



INSOL
INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE (ONLINE)

2021 / 2022

**Session 3 Materials - UK
Restructuring Practice on the
Ground**



CONTENTS

PowerPoint Slides to Support Session



GLOBAL INSOLVENCY
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UK Insolvency Landscape - an Overview

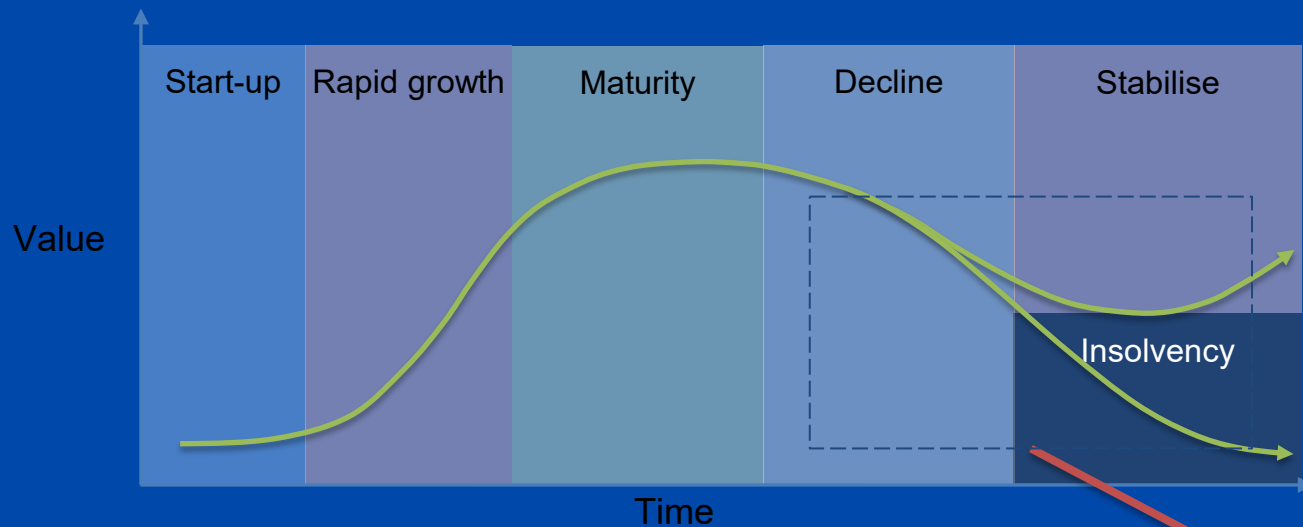
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November 2019



Business life cycle



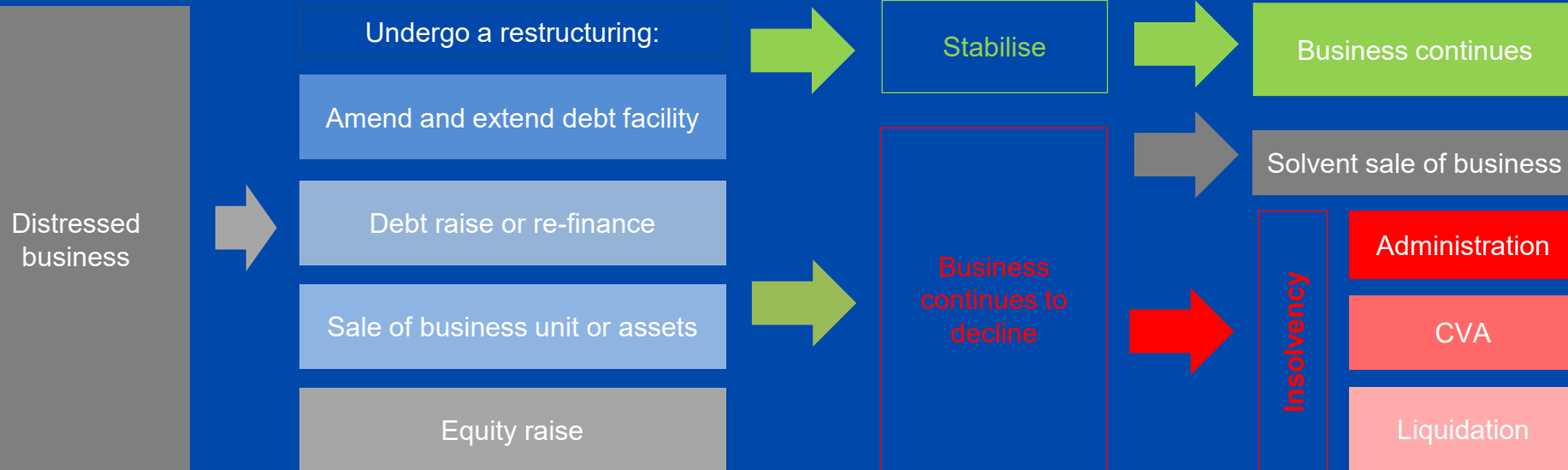
- Liquidity issues can be driven by a number of factors
- Companies can be profitable despite liquidity issues
- The number of turnaround options decline as time passes



What happens to a distressed business?

Depends on:

- Progression of the business lifecycle
- Origin of distress
- Degree of distress
- Short or long term implications
- Extent of cash needs





Restructuring Options



Restructuring options

1. Amend and extend debt facilities

What does this involve:

- Business will revise the debt terms with their financier including terms such as: value, repayment profile, servicing levels and costs/pricing
- May lead to providing additional security and forbearance considerations

Implications:

- Updated forecasts
- Pushing of creditor payments to finance
- Amended debt servicing profile and costs



Restructuring options

2. Debt raise or re-finance

What does this involve:

- Company raises money for working capital or capital expenditures by selling debt instruments to financiers

Implications:

- Additional cash flow
- Additional repayments and covenants to meet
- Further layers of funders



Restructuring options

3. Sale of non-core business assets/unit

What does this involve:

- Sale of a non-core business asset or unit to a competitor
- Additional cash flow is generated, usually to reduce debt
- Focus on core of the business in future

Implications:

- Additional cash flow, lower leverage
- Smaller, more focussed business model
- Separation issues



Restructuring options

4. Equity raise

What does this involve:

- Equity financing is the process of raising capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes.

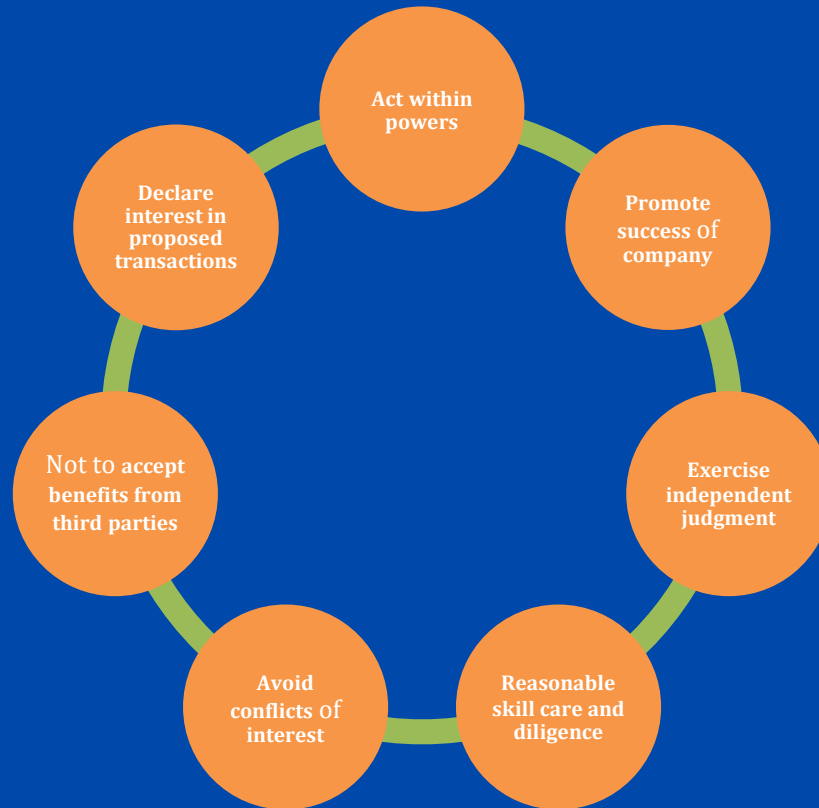
Implications:

- Additional cash flow, lower leverage
- Company can now invest in more products, services and sectors
- Potential growth in the business

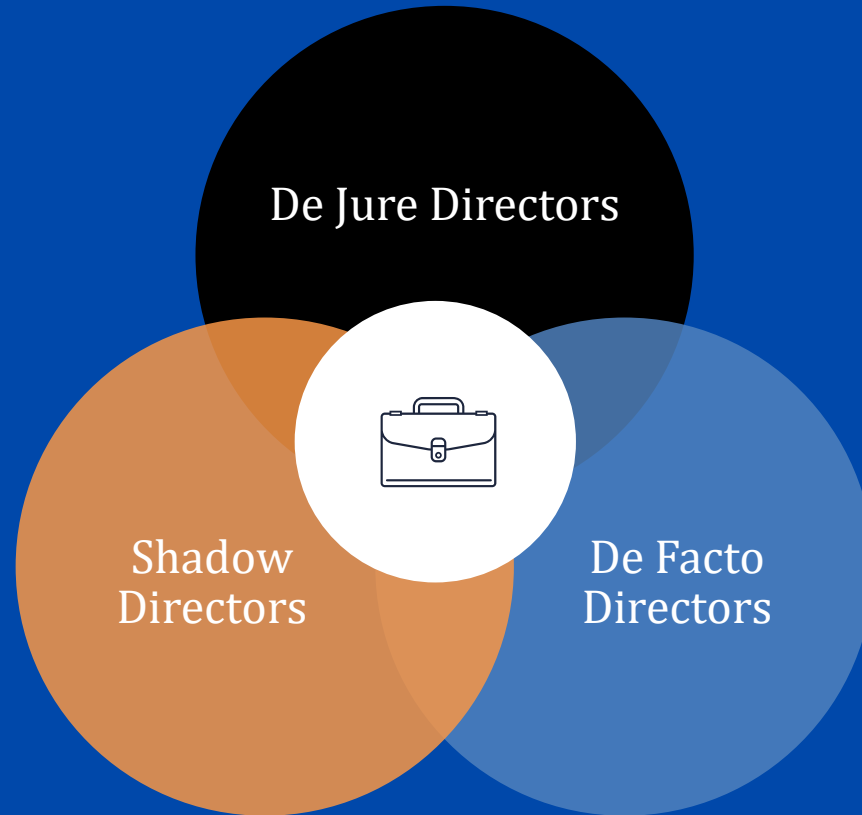


DIRECTORS DUTIES

Statutory general duties – Companies Act 2006



Who is a director?





Shadow directorship – do's and don'ts

- Do
 - Make recommendations as opposed to giving instructions
 - Recommend that professional advisers and/or key employees/non-execs be engaged by the company and feed into the shortlist of candidates and review the scope
- Don't
 - Make or influence major strategic decisions of the company or try to limit the discretion of the board other than pursuant to normal debate or professional advice
 - Negotiate with third parties on behalf of the board without the board having final approval
 - Insist on being added to the board (as opposed to recommending that the board needs support or strengthening)
 - If attending part of a board meeting for any reason, make sure it is clearly as an *observer* and not part of the decision making



To whom are the duties owed?

Shareholders

Creditors

Section 172 duty

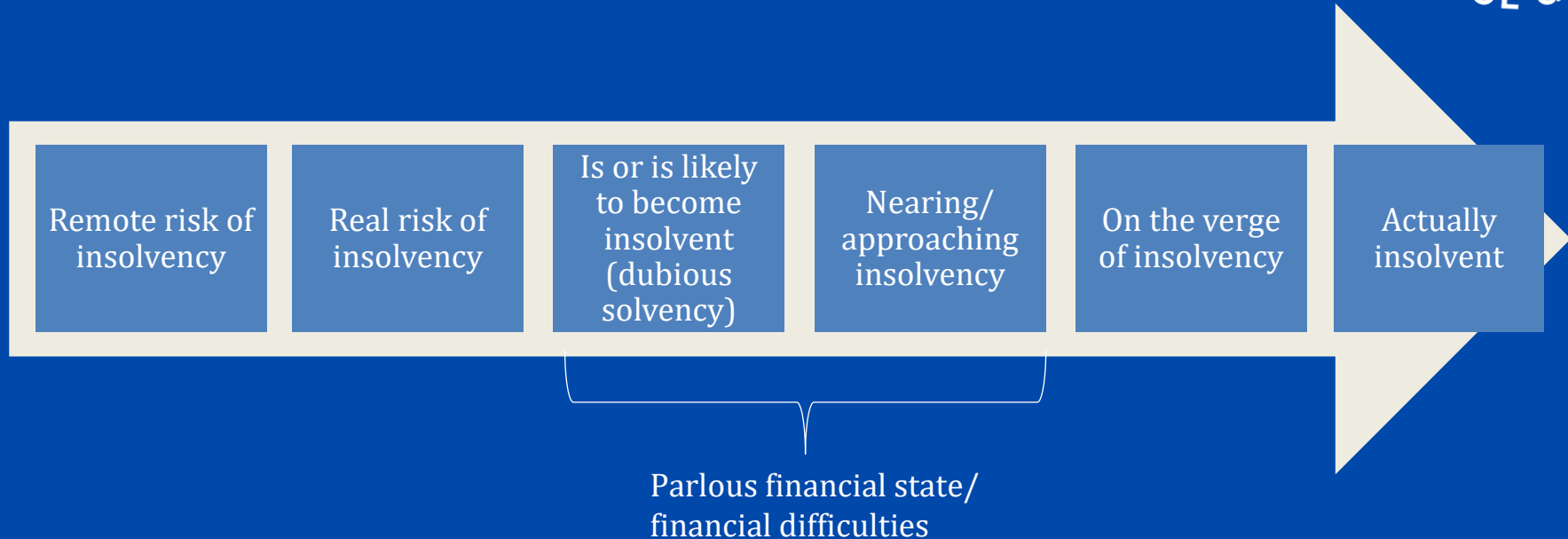


- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to...
- (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.





When is the 'creditors' interests' duty engaged?





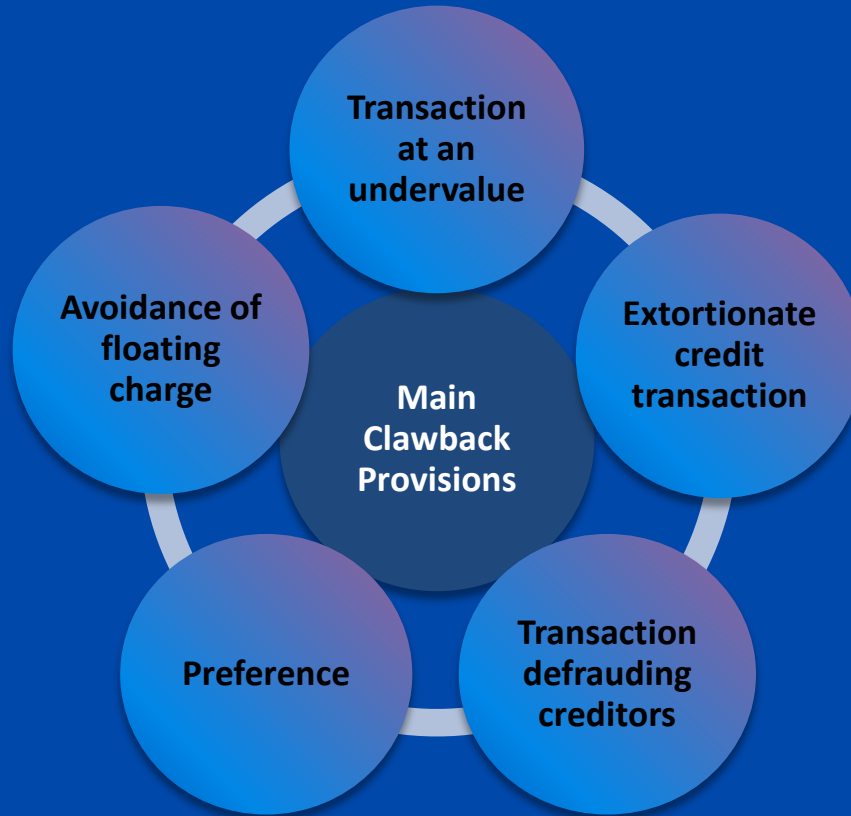
...the duty arises when the directors know or should know that the company is or is likely to become insolvent... "likely" means probable"



Antecedent Transactions



What are we covering?



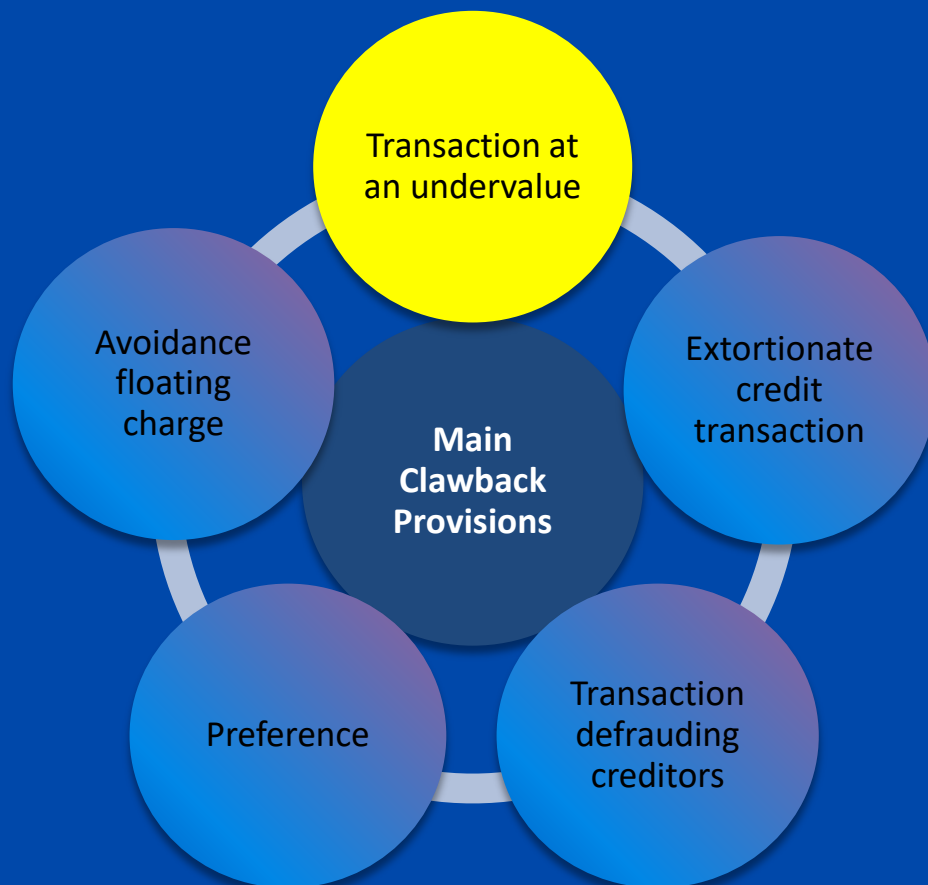


What are we not covering?

- Director malpractice and fraud – ss. 206 to 211
- Fraudulent trading – s. 213
- Wrongful trading – s. 214
- Personal liability for debts – s. 217
- Post-petition dispositions – s. 127



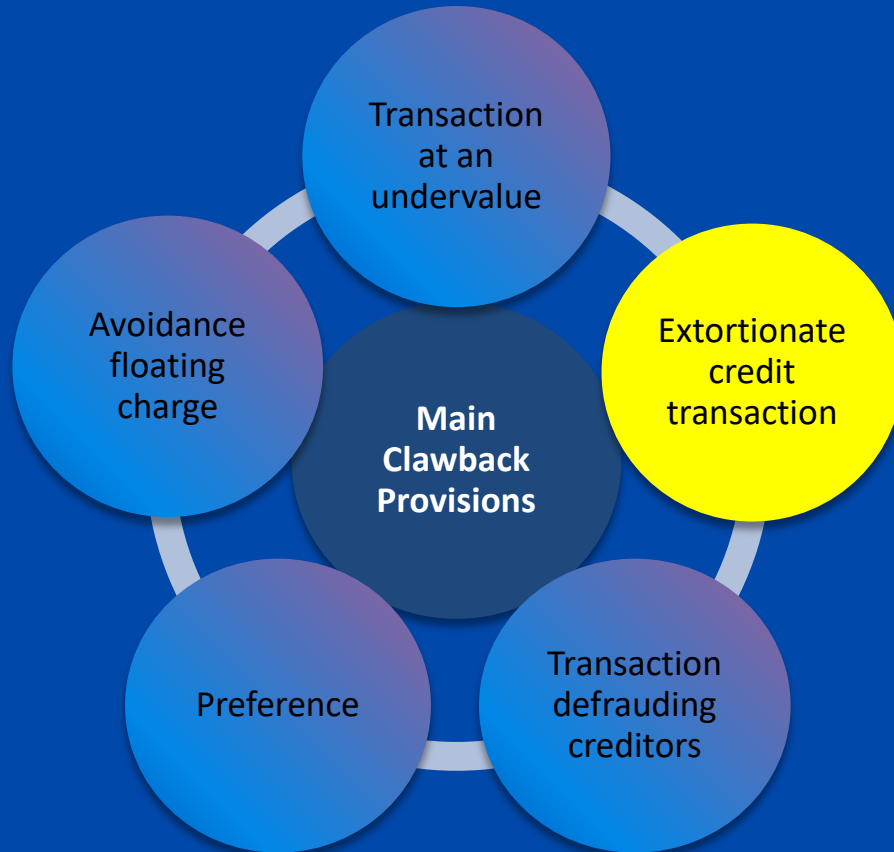
Transaction at an undervalue – s. 238



- Administrator or liquidator
- Gift, company received significantly less consideration than it ought to have received
- Two years
- Company insolvent at time of transaction, or rendered insolvent as a result of it
- Insolvency presumed if connected
- Restore position to what it would have been
- Defence – good faith & benefit to the company



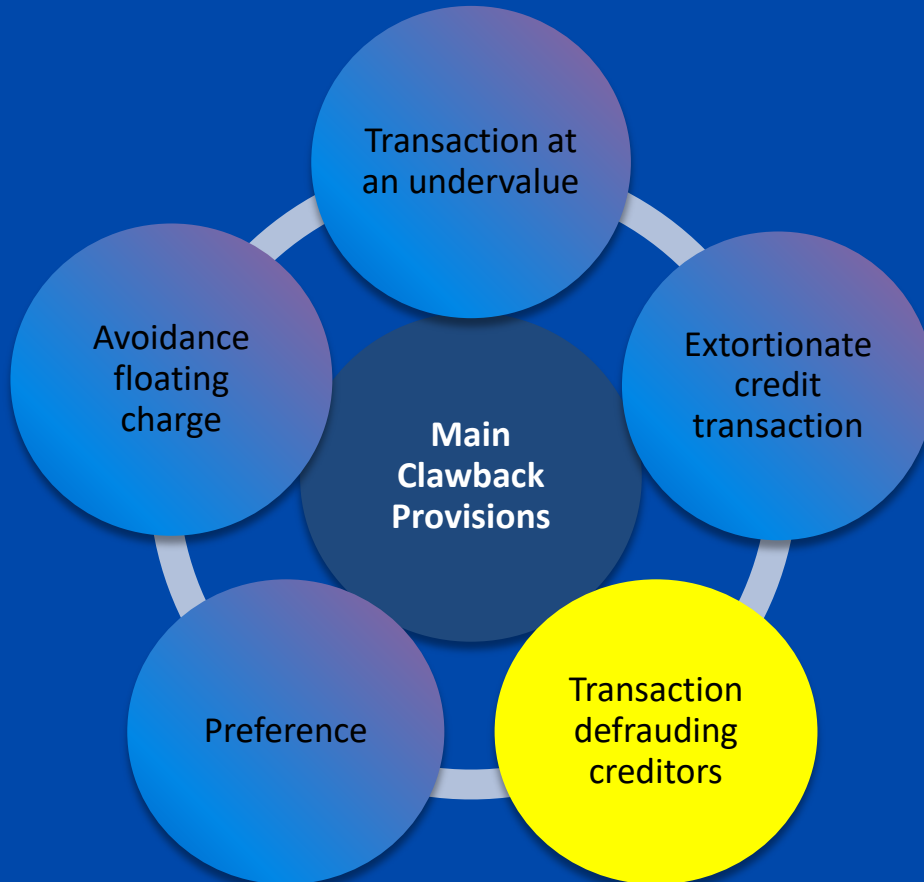
Extortionate credit transactions – s. 244



- Administrator or liquidator
- High threshold to demonstrate "extortionate"
- Three years before the day on which the company entered into administration or went into liquidation (note: not onset of insolvency)



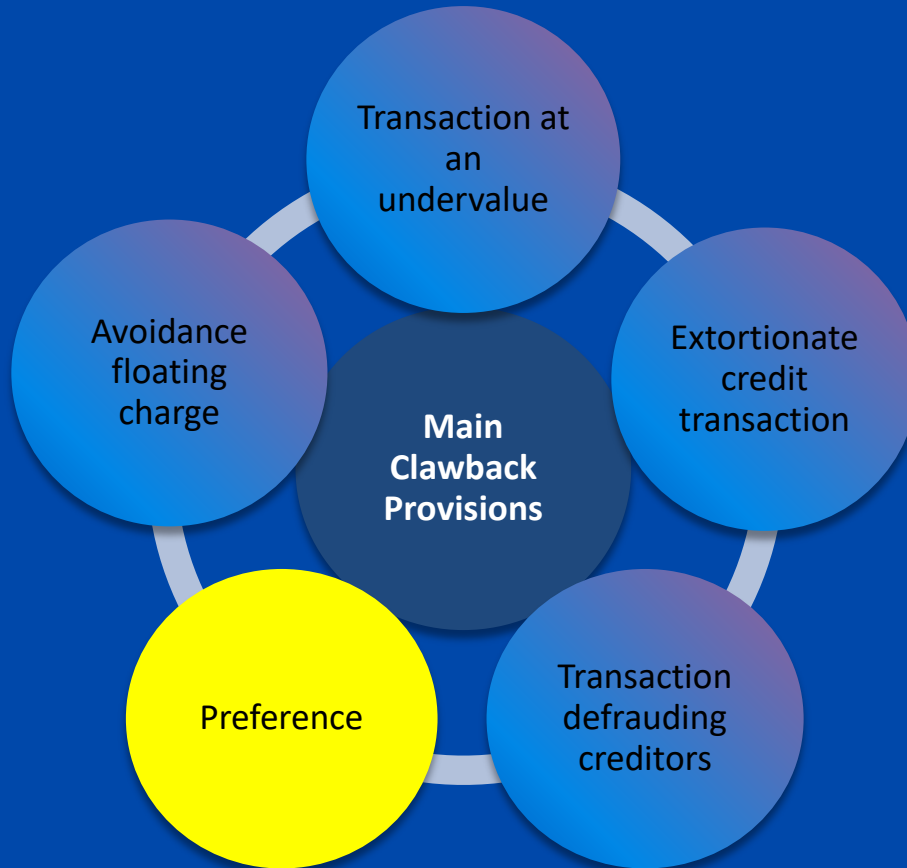
Transaction defrauding creditors – s. 423



- "Victims" can bring claim
- Gift, company received significantly less consideration than it ought to have received
- No relevant time
- For the "purpose" of putting assets beyond reach
- Restoration
- Defence for third parties – good faith



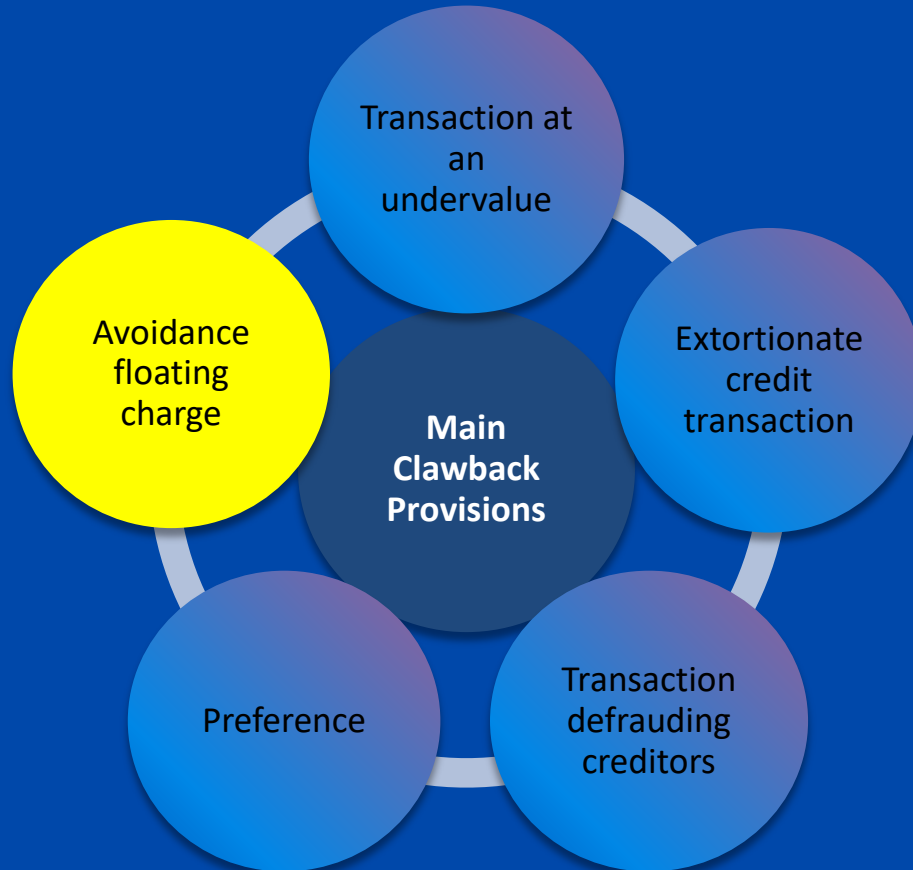
Preference – s. 239



- Administrator or liquidator
- Co must be influenced by a desire to put the creditor/surety/guarantor in a better position than they would have been had this preference not been given
- Desire presumed if connected
- Six months/two years
- Company insolvent at time of transaction, or rendered insolvent as a result of it



Avoiding floating charge – s. 245



- Administrator or liquidator
- Unconnected party: 12 months + insolvency requirement
- Connected party: 2 years + no insolvency requirement
- Consequence?



Insolvency options



What does insolvency mean?

Insolvency is determined by the following 2 tests (Insolvency Act 1986):

The 'cash flow' test

- The company is unable to pay its debts as and when they fall due
- Creditors may issue a statutory demand and, potentially, petition for the court to wind up (liquidate) the company

The balance sheet test

- The value of a company's assets are less than its liabilities (including contingent and prospective liabilities)



What are the types of creditors?

Secured creditors

- Fixed charge
- Floating charge
- Fixed and floating

- Banks / Invoice factoring company / Lenders with a charge

Preferential creditors

- Have a preferential ranking in an insolvency

- Employees for arrears of wages / accrued holiday pay / unpaid contributions to occupational pension schemes and state scheme premiums (all within certain limits)

Unsecured creditors

- Creditors with no fixed or floating charge (i.e. suppliers)

- Suppliers / Customers / HMRC / Contractors / Employees (non-preferential element)

The type of creditor determines the rights and claims in an insolvency



What types of insolvencies are there?

- Administration
 - Trading administration
 - Pre-pack administration (pre-pack)
 - Close-down administration
- Company Voluntary Arrangements (CVA)
- Liquidation



What is an administration?

- The Administrator is an officer of the court
- Has the power to trade the business and walk away from disadvantageous or unprofitable contracts
- Has a duty to all creditors
- Administration process requires creditor support
- Has the power to trade the business, although may require funding
- Must have an exit route
- Appointment is for a 12 month period, with the possibility of extensions

The administrator of a company must perform his function with the objective of:

1. Rescuing the company as a going concern, or
2. Achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
3. Realising property in order to make a distribution to one or more secured or preferential creditors



How does an appointment occur?

1. Out of court appointments

- Directors
- Company (i.e. the shareholders)
- Qualifying Floating Chargeholder (usually the Bank)

2. Court appointments

- Creditor's application (owed >£750)



Pre-pack administration processes

A sale of a business and assets agreed before, but completed immediately after, a formal insolvency appointment

Advantages:

- buyer in place pre-insolvency
- can be used at a holding company level to restructure ownership
- sale price agreed pre-insolvency
- costs are generally lower

Implications to unsecured creditor:

- Any amounts outstanding are frozen on appointment and become 'pre-appointment claims'
- The proceeds from the sale of business are distributed firstly to the secured creditor and then proportioned to the unsecured creditors
- Often this will result in a dividend of less than a £ per claim



Trading administration process

Advantages:

- Provides a creditor moratorium and retains control of the Company
- Time to explore a sale as a going concern (preserve value)
- Can be executed at short notice

However:

- Some contracts may be terminable by third parties on administration
- Requires support of customers / suppliers
- Generally more expensive

Implications to unsecured creditors:

- Freeze on accounts pre-appointment
- New agreement with some suppliers at liability of the administrators



Company voluntary arrangements (CVA)

- Allows a company with debt problems or that is insolvent to reach a voluntary agreement with its business creditors regarding repayment of all, or part of its corporate debts over an agreed period of time
- Binds all unsecured creditors
- e.g. Multi-outlet restructuring, tax efficient write-down of debt, pension restructuring
- Requires support of:
 - 75% (by value) of unsecured creditors to vote in favour, and;
 - at least 50% by value of 'unconnected' unsecured creditors

Implications to an unsecured creditor:

- Unsecured creditors will be bound into compromised claims
- This is usually proposed to the creditors via a comparison to the dividend outcome in a Liquidation scenario. This will offer a better option
- The company can continue to operate in the future



Liquidation

- A liquidation or "winding-up" is a terminal procedure under which the assets of a company are realised and distributed to the company's creditors
- Can be commenced by:
 - Out of court – a creditors voluntary liquidation. Led by the company and its creditors get to select the liquidator
 - Court appointment – a compulsory liquidation. Petition made to the court, usually by the creditor but can be by the company itself
- Liquidation can also occur after an administration whereby the business is sold or its assets are sold and the liquidation is used to distribute proceeds or conduct investigations

Implications to an unsecured creditor:

- This a terminal process
- Unsecured creditors will be asked to complete a proof of debt to support their claim



Proof of debt process

- Each creditor will be invited to provide the liquidator with details of any outstanding amounts
- This is provided by a proof of debt (example see overleaf)
- Usually any supporting evidence the creditor can provide is useful
- The liquidator will then assess all the proofs of debt. They may either accept a claim:
 - in whole;
 - in part; or
 - reject it



Proof of debt example

Ref.:

Claimant's ref:

COMPANY (U.K.) LIMITED

Creditor's Claim Form

Name and address of creditor: _____

Company registration number (if the creditor is a company) _____

Amount claimed in the liquidation: £ _____

Particulars of any security held _____

Value of security: £ _____

Signature: _____

Name and position of signatory
(if not personally the creditor): _____

Telephone: _____

E-mail: _____

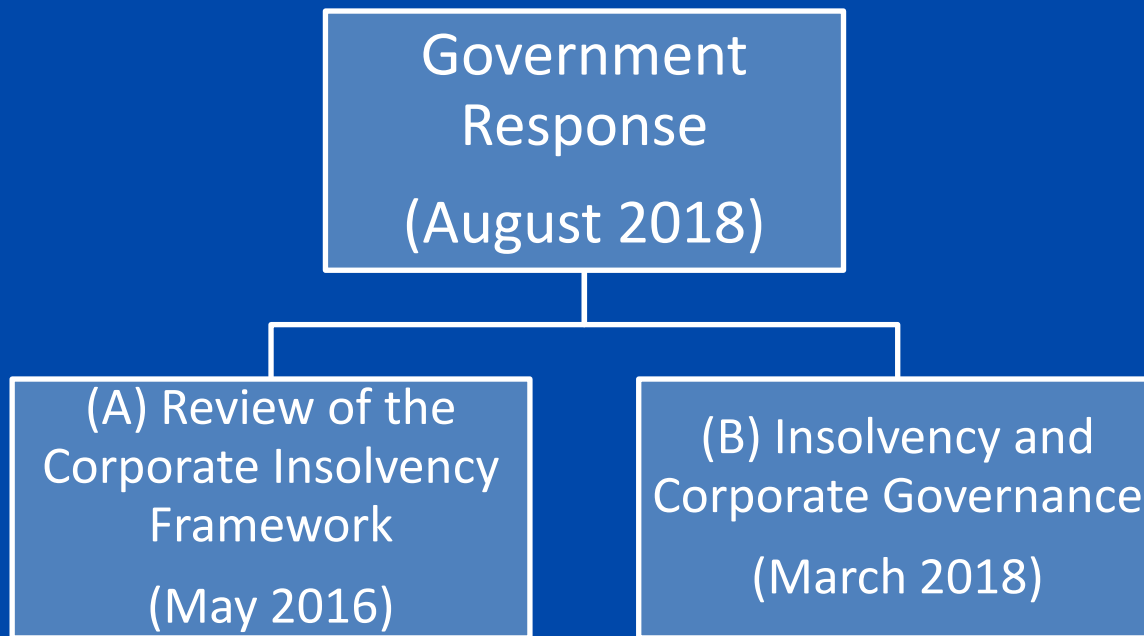
Date: _____

Please provide appropriate documentation in support of your claim.

If you are registered for VAT the amount claimed should include VAT even if VAT bad debt relief has been claimed under the Value Added Tax Act 1994.



The Future?





Pre-insolvency Moratorium



Pre-insolvency moratorium Scope and Duration

- Same basis as existing administration moratorium
- 28 days (extendable)
 - Qualifying conditions continue to be met
 - Creditor consent (50%+ in value of unsecureds/50%+ in value of secureds)
 - Court application
 - By way of piggy-backing a CVA or Scheme

Pre-insolvency moratorium – Qualifying Conditions



- Already or imminently in financial difficulty (if action is not taken the company will be insolvent)
- Not banks, FIs, insurance co's or FM co's
- Can't have entered into a moratorium, CVA or admin in previous 12 months (if subject to W/up petition requires court's consent before filing)
- Not excluded from CVA moratorium for small companies
- Likely to have sufficient funds to carry on its business during the moratorium (meeting current obligations as and when fall due as well as any new obligations incurred)
- Balance of probabilities: needs to demonstrate that it is more likely than not that a compromise or arrangement can be agreed with its creditors / exiting moratorium as going concern prospect
- Challenges (unfair prejudice and criteria not being met)
- Set-off



Pre-insolvency moratorium – possible impacts

LMA Event of Default (Insolvency)

- A member of the Group:
 - is unable or admits inability to pay its debts as they fall due;
 - [is deemed to, or is declared to, be unable to pay its debts under applicable law];
 - suspends or threatens to suspend making payments on any of its debts; or
 - by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors (excluding any Finance Party in its capacity as such) with a view to rescheduling any of its indebtedness.
- The value of the assets of any member of the Group is less than its liabilities (taking into account contingent and prospective liabilities).
- ***A moratorium is declared in respect of any indebtedness of any member of the Group. If a moratorium occurs, the ending of the moratorium will not remedy any Event of Default caused by that moratorium.***

Pre-insolvency moratorium – possible impacts



- LMA Event of Default (Insolvency Proceedings)
 - Any corporate action, legal proceedings or other procedure or step is taken in relation to:
 - ***the suspension of payments, a moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of any member of the Group;***
 - ***a composition, compromise, assignment or arrangement with any creditor of any member of the Group;***
 - the appointment of a liquidator, receiver, administrative receiver, administrator, compulsory manager or other similar officer in respect of any member of the Group or any of its assets; or
 - enforcement of any Security over any assets of any member of the Group,
- or any analogous procedure or step is taken in any jurisdiction.



So when might a company utilise it?

Eg - Retailer seeking moratorium prior to incurring CVA?

- But need to meet liabilities as they fall due in any event
- Announcement of a moratorium may cause trade insurers to pull lines increasing liquidity pressure
- Overdraft facility may still be demanded which may bring moratorium to an end
- Protecting against some non-financial/non-liquidity risk?
- Heads of challenge?



Role of the Monitor

- Insolvency practitioner and officer of the Court
 - verifies and monitors eligibility criteria
 - sanction all non-ordinary course dispositions of company assets
- Disqualified from acting as administrator or liquidator
- CVA and/or Restructuring Plan role
- Costs – super-priority status over costs or claims in any subsequent administration or liquidation (including expenses)

BUT

- Who will take a monitor role given conflict position on future work
- Liability issues?
- Impact of fees and "super-priority" on other stakeholders support?



Supplier Termination Clauses

"Ipso Facto" Clauses



Supplier Termination Clauses

- IPSO Facto prohibited but still able to terminate:
 - for non-payment of liabilities incurred following entry into a moratorium, restructuring plan or insolvency procedure
 - Giving notice under the contract
 - for reasons connected to the company's financial position (or the fact it has entered into a moratorium or restructuring plan
 - by order of the Court on grounds of "undue financial hardship"
- Exemptions? (e.g. overdrafts, leasing derivatives)
- "Smarter" termination clauses
- Undue hardship test (particularly where a Supplier is affected by multiple sector failures?)



Restructuring Plan

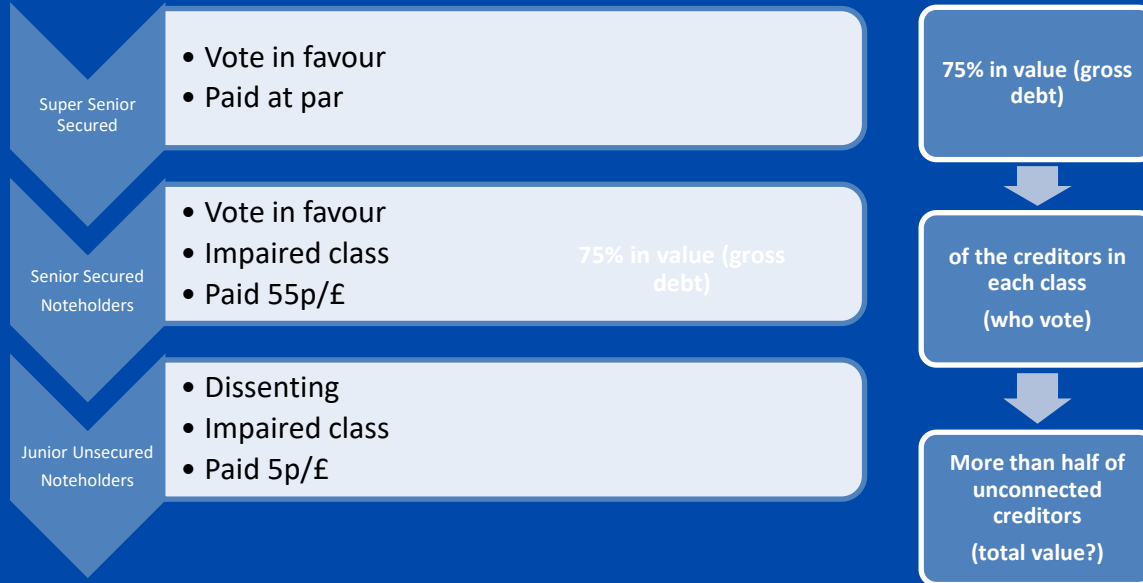


Restructuring Plan

- New standalone procedure but can be used in tandem with the all company moratorium
- No financial entry criteria - solvent or insolvent companies
- COMI required to be in the UK? Sufficient connection test? Similar to a SofA regarding proposal sent to creditors and shareholders and filed at court
- Class composition hearing
- (i) 75% in value (value of gross debt) of creditors in each class and (ii) more than 50% in number of unconnected parties to be approved (across the classes)?
- Where cross-class cram down is to be applied creditors interests must be respected including the "absolute priority rule" (although note the exceptions)
- Valuation is key / "best alternative valuation basis" should be used – will this encourage more consensual restructurings? No limit on how long the restructuring plan should be
- Complete flexibility may be possible no requirement for it to be a genuine form of compromise



Restructuring Plan - Cross-class cram down

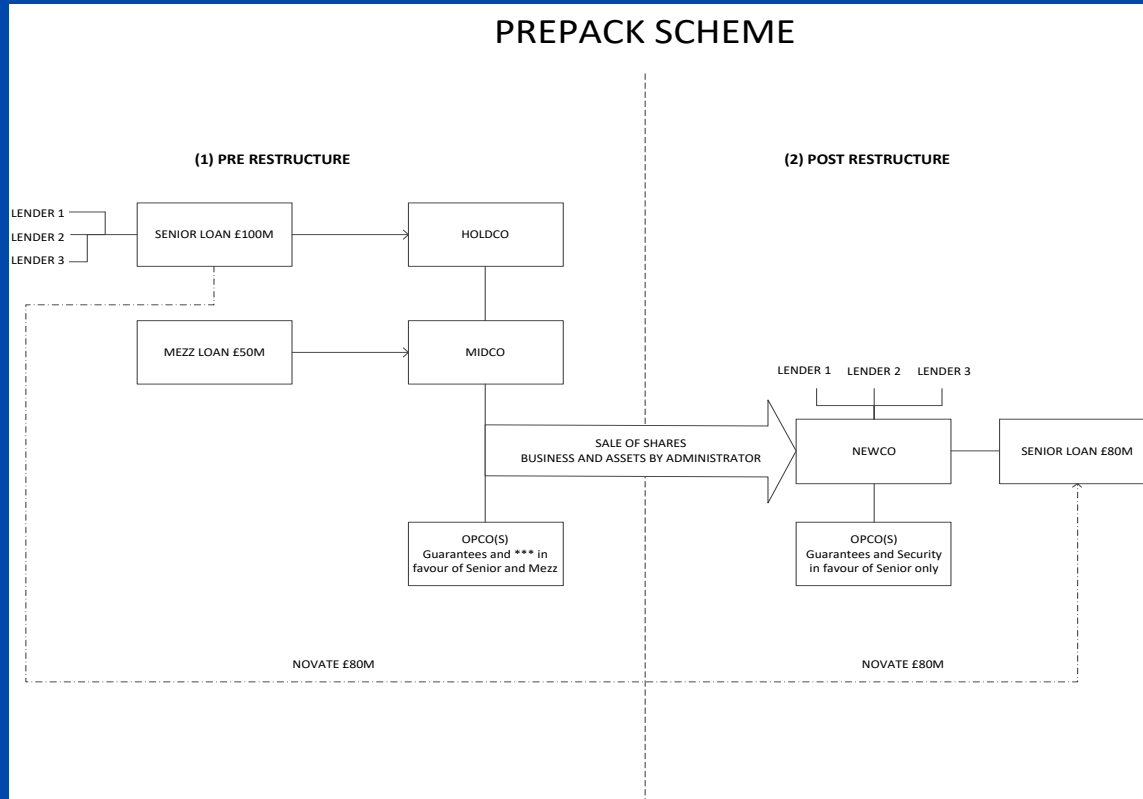


Absolute Priority Rule

- Considerations
- Necessary to achieve aims
 - Just and equitable
 - At least one class of impaired creditors vote in favour



Restructuring Plan v Prepack Scheme





Rescue Finance

Exploring Options for Rescue Financing:

- DIP or not to DIP?
- No thanks - too complex and large majority opposed
- UK market for rescue funding already functions well for viable businesses (existing lenders, order of priority in insolvency – para 99 Sch B1 / IR 3.51)
- Government will keep it under review



(B) Insolvency and Corporate Governance Consultation

- **Liabilities for directors of parent company when selling insolvent subs**
- **Tools to prevent rescue-funders "value extraction schemes"**
- Powers to investigate directors of dissolved companies
- Clearer records within Group company structures
- Investor/shareholder stewardship
- Distributable profits
- Directors understanding duties wider than their auditors
- Protecting companies in the supply chain from unfair practices
- Prescribed Part uplift
- **Amendment to s 240(2) of the IA 1986**

"As soon as parliamentary time permits"



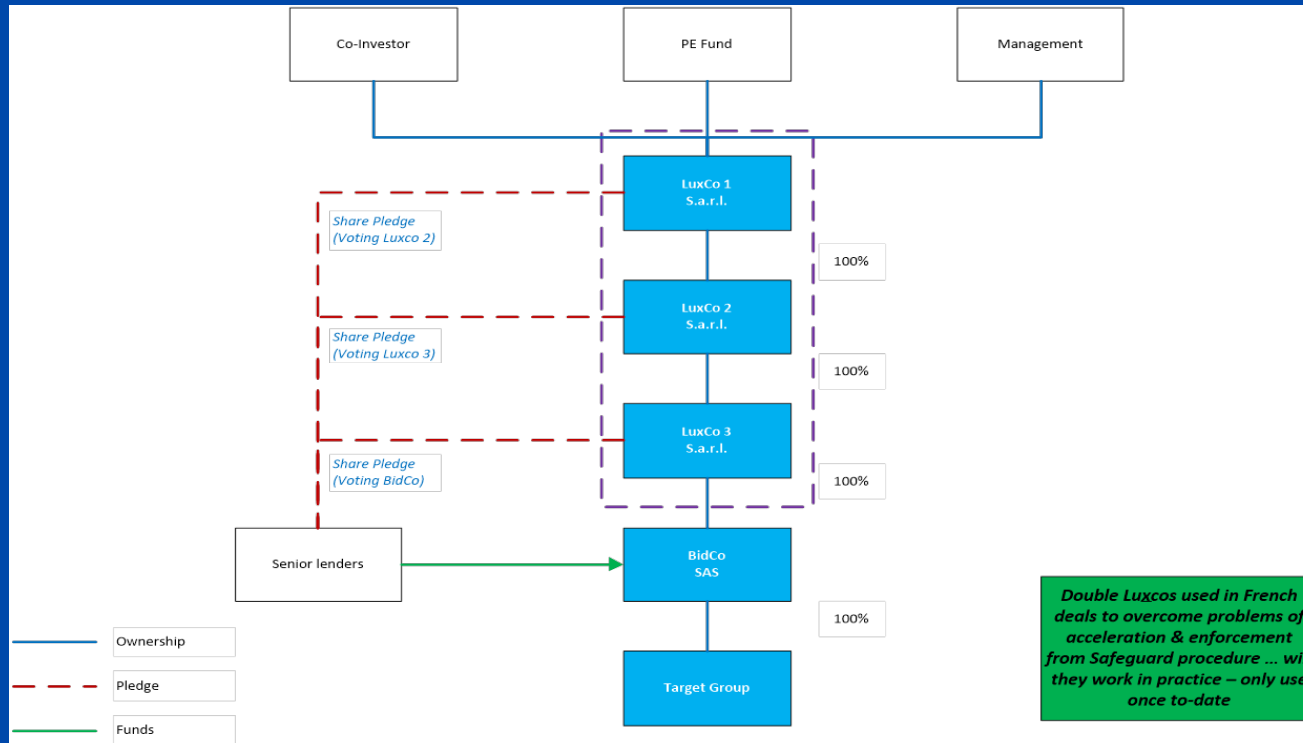
Selling Subs in Distress

Liabilities for directors of parent company when selling insolvent subsidiaries

- Gov will work with industry to develop guidance on the steps that a director of a parent company should take when considering a sale of an insolvent subsidiary
- Due consideration to the interests of the stakeholders of a financially distressed subsidiary when it is sold
- Non-exhaustive list of matters to consider (e.g. taking professional advice, involving consultation with the stakeholders and whether the sale would produce a worse result if the subsidiary had gone into insolvency process)
- Implications for investor directors / private equity
- Unintended consequences?



Selling Subs in Distress





Value Extraction Schemes

- Accusation that some lenders take on financially distressed companies specifically to extract as much value as possible before failure via management charges and other devices instead of giving the company a real chance to survive.
- Gov will work with stakeholders to develop or extend existing legislation which captures the behaviours it intends to address without deterring well motivated credit providers and allowing them to properly be rewarded for risk of lending to distressed businesses
- Responses will be balanced and proportionate (ability to reverse transactions?)
- Another form of antecedent transaction?



Main takeaways

New all moratorium

Prohibition of ipso facto clauses / "Essential Supplies"

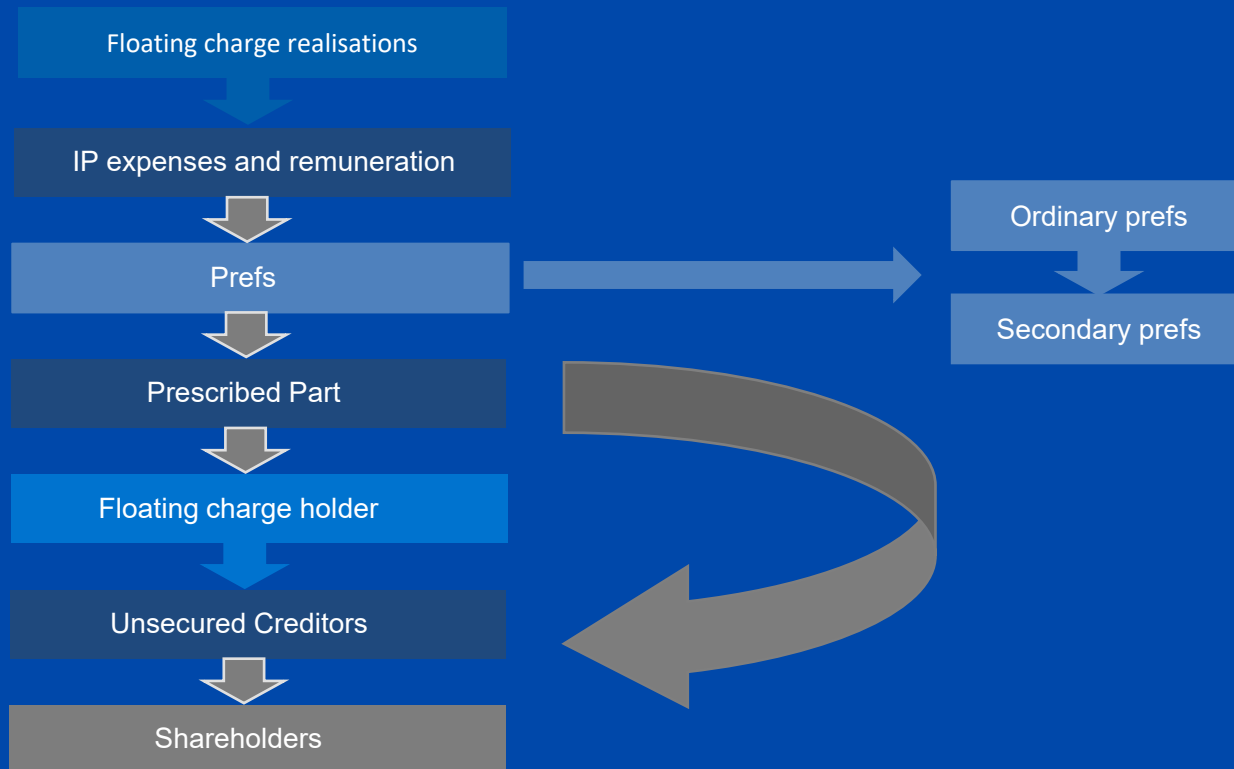
New restructuring plan / "super scheme"

Selling subs in distress

Value extraction schemes



1. Realisation of assets



1. HMRC Preferential claims

- **Draft** legislation to amend section 386 of the Insolvency Act 1986 to include certain HMRC debts as a new category of secondary preferential debt
- The certain HMRC debts include:
 - VAT; and
 - Other amounts owed to HMRC that qualify as a "relevant deduction"
- Technical consultation concluded on 5 September 2019
- Will apply where the "relevant date" is on or after 6 April 2020
- Proposed that HMRC will remain an unsecured creditor for taxes levied directly on businesses (e.g. corporation tax and employer NICs).

a deduction is "relevant" if—

- a) the debtor is required, by virtue of an enactment, to make the deduction from a payment made to another person and to pay an amount to the Commissioners on account of the deduction,*
- b) the payment to the Commissioners is credited against any liabilities of the other person, and*
- c) the deduction is of a kind specified in regulations made by the Commissioners by statutory instrument.*



1. Industry Response

In summary, the proposal is to shift the burden of certain bad tax debts from HMRC into the wider economy by according them secondary preferential status ie ranking behind employee claims, alongside depositor claims against failed financial institutions and ahead of floating charges and the general body of creditors. The amount of lost tax revenue is a tiny proportion of total Government revenue but its potential effect on distributions to creditors in any given insolvency could be very substantial.

Letter from The City of London Law Society to Sajid Javid dated 3 September 2019

With the repayment of some tax debts set to take priority over repayments of 'floating charge' debts in insolvency procedures from 6 April 2020, those who provide finance on a 'floating charge' basis will have to take steps to mitigate this risk to the value of their capital. Simply put, this proposal will limit the appetite of lenders to provide capital to businesses on a 'floating charge' basis. UK businesses, including, crucially, SMEs, will therefore have fewer financing options available to them.

We urge the Government to consider the bigger picture. Based on its wider impact on UK corporates and the economy, this policy proposal should be withdrawn.

Letter from R3 to Sajid Javid dated 3 September 2019