts have taken a number of approaches, but a class is likely to be constituted if its members can consult together with a view to their common interest based on an analysis of the rights which are to be released or varied under the Scheme and the new rights (if any) which the Scheme gives to those persons whose rights are to be released and varied. Equally, under the current case law it is possible to discern that a class will be formed if it can be determined that the rights of the relevant creditors are sufficiently similar to justify them voting in a single class. The similarity or community of rights resulting in a specific class will be a question of degree in each case based on the specific facts which the court should construe carefully.

9.4 Claims of a Dissenting Class of Creditors
In a CVA, dissenting creditors will be bound by the CVA approved by the requisite majority of unsecured creditors and this operates as a cram-down of the unsecured class. There is no possibility of binding secured creditors. The same principle applies in a Scheme and dissenting creditors will be bound by the Scheme and will be crammed down with their rights modified.

9.5 Trading Claims of Dissenting Creditors
Claims can be traded in a CVA and a Scheme and can be transferred at any time. Transfers will be notified to the nominee or the supervisor of the CVA and to the company in a Scheme pursuant, in each case, to the transfer provisions in any relevant financing documents as applicable. As part of the CVA and the Scheme, arrangements and procedures may have been established for debt trades to be notified to the nominees, supervisors and the company as the case may be. The only caveat to this is the existence of a lock-up into a CVA or a Scheme. If debt has committed to vote in a specified way in connection with the CVA or Scheme process, it will be normal for debt to be traded subject to that voting commitment and the terms of the lock-up.

9.6 Re-organising a Corporate Group
In a CVA, each separate group member will have to undergo a separate arrangement with its separate creditors, but for administrative convenience the same nominee and supervisor can be used, the reports filed at court can be linked and the relevant meetings fully co-ordinated. It can also be a term of a CVA that connected arrangements with separate companies in the group are agreed.

In a Scheme, it is much easier to consolidate the cases and hear them collectively, and for the Explanatory Statement to include more than one company. In addition, although Schemes are technically limited to compromises or arrangements between the relevant company and its creditors or members, the courts have accepted that Schemes can include releases of “third parties” when such releases can be regarded as ancillary to the arrangement between the company and its creditors. For example, if a Scheme involves a discharge or variation of debt borrowed by the relevant Scheme company, it may be necessary to release any related guarantees or indemnities provided by other members of the group, otherwise the purpose of the Scheme will be frustrated. It is now established law that guarantee claims can be released without the need for the guarantor to also propose a Scheme.

9.7 Conditions Applied to Use or Sale of Assets
There are no conditions imposed on the use of assets in a CVA unless that is a term of the plan. Similarly, with respect to disposals, a CVA does not automatically remove the management of the company from the directors; however, the terms of the CVA should be checked to see if any restrictions, for example, in relation to dealings with assets, are placed on them by the CVA or if assets are in the control of the supervisor in any way following the approval of the CVA. If the CVA has not curtailed or restricted the powers of the directors to manage the company and thus to sell assets, there is no need for the supervisor to be a party to a sale agreement or to sign on behalf of the company (and, indeed, may not have power to do so under the terms of the CVA). In cases of doubt, the supervisor could be consulted directly to confirm that in effecting the sale, the director’s powers have not been curtailed nor the disposal of the asset prohibited by the CVA. The buyer should be able to acquire good title from the directors in such circumstances, having conducted this diligence.
During the Scheme process, the directors stay in management control of the company and in possession and control of the assets. Subject to existing contractual provisions regulating the sale of assets and their proceeds, there are no additional permissions or restrictions. The directors execute the sale in the normal way and purchasers will acquire title in the conventional way. Post-completion of the Scheme, the company will be subject to the terms of the restructuring and any new financing covenants relating to the sale of assets.

9.8 Distressed Disposals
It can be a term of a CVA that disposals are executed as part of it on a pre-agreed basis and that certain creditors voting on the plan can acquire those assets. The plan would need to be approved by the requisite majorities and the price would have to be legitimate and at fair value to avoid claims of unfair prejudice and material irregularity. If any lenders have been a stalking horse pre-scheme, it would be advisable to disclose this to the court.

Many schemes include a debt for equity conversion and/or an acquisition by a lender-formed SPV which will, for all intents and purposes, acquire the value in the legacy group. Quite often, this type of Scheme will be executed through a pre-packaged administration where the existing creditors “credit-bid” their existing debt and use this as currency to acquire the value in the legacy group.

9.9 Release of Security and Other Claims
In a CVA, the parties voting are not secured creditors and the CVA is unable to affect the rights of secured creditors. Guarantee and other security claims can be released as part of the Scheme in relation to the companies undertaking a Scheme, but as indicated in 9.6 releases can also be achieved in relation to other members of the group not subject to the Scheme.

9.10 Priority
If the creditors vote for priority new money (secured or unsecured) as part of the CVA plan, this will be binding. The risk is that the plan may not be approved and therefore the parties providing it would almost certainly seek a voting lock-up agreement ahead of providing it before plan approval.

Priority secured new money advanced ahead of the Scheme can have its priority enshrined as part of the Scheme. It is again typical for such priority to be enshrined in the Scheme lock-up agreement.

9.11 Determining the Value of Claims
The provisions of the Insolvency Act and the Insolvency Rules provide a basis for valuing claims in a CVA. Liquidated claims will be admitted at their full value. Unliquidated, unascertained and contingent unsecured debt will (in the absence of agreement from the nominee) be valued at GBP1. The nominee however, has a degree of discretion in valuing such claims. Case law demonstrates that the court is unlikely to allow challenges to estimates made in good faith of the value of the creditors’ debts.

In a Scheme, the Explanatory Memorandum will set out a basis for calculating claims fairly. This is a key part of the Scheme and any procedural or substantive unfairness in this regard may affect the final sanction of the Scheme.

9.12 The Agreement Amongst Creditors
In a CVA there is no specific fairness test but the plan must, by implication, be fair both substantively and procedurally since it can be challenged on the grounds unfair prejudice and material irregularity.

The court’s sanctioning discretion in relation to a Scheme is unfettered, and creditors are advised to vote legitiately and in a bona fide manner without coercing a minority in order to promote interests that are not adverse to the class that they purport to form part of. The final consideration made by a court in a Scheme is whether the arrangement could be considered by an intelligent and honest businessperson acting in their own interest to be one, which they could reasonably approve.

9.13 Rejecting or Dismissing Claims
In a CVA and a Scheme, whilst it is possible to compromise contractual claims, it is not possible to disclaim debts or contracts. The nominee and the company in a Scheme can legitimately challenge claims and can allocate nominal value to contingent unliquidated claims that are unascertained if this is done in a fair, objective and consistent way.

9.14 Releasing Non-Debtor Parties from Liability
In a CVA it is possible to release non-debtor parties, such as a guarantor, from claims if that is a term of the plan and it is properly approved. The courts have, however, held that such a release can constitute unfair prejudice unless the prejudice was justifiable in the overall context of the CVA. The CVA may need to offer compensation to the creditors for the loss of their rights against the guarantor to avoid being unfairly prejudicial.

It is increasingly becoming market practice in large multi-creditor restructurings for releases to be given by scheme creditors to the debtor’s advisers and the members of any creditors’ committees and their advisers from any liability attaching to them in connection with the restructuring process. As previously indicated, guarantee claims of subsidiaries and affiliates can be released in a Scheme.
9.16 Implications of Failure to Observe Agreed Plan

The starting point in deciding whether the CVA has come to an end is a consideration of the actual terms of the CVA. It will usually terminate when there is a breach of its terms by the company. A creditor will be liable for the consequences of its own breach and may also be subject to injunctive relief pursued by the company and the other creditors.

Where the arrangement is silent on the implications of a breach by the company and termination generally, the courts will ascertain the presumed intention of the parties having regard to the circumstances surrounding the CVA and the underlying provisions of the Insolvency Act 1986 and the Insolvency Rules 1986. If there is a termination of the CVA and a liquidation or administration petition is presented by the CVA supervisor, or a CVA creditor, which has the effect of ending the CVA and any trust of CVA monies held by the supervisor, then those monies will usually pass to the liquidator and be distributed in accordance with the statutory order of distribution. If the CVA comes to an end because of a breach by a non-CVA creditor for new non-CVA debts, the company and the current case law suggests that the CVA will not be brought to an end and the trust of the CVA assets will continue with the effect that the CVA assets will be distributed for the benefit of the CVA creditors under the terms of the CVA.

If a company fails to observe the procedural requirements in relation to a Scheme and its implementation, it will likely fail at the creditors' meeting or at the sanction hearing. After completion of the Scheme and the implementation of the new financing terms, the company will be exposed to the consequences of any breach in the normal manner subject to the terms of the relevant agreements and applicable law. There is no continuing protection through the Scheme.

A creditor who does not adhere to the Scheme will be liable for the consequences of its breach and may also be subject to injunctive relief pursued by the company and the other creditors.

10. Mandatory Commencement of Insolvency Proceedings

10.1 Obligation to File Within Specific Timeline

There are no mandatory English law provisions that compel a company to file for insolvency within any specific period. The Insolvency Act 1986 s.123 contains both balance sheet and cash flow insolvency tests but there are no related provisions that compel a filing even if the company is insolvent under those tests.

10.2 Procedural Options

Although a company is not obliged to commence a filing under English law, it is likely that creditor pressure may cause it to consider its procedural options. Equally, creditors exerting pressure can pursue an administration or a compulsory liquidation, in each case on an involuntary basis.

10.3 Implications of Not Commencing Insolvency Proceedings

As noted in 8.2, at the point of insolvency once the directors knew or ought to have concluded that there was “no reasonable prospect” of avoiding an insolvent liquidation (because, for example, they were aware of the balance sheet/cash flow insolvency of the company), directors may take on an increased risk of personal liability for wrongful trading under the Insolvency Act 1986 s.214 if they do not commence an insolvency proceeding and they fail to protect the creditors’ interests by taking every step to minimise loss to creditors. The risk of fraudulent trading under the Insolvency Act s.213 and disqualification under the Company Directors Disqualification Act 1986 is also heightened at the point of insolvency. Equally, if the company is insolvent as defined in s.123, the possibilities of transactions entered into by the company being classified as “preferences” and “transactions at an undervalue” is increased as insolvency is the gateway to transactions being classified as such (see section 12).

11. Insolvency Proceedings

11.1 Types of Voluntary and Involuntary Insolvency Proceedings

Administration

Administration enables a company to undertake a formal reorganisation and rescue or, alternatively, an insolvency process which would achieve a better result for the company’s creditors or the realisation of property in order to make a distribution to one or more secured or preferential creditors. An administrator must attempt to achieve the objectives and “statutory purposes” of administration in that order.

In terms of a rescue/reorganisation, a formal administration may be required if the company requires a moratorium or if creditors have lost faith in management and would prefer administrators to execute the restructuring or a quasi-liq-
udiation process and sale of assets. Equally, an administration may be needed if the shareholders of the company are not co-operating or the directors are unwilling to execute a transaction and it is necessary to execute a sale of assets or shares owned by the company. Administration may, of course, operate alongside a Scheme or a CVA, or both.

Administration may be preferable to a liquidation because it enables the company to trade more normally with the benefit of a moratorium. A company gains the benefit of the statutory moratorium when it files the application and before it goes into administration pursuant to an interim moratorium. The scope of the interim moratorium is identical to that of the moratorium that applies to a company in administration and protects the company and its assets in the period between the start of the administration process and the appointment of an administrator. As there may be no administrator in office, a party that wishes to exercise any rights caught by the moratorium must apply to court for permission to exercise those rights.

When a company enters administration, an insolvency practitioner is appointed as the company’s administrator. The administrator takes over the control of the company's business and assets from the company’s directors, in order to achieve one of the statutory purposes of administration outlined above. The director's powers cease from the commencement of the administration even though they stay in office.

An administration can be commenced “in-court” on a formal application to court pursuant to which a court order is then made in open court. The court must be satisfied that the company is, or is likely to become, unable to pay its debts and that the administration order will meet one of the “statutory purposes” described above. The company, the directors or one or more creditors may make the in-court application by filing the relevant applications and documents at court.

Alternatively, an “out-of-court” application for administration can be made by a floating charge holder having security over the whole or substantially the whole of the company's assets and undertaking (see 6.1) or by the directors or the company, by filing at court electronically the prescribed series of documents. If a company is the subject of an outstanding winding-up petition, neither the company nor its directors can use the out-of-court route to enter administration but a floating charge holder can.

The timeline for the appointment is very short and in an out-of-court process it can be made the same day unless the company or the directors are making the appointment in which case the floating charge holder must be given five days' notice of the intention to appoint (which can be waived). With an in-court appointment the timeline depends on court availability, but from filing papers at court the application will be heard on an expedited basis usually within 24-72 hours. It should be noted, however, that almost all applications in larger cases will have been subject to extensive contingency planning before an appointment is made.

As soon as reasonably practicable after their appointment, the administrator must send notice of their appointment to the company, every creditor of the company of whom they are aware and publish notice of their appointment. The administrator must advertise their appointment in the London Gazette and in any other publication or manner they think appropriate.

The management of the company must, if required by the administrator, provide the administrator with a statement of the company's affairs, which must be delivered within 11 days of the request. Failure to submit a statement of affairs on time is a criminal offence. A statement of affairs must set out the company’s assets and liabilities, including assets that are subject to any fixed charges or floating charges. The statement of affairs enables the administrator to assess the company’s financial position as they prepare their proposals for the conduct of the administration.

One of the key initial tasks of an administrator is to prepare a statement of how they propose to conduct the administration. As soon as reasonably practicable after the company enters administration and, in any event, no later than eight weeks from the date of their appointment, the administrator must send their proposals to the registrar of companies, all creditors and members for whom they have an address. The proposals must set out the statutory purposes of administration that will be pursued and how the administration will end after the achievement of that purpose. Any asset sales or disposals made since the company entered administration and the reasons for doing so must also be disclosed as must the basis of the administrator’s remuneration and the details of any costs and expenses incurred by the administrator before their appointment, which they seek to recover from the company's estate.

All creditors will submit a proof of debt to the administrator setting out the particulars of their claim and the calculation of their interest. A debt will be admitted in an administration if it is a provable debt – this includes financial and contractual obligations and can include contingent and unascertained debts.

Mandatory statutory set-off applies only after the administrators have given notice of their intention to make a distribution. It is important to note however that this does not preclude the operation of other types of set-off during an administration such as contractual set-off which can be exercised in accordance with its terms.
It is possible to trade claims in an administration and this is a common occurrence. The traded claim will be recognised by the administrator and will still prove for its full value even if it has been bought for a discount. Typically, the administrators on large cases will set up a claims notification process.

At various points in the administration, the administrator will report to creditors and will seek approval for their proposals. Invariably, the creditors will form a committee to provide feedback and to have a supervisory capacity. The administrator as a court officer always has the option of applying to court for directions. Dissatisfied creditors can always apply to court for relief including the appointment of a new administrator and the removal of the existing administrator.

An administrator has wide powers set out in Schedule 1 of Schedule B1 of the Insolvency Act 1986 but they cannot disclaim onerous property of the company and, as a matter of law, administration does not terminate contracts entered into by the company. As a practical matter, however, administrators often choose not to comply with a given contract if it is onerous or uneconomic and this is not in the best interests of creditors. If this results in a breach of a pre-administration contract, a provable debt in the estate will result. Administrators will be careful to distinguish between pre and post-administration contracts as the latter will be an expense of the administration having priority ahead of floating charge creditors and unsecured creditors.

An administrator has a general power to distribute the assets of a company to its creditors. However, before making a distribution to unsecured creditors, the administrator must obtain a court order permitting that distribution. A creditor who holds a valid fixed charge (provided that it was created as a fixed charge and is not a crystallised floating charge) over a company’s asset is entitled to the proceeds of the realisation of that asset in satisfaction of the liability due to them from the company. The holder of a valid fixed charge will suffer no deductions in an insolvency process from the realisation of property secured by their fixed charge. Floating charge creditors will have deductions made from the realisations of sale of assets covered by such floating security in order to discharge the administration expenses, preferential creditors (namely pension and employee claims) and the small statutory prescribed part.

Unless extended by a court order or with the consent of the company’s creditors, an administrator’s appointment automatically ceases to have effect 12 months from the day that the company entered administration. Conversely, the administrator can apply to court to terminate the administration at any time and they are obliged to end the administration if they think that the administration can no longer achieve its purpose, the company should not have entered administration or a resolution of a creditors’ meeting requires them to apply to court to end the administration. If other circumstances exist which lead the administrator to believe that the administration should be terminated, they can apply to court for an order ending the administration and the court has wide discretion to make an order including placing the company into compulsory liquidation. The termination of an unsuccessful administration can be converted into a creditor’s voluntary winding up or the company could be dissolved out of administration.

The administrator will usually make interim distributions during the term of the appointment on a periodic basis and there is an ability to adjust ongoing payments in order to “true-up” the position of creditors. Prior to terminating the administration, the administrator will seek to make a final distribution to the company’s creditors and need not place the company into liquidation solely for this purpose.

**Voluntary Liquidations**

Under English law there are two types of voluntary liquidation: (i) members’ voluntary liquidation (MVL) which is a solvent liquidation; and (ii) creditors’ voluntary liquidation (CVL) which is ordinarily an insolvent liquidation but which could in rare circumstances be solvent.

**MVLs**

Given that this is a solvent liquidation, the fundamental aspect of which is that all creditors of the company are paid in full, the directors of the company will need to swear a statutory declaration that the company is solvent. This is likely to require a claims valuation process and expert advice in advance. There is potential liability for the directors if the statutory declaration is incorrect.

Claims will be submitted to the liquidator and the liquidator will also consult creditors on their claims to ensure that the liquidation is solvent. It should be noted that mandatory statutory set-off applies from the date of the appointment of the liquidator.

MVL is commenced once the members pass a special resolution with 75% support and the statutory declarations have been presented at the members’ meeting. The special resolution must be passed within five weeks of the statutory declaration of solvency. The liquidator is selected by an ordinary resolution of more than 50% of the members. Following the appointment of the liquidator the powers of the directors terminate. The role of the liquidator is to collect in and realise the company’s assets and to distribute the proceeds to the company’s creditors and any surplus to its members. A liquidator has wide-reaching powers that they may exercise to fulfil this function (such as a power to carry on the business and to sell property) as set out by s.165 and Schedule 4 of the Insolvency Act 1986. A liquidator no longer needs the
sanction of the court or a liquidation committee to exercise these powers.

Although there is no automatic stay, the solvent status of the company does not require this. There is no court involvement in the process although the court has wide powers and discretions, and on an application by the liquidator it can stay the procedure and can give directions.

If the statutory declaration proves incorrect and there are claims against the company which render it insolvent, the MVL will convert to a CVL. The members are able to exercise certain rights if they are concerned about how the liquidator is handling the MVL. For example, members may be able to challenge the level of the liquidator’s remuneration.

If the MVL is successful, the liquidator will convene a meeting of creditors to show how the liquidation has been conducted and will file the liquidation accounts with the registrar of companies. The company is then automatically dissolved three months after that filing.

CVLs
If the directors are unable to swear a statutory declaration or the company is insolvent and it seeks to pursue a liquidation, then a resolution of 75% of the members can resolve to place the company into a CVL. The purpose of the CVL is for the assets of the insolvent company to be sold and for the proceeds to be distributed to the company’s creditors. At the end of the liquidation the company is dissolved. The liquidation is deemed to commence from the passing of the resolution.

The liquidator will initially be appointed by the members but they will have limited powers until the subsequent creditors’ meeting, at which point the creditors by a majority of those present and voting may resolve to appoint their own liquidator. This choice will prevail.

Following the passing of the resolution by the members, the directors’ powers cease and the directors must convene a creditors’ meeting which must take place within 14 days of the resolution to wind up the company. In most cases, the creditor’s meeting is planned so that it takes place on the same day as the members’ meeting. The directors must prepare a statement of affairs for the creditors’ meeting and one of the directors must chair the meeting.

All creditors will submit a proof of debt to the liquidator setting out the particulars of their claim and the calculation of their interest. A debt will be admitted in the liquidation if it is a provable debt – this includes financial and contractual obligations and can include contingent and unascertained debts. The liquidator will then assess all the proofs of debt. They may either accept a claim in whole or part, or reject it.

The liquidator’s decision in relation to any proof of debt may be challenged in court by a creditor.

Claims of unsecured creditors rank pari passu and are discharged on a pro rata basis at the end of the liquidation. Interim dividends may also be paid. In many cases, the dividend to unsecured creditors is a low percentage of their claims and there may even be no recoveries. It should be noted, however, that mandatory statutory set-off applies from the date of the appointment of the liquidator. Secured creditors are generally entitled to be paid from the proceeds of sale of the secured assets.

A liquidator has wide-reaching powers pursuant to s.165 and Schedule 4 of the Insolvency Act 1986 that enable them to discharge their role and functions – including the power to continue the company’s business so far as they consider this is necessary for the beneficial winding up of the company and a power of sale. A liquidator no longer needs sanction from the court or creditors before exercising any of these powers, such as bringing legal proceedings for wrongful trading or challenging antecedent transactions. In this regard, it should be noted that the liquidator will report to the Secretary of State, any conduct of a director (or shadow director) that they believe satisfies the conditions for director disqualification. The liquidator will also circulate reports to creditors and will convene creditors’ meetings.

As with an MVL there is no automatic stay, but with a CVL this is more problematic given the insolvent status of the company. It is therefore useful that on an application by the liquidator the court can stay proceedings and can give directions. A stay is typically granted.

Liquidators are able to disclaim onerous property in a CVL. Onerous property is an unprofitable contract and any other property that is unsaleable or which might give rise to a liability. Property is widely defined for these purposes. For the avoidance of doubt, a liquidator cannot disclaim only part of a contract or a completed contract where the company retains a liability to pay. The claims of the counterparty to a disclaimed contract will be a claim in the liquidation. Counterparties can contest the disclaimer in court, but the courts have proven reluctant to reverse the liquidator’s decision.

It is possible to trade claims in liquidation. The traded claim will be recognised by the liquidator and will still prove for its full value, even if it has been bought for a discount.

The liquidator’s fees are generally paid as an expense of the winding up. As such, they are typically paid out of the company’s assets, after secured creditors holding fixed charge security have been paid, but in priority to creditors who either have no security or have floating charge security over the company’s assets. Creditors may be able to challenge the level
of the liquidator’s remuneration and can also apply to court for an order removing the liquidator or convene a general meeting of creditors to resolve to remove them from office.

At the end of the CVL when the process is complete, the liquidator will summon a final meeting of creditors and present their report to them. The registrar of companies is then notified that the final meeting has been held and the company will be dissolved three months after the registrar registers the notice.

Involuntary Liquidations (ie Compulsory Liquidations/ Winding up by the Court)
In addition to voluntary liquidations which are commenced by the company, English law also provides for compulsory liquidations/winding up of a company by the court which is an involuntary form of liquidation. Compulsory liquidation is a procedure by which the assets of a company are sold and the proceeds are distributed to the company’s creditors. A court order is required to put a company into compulsory liquidation. At the end of the liquidation, the company is dissolved. Many of the features of a compulsory liquidation are similar to a CVL.

The process is usually started by a petitioning creditor presenting a winding-up petition at court although it is also possible for the company or the directors to present the petition. Petitioning creditors normally present the petition on the basis that the company is insolvent and cannot pay its debts as they fall due. To evidence this, the creditor may have previously submitted a statutory demand to the company requesting payment of a due debt within 21 days. If the debt is legitimately disputed or the company has a counterclaim, the court will usually dismiss the petition and the petitioner will be liable for costs on a full indemnity basis. Courts are reluctant to see the winding-up procedure abused as an aggressive debt collection tactic.

The petition must be accompanied by a statement of truth setting out the jurisdictional basis of the claim and the nature of it and an endorsement that the contents of the petition are true to the best of the petitioner’s knowledge, information and belief.

The petitioner must serve a copy of the petition (sealed by the court) on the company. Service should usually take place at the company’s registered office. A certificate confirming service of the petition must be filed at court and no earlier than seven business days after the petition is served on the company, but at least seven business days before the hearing of the petition, the petitioner must advertise notice of the petition in the London Gazette. The advertisement is a fundamental requirement and enables other interested parties to inform the petitioner that they wish to attend the hearing and whether they wish to support or oppose the petition. A copy of the advertisement must also be lodged at court as soon as possible after publication in the London Gazette and, in any event, not later than five business days before the hearing of the petition. If the advertisement has not been lodged, the hearing of the petition will be adjourned.

There is no expedited process and a company can oppose a petition, but to do so it must file its evidence in opposition at least five business days before the hearing. In practice, however, if the company does not file evidence before the first hearing of the petition, but indicates at that hearing that it wishes to oppose it, the court will usually adjourn the hearing and will give directions for the company to file evidence in opposition and for the petitioning creditor subsequently to file evidence in reply.

At the initial or final hearing, the court has a number of options: it can dismiss the petition, adjourn the hearing, make a winding-up order, make an interim order or make any other order it thinks fit, which is most likely time to pay, as a last resort.

If a winding-up order is made, the Official Receiver is initially appointed as liquidator, but typically the company’s creditors appoint another licensed insolvency practitioner (or two licensed individuals to act jointly), to act as liquidator(s). The liquidator is an officer of the court and so has a duty to act fairly and impartially.

The powers of the directors cease upon the order being made and they are automatically dismissed. However, the directors may be required to assist the liquidator and to provide a statement of the company’s assets and liabilities. In due course, the liquidator will report to the Secretary of State, any conduct of a director (or shadow director) which they believe satisfies the conditions for director disqualification.

The liquidator’s role is to realise the assets and to distribute the proceeds to the company’s creditors. In fulfilling this objective the liquidator has wide-reaching powers pursuant to Schedule 4 of the Insolvency Act 1986 including the power to continue the company’s business so far as they consider this is necessary for the beneficial winding up of the company and a power of sale.

A compulsory liquidation benefits from an automatic stay of legal proceedings against the company and its assets, and to bring or pursue legal proceedings against the company a creditor must first apply to court for permission. Where the claim is for monetary relief only, the creditor is unlikely to be granted permission and as a general principle only claims that have a proprietary nature are allowed to continue. A liquidator is able to disclaim contracts in substantially the same manner as in a CVL.
Claims are calculated in the same manner as in a CVL: creditors will submit a proof of debt to the liquidator setting out the particulars of their claim and the calculation of their interest and it will be admitted in the liquidation if it is a provable debt – this includes financial and contractual obligations and can include contingent and unascertained debts. Claims are assessed and will be rejected or accepted in whole or part. The liquidator's decision in relation to any proof of debt may be challenged in court by a creditor.

Claims of unsecured creditors rank pari passu and are discharged on a pro rata basis at the end of the liquidation. Interim dividends may also be paid. In many cases, the dividend to unsecured creditors is a low percentage of their claims and there may even be no recoveries. It should be noted, however, that mandatory statutory set-off applies from the date of the appointment of the liquidator. Secured creditors are generally entitled to be paid from the proceeds of sale of the secured assets.

As with a CVL there is no limit on claims or debt trading and the traded claim will be recognised by the liquidator and will still prove for its full value, even if it has been bought for a discount. In the larger cases, a process for the notification of traded claims might be established by the liquidators.

The liquidator's fees in a compulsory liquidation are generally paid as an expense of the winding up. As such, they are typically paid out of the company's assets, after secured creditors holding fixed charge security have been paid, but in priority to creditors who either have no security or have floating charge security over the company's assets.

Creditors may be able to challenge the level of the liquidator's remuneration and can also apply to court for an order removing the liquidator or convene a general meeting of creditors to resolve to remove them from office.

At the end of the compulsory liquidation (where the liquidator is not the Official Receiver) when the process is complete, the liquidator will summon a final meeting of creditors and present their report to them. The registrar of companies is then notified that the final meeting has been held and the company will be dissolved three months after the registrar registers the notice. If the Official Receiver is the liquidator, there is no meeting and dissolution occurs on the earlier of three months after the Official Receiver notifies the registrar of companies that the liquidation is complete or the date when the Official Receiver is satisfied that there is no further role to be undertaken and the Official Receiver applies to the registrar for the company to be dissolved.

11.2 Distressed Disposals

During an administration and a liquidation it will be the office-holder using the statutory power of sale who will dispose of assets – the office-holder will, however, require consent from secured creditors before selling assets and may seek directions from the court. It will be a matter of negotiation as to whether the asset is sold free and clear of the fixed charge (with the office-holder accounting for the proceeds) or subject to it. An office-holder can sell free of a floating charge as if it did not exist and will account to the charge holder for sums in excess of the office-holder's expenses. Office-holders will typically give no representations or warranties on a sale of assets and will seek to exclude their own personal liability as well as seeking indemnities in relation to certain assets and potential liabilities relating to, inter alia, retention of title, book debts and employee matters.

A purchase from an office-holder will acquire good title save for claims attaching to the assets in the ordinary course such as retention of title claims and other competing ownership claims and liens, and the transfer will benefit from very few warranties; a position which is usually reflected in the price. There are no rules preventing credit bids or the creditor acting as a stalking horse to drive the price of the assets up in an auction process. Save where the office-holder is entering into a pre-pack, the office-holder will seek to run a competitive process and potentially an auction to maximise the price on a sale. The administrators may also procure a valuation and/or a fairness opinion, but a liquidator is less likely to do this.

An office-holder may conclude that the best means of rescuing the business will be to dispose of it via a pre-pack sale – this is effectively a transaction negotiated, agreed and diligenced by the buyer, before the company's entry into the relevant insolvency process and which completes contemporaneously with or shortly after the appointment of the office-holder. A sale of this kind is appropriate where, for example, a going concern sale represents the best value for creditors but there are insufficient assets to trade the company's business in administration/liquidation whilst a buyer is sought.

A pre-pack sale imposes strict requirements on the administrator specifically (although liquidators are also likely to follow similar best practice), and before completion of of the sale, the administrator must circulate a detailed report to creditors giving details of the sale at the same time they send notice of their appointment to creditors and in any event within seven days of the transaction. The report (known as a SIP 16 report) must include detailed information on the sale and the circumstances and rationale under which it was undertaken. SIP 16 also imposes compliance standards on the preparatory work that the putative administrator must undertake before executing such a sale and the advice that they should offer the company on the pre-appointment and sale marketing process.
11.3 Failure to Observe Agreed Rescue Plan
In administration and liquidation there is no plan as such; instead there will be a sale of assets and a distribution. Creditors or directors failing to observe the administrator’s or liquidator’s directions (for example, in relation to set-off or custody of assets, etc) or information requests of the office-holder can be exposed to litigation in the ordinary course.

11.4 Priority New Money
In administration and liquidation new money can be secured on unencumbered assets of the company and/or can rank behind existing fixed charge security if there is sufficient equity value and any contractual restrictions such as negative pledges are observed or waived by those benefiting from the existing fixed charge security or any other person having a negative pledge.

It is not possible to prime secured creditors or to create any priority for new money with regards to their secured assets. With respect to unencumbered assets, the new money would have priority as an administration or liquidation expense over any other indebtedness as an administration or liquidation expense. Floating charge assets (as opposed to fixed charge assets) might also be utilised to secure new money given that liquidation and administration expenses are paid out of floating charge realisations in priority to payments to floating charge holders.

11.5 Liquidation on a Combined Basis/Under Related Proceedings
There are no procedures available under English law to deal with the administration or liquidation of a corporate group on a collective basis. Each corporate entity is dealt with on an entity-by-entity basis and there is no device which will allow for a pooling of assets. As a matter of administrative convenience it is usually possible for the same office-holder to be appointed to a corporate group and for connected companies to be subject to combined court proceedings with the same judge.

11.6 Organisation of Creditors
It is not uncommon to have creditors’ committees in an administration or a liquidation. The number of members varies but is typically between three and seven on larger administration cases and these members will be voted on by other creditors. In a CVL the liquidation committee can be no more than four creditors.

The role of the committees will vary and will be more supervisory in a liquidation where the committee will strive to agree the liquidator’s remuneration and sanction certain liquidator powers. An administration committee will be similarly constituted but an administrator has broader statutory powers and will not require the same sanction or supervision from the committee. Committees can retain advisers but they are not paid for out of the estate.

11.7 Use or Sale of Assets During Insolvency Proceedings
Conditions are not imposed on the use of assets under the Insolvency Act 1986 and the office-holders have wide powers to take possession, use, sell and lease assets. Where the office-holder has no title to the assets or they are held on trust, the office-holder will almost always allow those assets to be repossessed in order to avoid conversion claims.

12. Transactions That May Be Set Aside
12.1 Grounds to Set Aside/Annul Transactions
As a matter of English law, assuming that a financing arrangement does not contravene the Unfair Contract Terms Act 1977 and the Consumer Credit Act 1974 (where applicable), is not an extortionate credit bargain for the purposes of the Insolvency Act 1986 s.244 and has been validly executed in accordance with the Companies Act 2006 s.44, the possibility of it being set aside is very remote.

With reference to guarantees and security, there are four key provisions under the Insolvency Act 1986 that could be relevant. It is important to note that none of these provisions that enable transactions to be reversed are applicable in a solvent restructuring with the exception of transactions to defraud creditors under the Insolvency Act 1986 s.423, which is analysed below.

The first of these is s.245 which provides for the avoidance of certain floating charges when a company is in administration or liquidation. A floating charge created in the year (or two years, where the floating charge is created in favour of a connected person) before the onset of company’s insolvency is valid only to the extent of the value of consideration provided to the company at the same time or after the creation of the charge – effectively this is “new money” consideration. Therefore, if the floating charge is purporting to secure “old money” it will be exposed for the vulnerability period of up to two years. In order to be avoided, the company must have been or became unable, to pay its debts as a result of the charge. It should be noted, however, that this insolvency requirement is not applicable where the recipient of the floating charge is connected to the company. It should also be noted that the floating charge will be automatically void if the test is met and no application to court needs to be made by the office-holder. If, however, the office-holder claims that the floating charge is invalid, the beneficiary of it may attempt to enforce the charge, in which case litigation will likely ensue.

Security and guarantees can also be challenged by a liquidator or administrator under s.238 as a transaction at under-
value if the transaction was entered into for a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the company. The vulnerability period is for transactions entered into up to two years prior to the onset of insolvency. In order to be avoided, the company must have been or became unable to pay its debts at the time of the transaction. It will be a defence to a s.238 claim by the office-holder if the party to the transaction can show that the company entered into the transaction in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company. The court has wide powers to restore the position to what it would have been if the company had not entered into that transaction but, in reality, this is likely to mean the release of the relevant security and/or the guarantee.

The third provision of the Insolvency Act 1986 that might be relevant in an insolvency situation and which might be initiated by a liquidator or an administrator is a preference claim under s.239. A company grants a preference where it takes any action (such as granting security or a guarantee) or allows anything to be done which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position they would have been in if that thing had not been done. To make an order, the court will need to be satisfied that the company had a desire to prefer the person who is in a better position as a result of the act it has undertaken. The desire to prefer will be assumed where the person is connected (such as a shareholder). The vulnerability period for a preference is between six months and two years with respect to a connected person, prior to the onset of insolvency. Again the court has wide powers to restore the position to what it would have been if the company had not granted the preference but, in reality, this is likely to mean the release of the relevant security and/or the guarantee that constituted the preference.

The last form of vulnerable transaction is a transaction to defraud creditors under the Insolvency Act 1986 s.423. Any person affected by such a transaction can bring such a claim where it is entered into at an undervalue (as per s.238) and the purpose of the transaction (subjectively on the part of the company) was to put assets beyond the reach of a person who is making or may make a claim against the company, or to otherwise prejudice a person’s interests in relation to such a claim. The purpose of putting the assets out of reach of the person making the claim must have been the substantive purpose of the company (not the dominant purpose). The vulnerability period is six years for fraud and this generally runs from the discovery of it. The court can similarly reverse the fraudulent transaction.

13. Priorities and Waterfalls

13.1 Priority Claims

The order of priority in English Law insolvency is complex. The first objective of an office-holder will be to determine which assets form part of the estate. Creditors who have a proprietary right in an asset, such as via a retention of title right such that that title never passed to the insolvent company, will have a right to have their property returned to them. Equally, creditors who have assets held by the company subject to a trust will have those assets returned to them. Examples of such trusts are where a deposit was paid on trust by a customer and this continues to be held in a separate segregated account, or funds advanced by a lender for a specific purpose, but the advance has not been used for that purpose by the insolvency date.

Save with respect to the costs of preserving and realising legally mortgaged assets and fixed charge assets, there are no priority claims that will diminish the recoveries of such security holders on the assets specifically subject to such priority security.

Floating charge realisations will be diminished to the detriment of the holder by the costs of preserving and realising them and also by priority preferential debts (namely certain pension and employment claims) and payments to unsecured creditors out of the small prescribed part (GBP600,000) reserved for them. It is worth noting that taxes are not a preference claim. The most significant claim, however, having a priority ahead of the floating charge holders will be administration and liquidation expenses to the extent that other asset realisations are insufficient to discharge these expenses.

Following the discharge of the office-holder’s expenses, unsecured creditors (including unsecured tax and VAT creditors) will be entitled to a distribution. The courts have no jurisdiction to modify the priority of creditors which are determined by statute.

14. Courts and Arbitration

14.1 Courts

Insolvency cases, CVAs and Schemes are dealt with by the Companies Court which is a specialist court within the Chancery Division of the High Court of Justice. It employs exceptional lawyers (usually barristers) who tend to have had exceptional careers in the field of corporate insolvency law and practice. The London Companies Court will hear and manage Scheme cases and other more complex insolvency matters via approximately five registrars and a number of other judges. Other insolvency cases are heard nationally at district registries by district judges. Such courts will not hear the criminal aspects of an insolvency, but such is the sophistication of the judges, they are able to deal with trust,
contractual and other complex legal issues relating to the cases. Increasingly, the Companies Court judges are able to deal with international cases and to co-operate with the courts of other jurisdictions. Arbitration is not utilised in English law cases and the courts have sole jurisdiction of insolvency matters.

15. International Issues and Recognition

15.1 Recognition/Relief in Connection with Overseas Proceedings

The legal framework pursuant to which recognition or other relief in connection with foreign insolvency proceedings comprises:

- Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings (the “EC Insolvency Regulation”) and, when it comes into force in 2017, the recast Regulation (EU) 2015/848 on insolvency proceedings (the “Recast Insolvency Regulation”);
- Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (the “CBIR”), which implements the UNCITRAL Model Law on Cross-Border Insolvency (the “Model Law”) in Great Britain;
- Insolvency Act 1986 s.425; and
- common law.

EC Insolvency Regulation and the Recast Insolvency Regulation

The EC Insolvency Regulations have direct effect in all member states of the EU except Denmark and so applies in England and Wales. Under the EC Insolvency Regulation, main insolvency proceedings are opened in the jurisdiction in which the debtor has its centre of main interests (“COMI”). Main insolvency proceedings can be any type of the proceedings listed in Annex A to the EC Insolvency Regulations, which includes winding-up proceedings as well as specified reorganisation proceedings in the relevant jurisdictions. These proceedings are universal in scope and are automatically recognised in all of the relevant member states.

In other jurisdictions where the debtor has an establishment, secondary insolvency proceedings may also be opened after the main insolvency proceeding has been opened. Secondary proceedings are limited to winding-up proceedings listed in Annex B to the EC Insolvency Regulations, and are confined to the assets of the debtor in the member state in which the secondary proceedings are opened and must run parallel with the main proceedings. In limited circumstances, territorial proceedings can be opened in any jurisdiction that the debtor has its establishment before main insolvency proceeding. Similar to the secondary proceeding, territorial proceedings are limited to the assets of the debtor located in the relevant member state.

The Recast Insolvency Regulation extends the scope of the insolvency proceedings to cover certain other hybrid or pre-insolvency proceedings in the relevant member states, codifies the tests for determining the COMI, and introduces a framework for co-operation between different office-holders and courts in the context of group insolvency proceedings and facilitates the effective administration of those proceedings.

CBIR

Under the CBIR, foreign insolvency proceedings can be recognised if the foreign representative of that proceeding applies for recognition in the courts of Great Britain. Such foreign insolvency proceedings are limited to collective insolvency proceedings that are subject to the supervision and control of a foreign court.

There are two types of foreign proceedings that can be recognised under the CBIR. Foreign main proceedings take place in the state where the debtor has its COMI, while foreign non-main proceedings are take place in a state in which the debtor has an establishment. If a foreign main proceeding is recognised as such, an automatic stay will apply preventing actions being taken against the debtor or its assets. However, the automatic stay does not extend to any right to enforce security against debtor’s property or to the exercise of any set-off rights, as long as such rights could be exercised in a winding-up proceeding. A court may also grant discretionary relief if it would be appropriate to do so in order to protect the assets of the debtor or the interest of creditors.

No automatic stay applies in foreign non-main proceedings, but the foreign representative can apply for the same discretionary relief as in a foreign main proceeding.

Insolvency Act 1986 s.425

A court in the Channel Islands, Isle of Man or any country or territory designated by the Secretary of State (which are mostly Commonwealth countries) can apply to the UK courts for assistance in insolvency proceedings pursuant to the Insolvency Act 1986 s.426. The UK court has wide discretion in co-operating with and assisting the foreign court in relation to such insolvency proceedings, including the application of UK or foreign law or making of an administration order.

Common law

English courts have traditionally promoted the concept of “modified universalism” when considering the assistance that it should provide to insolvency proceedings of a debtor under common law on the basis of the principle of international comity. Under modified universalism, an English
court would provide assistance to a foreign insolvency proceeding provided it was satisfied as to the fairness of the procedures of those proceedings and the protection of the interest of the local creditors. However, following the Supreme Court's decision in Rubin v Eurofinance SA [2012] UKSC 46, the application of "modified universalism" has been curtailed. It was held in Rubin that insolvency proceedings are not a separate class of proceedings in which common law rules prescribing the circumstances in which the English courts would recognise foreign judgments are displaced or extended. Nevertheless, an English court may be able to exercise common law powers to assist foreign proceedings by, eg compel the provision of information to foreign liquidators.

15.2 Protocols in Cross-Border Cases
Insolvency protocols have been used in cross-border insolvencies to harmonise proceedings between the UK and other countries. Below are some notable case examples where protocols or insolvency agreements were employed. The examples are fantastic examples of what can be achieved by adopting judicial co-operation and assistance in international restructuring cases.

Between the UK and the US
Maxwell (1991/1992)
Cross-border insolvency protocols have their origin in the 1991 case of Maxwell Communication Corporation plc., which involved two primary insolvency proceedings initiated by a single debtor, one in the USA and the other in the UK, and the appointment of two different and separate insolvency representatives in the two states, each charged with a similar responsibility.

The US and UK judges independently raised with their respective counsel the idea that an insolvency agreement between the two administrations could resolve conflicts and facilitate the exchange of information. Under the agreement, two goals were set to guide the insolvency representatives: maximising the value of the estate and harmonising the proceedings to minimise expense, waste and jurisdictional conflict. In December 1993, both the plan of reorganisation and the scheme of arrangement were overwhelmingly approved without a major conflict between the two jurisdictions that required judicial resolution. The result was a Maxwell entity that was partially reorganised and partially liquidated. The case was an important milestone in international insolvency and introduced protocols as important tools in cross-border cases.

Inverworld (1999)
Inverworld involved the USA, the UK and the Cayman Islands. It was a complicated case in which applications for commencement of insolvency proceedings were made for the debtor and several subsidiaries in the three jurisdictions.

To avoid the ensuing conflicts, various parties created insolvency agreements that were approved by the courts in each of the three jurisdictions. The agreement arrangements included: dismissal of the UK proceedings, with certain conditions being imposed regarding the treatment of UK creditors; strict division of outstanding issues between the other two courts; and recognition by each court of the other court's actions as binding, in order to prevent parallel litigation and lead to a co-ordinated worldwide settlement.

Federal-Mogul (2001)
Federal-Mogul Global Inc. concerned reorganisation proceedings of a major automotive parts supplier in the USA and in Great Britain. The insolvency agreement dealt with communication procedures between the debtors and the insolvency representatives; confidentiality issues; rights to appear before the respective courts; the mutual recognition of stays of proceedings; and the retention and compensation of insolvency representatives and professionals.

Lehman Brothers (2009)
In the Lehman Brothers case, international co-operation would be crucial due to the volume and size of the claims involved, and the international dimension of the business. In 2009, Lehman Brothers' administrators in several jurisdictions signed a protocol that focused on co-operation and exchange of information. Crucially, the English administrators did not sign the protocol. The English administrators said in a report to the creditors that they did not consider it to be in the best interests of the English Lehman Brothers' entity to 'be party to or bound by such a broad arrangement'.

Madoff (2009)
In Madoff Securities, Judge Burton R. Lifland was faced with a complex case involving the disappearance of huge sums of money in a complex structure of international entities and accounts. Insolvency proceedings had been undertaken in England and proceedings had been taken under the Securities Investor Protection Act in the USA and insolvency representatives had been appointed in each of the cases. The joint administrators (in England) and the Trustee (in the USA) consequently negotiated a Cross-Border Insolvency Protocol to co-ordinate their administrations. Under the Protocol, each insolvency representative has the right to appear in the proceedings in the other country and both representatives agreed to provide each other with notice of hearings, meetings, applications, deadlines and other matter in which the other representative had an interest. The insolvency representatives also entered into a separate Protocol for the formal sharing of information between their respective estates.

One of the primary objectives of the Protocol in Madoff Securities was to improve communication, information shar-
ing and access for each of the insolvency representatives to the proceedings in the other country.

**Between the UK and Countries within the EU**

**Swissair (2003)**

Insolvency proceedings were commenced in Switzerland over several companies of the Swissair Group (Schweizerische Luftverkehr AG). To protect the assets of the respective companies abroad, insolvency proceedings were also initiated in other jurisdictions, including in England. To facilitate co-ordination, the Swiss and English insolvency representatives entered into an insolvency agreement. The insolvency agreement dealt with the realisation of assets, the payment of liabilities, costs and expenses, and the exchange of information, as well as the receipt and adjudication of creditor claims. It was designed to avoid duplication of work whilst at the same time protecting creditor rights and respecting priorities.

**SEndo (2006)**

In the case of SEndO International Limited, main insolvency proceedings were pending in the UK and non-main insolvency proceedings in France. The liquidators of both proceedings had entered into a protocol intended to establish a practical modus operandi in order to enable effective co-operation between the two insolvency proceedings. This protocol notably provided a framework on how to proceed with the statements of claims and realisation of the debtor’s assets as well as the distribution of liquidation proceeds.

**ISA-Daisytek (2007)**

In the ISA-Daisytek case, parallel insolvency proceedings commenced in England and in Germany. After the German courts recognised the English proceeding as the main proceeding, the German and English insolvency representatives developed a “co-operation and compromise agreement” which included a compromise provision, which regulated payment of proceeds in the German proceedings and dividends from certain foreign subsidies to the English proceedings, distributions to creditors and liability of the insolvency representatives. The agreement also included a provision on approval, specifying that according to German law, the effectiveness of the agreement was subject to the approval of the creditors and that the German insolvency representative would report the terms of the agreement to the responsible German court after the creditors’ meeting and that the English insolvency representatives would report the terms of the agreement to the responsible English court.

A protocol or insolvency agreement may not be the appropriate solution for all cases, being case-specific to its content and requiring time for its negotiation as well as a sufficient asset base to justify the costs associated with negotiation and co-operation between the courts and the insolvency representatives in each jurisdiction. Nevertheless, the protocols developed in historic cases have often provided innovative solutions to cross-border issues and have enabled courts to address the specific facts of individual cases. The upcoming changes to the Recast Insolvency Regulation which specifically sanction the use of protocols may also result in more protocols being implemented.

**15.3 Foreign Creditors**

Generally, foreign creditors can file claims and provide evidence for debts due to them in UK insolvency proceedings in the same manner as local creditors. However, to ensure that local creditors are not prejudiced, if there is a concurrent liquidation of the same company in the foreign jurisdiction, then any recovery made in the foreign insolvency proceedings will be taken into account. Foreign currency debts are converted into sterling under the Insolvency Act.
Doing Business in UK

Country Profile
The UK has shown resilience in the face of the current sovereign debt crisis affecting the rest of Europe. Although wage growth remains stagnant, the unemployment rate is steadily improving.

London is a major financial centre that attracts international business and is an important part of the UK’s service-based economy.

An EU Referendum on 23rd June saw the United Kingdom vote to leave the European Union (EU). At the time of going to press the country was navigating both political uncertainty and market instability as a result of the vote. The outcome in London, Scotland and Northern Ireland was notably at odds with that in England and Wales, with the former voting to remain in the EU and raising the prospect of division within the United Kingdom.

Business Culture
According to sources, the UK remains "a highly competitive market." Businesspeople note: "There is still a lot of money sitting around. Whenever a good opportunity comes up it gets plenty of suitors." The market is widely considered to be an easy one to enter. "The entire system is conducive to getting things done," enthuses one businessperson. "Even simple things, like setting up a company, can be done in less than ten minutes." Another agrees that: "It is probably easier to overcome potential obstacles here than in other countries."

A further attraction of the market is its probity. "People tend to keep their word in the UK and integrity is key," says one source. Another adds: "The jurisdiction is one of the least corrupt countries in the world and maintains very high ethical standards."

Legal Market
In the UK, the practice of law is divided between solicitors and barristers.

On contentious matters, solicitors have traditionally been responsible for handling legal proceedings up to the High Court where they have been required to instruct a barrister to handle the advocacy.

Whilst this remains the usual mode of operation, the strict distinction between the two professions no longer exists. Solicitors may now extend their rights of advocacy to appear before the higher courts, and members of the public may now instruct barristers directly. Formerly, they required a solicitor to do so on their behalf.

According to experts, the unique aspect of the UK legal market is “the depth of knowledge and experience across the board.” The size of a firm and breadth of choice are also cited as distinguishing factors.

Regulatory System
“There is a lot of red tape in the UK and a tremendous amount of administration,” says an interviewee.

Although the amount is an issue, the regulations themselves are generally referred to positively by sources. "I do a number of transactions in multiple countries and I think the UK is probably one of the most user-friendly environments," says one. Another describes the rules as very clear and with no space for ambiguity.

The level of regulation a company will be subject to depends on the market sectors in which it operates. The financial sector, in particular, has seen “an increasing emphasis on investigatory work. There are several complex, messy investigations going on.”

Experts explain that a proactive approach is key to managing regulatory requirements. “In many cases, filing a formal or informal notification to gain legal certainty is highly recommended.” Sources suggest that it is also important to consider the impact of the UK Takeover Code which came into force in September 2013. “This makes truly hostile bids more difficult for a very large company," cautions an expert. "Conducting processes such as anti-trust clearance and prospectuses without the help of the target is pretty difficult.”

Fees and Billing Methods
Hourly rates are notoriously high in the UK, and in London in particular. Clients should expect to pay very large figures for the very biggest individuals on the market, or when litigating, especially if barristers are required. Barristers’ bills, in particular, are criticised by sources for their complexity.

Despite this reputation for expense, there are suggestions that the market is adapting, with M&A experts reporting that firms are moving away from hourly rates and onto fixed fees for projects, whilst litigation practitioners are also adopting a more flexible approach involving Conditional Fee Arrangements, Damages-based Agreements, detailed estimates and caps. This change is partly driven by the fierce level of competition in the market.

A useful tip shared by businesspeople is to be careful when choosing what level of lawyer one instructs on a project. Many noted that considerable savings could be made by instructing a top-level associate, rather than a partner, with
very little drop in the quality of work produced. Such an approach requires a party to invest some time to build a good relationship with the right individual, but the results pay dividends. Alternatively, regional firms also offer excellent products at lower rates than can be found in London.