# THE INSOLVENCY REVIEW

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**Chapter 8**

# ENGLAND AND WALES

*Karen McMaster and Sarah Levin*[1]

## I INSOLVENCY LAW, POLICY AND PROCEDURE

### i Statutory framework and substantive law

This chapter details the following English insolvency and restructuring processes,[2] which are the key tools available under English law to restructure or wind down (or both) a company:

*a* formal insolvency processes, including liquidation, administration and company voluntary arrangements (CVAs), which are governed by the Insolvency Act 1986 (Insolvency Act) and the Insolvency Rules (England and Wales) 2016 (Insolvency Rules);[3]

*b* a stand-alone moratorium process during which a financially distressed company can engage in negotiations with creditors or otherwise prepare for restructuring, which is also governed by the Insolvency Act, as amended by the Corporate Insolvency and Governance Act 2020 (CIGA);

*c* schemes of arrangement (schemes) and restructuring plans, which are two pre-insolvency restructuring tools that can be used to compromise or reschedule debt with agreement from a statutory majority of creditors, subject to certain requirements being satisfied as set out in the Companies Act 2006 (Companies Act), as amended by CIGA;[4] and

*d* procedures for the recognition of foreign insolvency proceedings, which are governed by the Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (CBIR) that implement the UNCITRAL Model Law on Cross Border Insolvency (UNCITRAL Model Law) in the United Kingdom.

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1 Karen McMaster and Sarah Levin are partners at Milbank LLP.

2 This chapter considers insolvency and related restructuring laws applicable in England and Wales. It does not address analogous, but different, laws that apply in Scotland and Northern Ireland. This chapter does not consider receivership or administrative receivership – a self-help remedy for secured creditors to realise charged assets – as it is not a collective process. English insolvency tools available to individuals fall outside this chapter's scope.

3 The Insolvency Rules came into force on 6 April 2017, in most cases, replacing the Insolvency Rules 1986 in their entirety.

4 Note that there is some disagreement as to whether restructuring plans are an insolvency or pre-insolvency tool. To propose a restructuring plan, a company must show financial difficulties that may affect the company's ability to carry on as a going concern, as discussed in Section I.iv, in *Gategroup*, whether a restructuring plan should be considered an insolvency proceeding for the purposes of the Lugano Convention was hotly contested. In large part due to the financial difficulty requirement, the court found a restructuring plan was an insolvency process. See Section III.

### ii Policy

Until the 1980s, the most common outcomes for an over-indebted company were receivership initiated by the secured creditor to realise its collateral followed by liquidation.[5] Since the publication of the Cork Report in 1982, however, English insolvency law increasingly centres on corporate rescue.[6] The Insolvency Act, adopted in 1985 (and quickly reworked and replaced in 1986), saw the advent of administration – a rescue process that permits the ongoing operation of a business under the protection of a moratorium and the guardianship of an impartial insolvency practitioner.

The Enterprise Act 2002 later simplified the administration regime and introduced the 'qualified floating charge holder' – a creditor entitled to appoint an out-of-court administrator to enforce security in the event of default under a floating charge.[7] This replaced the more advantageous right that floating charge holders previously had to appoint a receiver.[8] The change directed secured creditors into a better balanced and more debtor-friendly procedure, as the administrator's primary objective is to rescue the company while acting in the interests of all creditors.[9]

The passage of CIGA in 2020 further transformed the restructuring regime, introducing a new stand-alone moratorium process, restrictions on certain termination rights of contractual counterparties (including a ban on *ipso facto* termination rights) and, crucially, the introduction of the restructuring plan, which permits cross-class cramdown.

The inclusion of more flexible, debtor-friendly processes is a result, in part, of the increasing complexity of corporate capital structures. The growth of secondary debt markets also renders more divergent interests among company stakeholders and having to solve multifarious collective action problems to ensure a company's going concern. This therefore requires a shift from the traditional approach of achieving purely consensual restructuring solutions. Debtors under English insolvency law now have access to a variety of tools that prevent creditor hold-outs: CVAs, schemes of arrangement and restructuring plans each provide debtors with a form of majority rule that encourages compromise and consensus among creditor groups.

### iii Insolvency procedures

The following processes, referenced above, can be used to rescue or wind up a company in England, subject to eligibility requirements. Some processes, such as stand-alone moratoria, CVAs, schemes of arrangement and restructuring plans, may form part of a wider restructuring or may offer a means to rescue a company on their own.

5 Omar, Paul and Gant, Jennifer, 'Corporate Rescue in the United Kingdom: Past, Present and Future Reforms' (May 18, 2016), (2016) 24 *Australian Insolvency Law Journal* 40, available at https://ssrn.com/abstract=3848575.

6 Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558.

7 A floating charge qualifies if its terms give the holder power to appoint an administrator, and the charge (alone or together with other charges held) relates to the whole or substantially the whole of the company's property. See Insolvency Act 1986 (Insolvency Act), Schedule B1 Paragraphs 14 and 16.

8 See Department of Trade and Industry, Productivity and Enterprise: Insolvency – A Second Chance (White Paper, Cm 5234, 2001) Paragraphs 2.4–2.6.

9 Insolvency Act, Schedule B1 Paragraph 3.

***Liquidation***

Liquidation is a company dissolution procedure pursuant to which a liquidator realises the assets of a company and distributes them to creditors in the priority prescribed by the Insolvency Act. Once concluded, the company will be dissolved and removed from the register of companies.

There are two forms of liquidation, also known as winding up, under the Insolvency Act:

*a* compulsory liquidation, by order of the court; and

*b* voluntary liquidation, which is divided into a members' voluntary liquidation (MVL) or a creditors' voluntary liquidation (CVL). An MVL is a solvent liquidation and requires a statutory declaration of solvency from the company's directors within the five weeks immediately preceding the date of the resolution for winding up.[10] A CVL can be a solvent or insolvent liquidation, but is subject to some degree of control by creditors.

***Administration***

Administration is a rescue procedure that allows for the reorganisation of a company's debts or the realisation of its assets, or both, under the protection of a statutory moratorium on creditor action. Upon appointment of the administrator, the moratorium prevents action against the company or its property, including enforcement of security, absent consent of the administrator or leave of the court, subject to some exceptions.[11]

An administration must achieve one of three statutory objectives, listed in order of priority:

*a* rescue the company as a going concern;

*b* achieve a better result for the company's creditors, as a whole, than would be likely in a winding up if the first objective cannot be achieved or it would achieve a better result for creditors as a whole than the first objective; or

*c* realise the company's property for distribution to one or more of its secured or preferential creditors, if it is not reasonably practicable to achieve either of the first two objectives and it will not unnecessarily harm the interests of creditors as a whole.[12]

An administrator must, subject to certain exceptions, submit a proposal to creditors for approval within the first several weeks of the administration (subject to extension). The administration ends automatically after one year, unless extended by court order or with creditors' consent. Complex administrations often require extensions. A company may exit administration prior to the deadline if the administrator (and the court, where necessary) is satisfied that one or more of the statutory objectives have been achieved. On exiting administration, the company may resume normal business. The administrator may alternatively place the company into a CVL or distribute the company's assets in accordance with the Insolvency Act (achieving substantially the same result as a liquidation) should they conclude that there is no reasonable prospect of rescuing the company.

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10 Insolvency Act, Section 89.

11 Insolvency Act, Schedule B1 Paragraphs 43 and 44. Exceptions include contractual set-off rights (at least until the administrator makes an authorised distribution) and secured creditors' rights to enforce against certain collateral to which the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226) apply, including shares.

12 Insolvency Act, Schedule B1 Paragraph 3.

Administrations are sometimes used to facilitate a pre-packaged sale of the company's business or assets, where the terms of the sale are agreed before the appointment of an administrator (referred to as a pre-pack). The sale is effected immediately upon (or soon after) the administrator's appointment.[13] Neither notification to, nor consent from, unsecured creditors is required.[14] Given the potential for abuse, various regulations increase transparency and fairness in pre-packs, including certain disclosure requirements to creditors of the details and justification for a pre-pack sale and certain protections in the event of a pre-pack sale to a connected party.[15]

### *CVA*

A CVA constitutes a binding agreement between a company and its unsecured creditors to compromise the company's debts, usually made with the aim of allowing the company in financial difficulty to avoid liquidation. CVAs are traditionally popular with companies that have significant unsecured debts with similar features, such as lease liabilities. Secured creditors and preferential creditors are not bound by a CVA unless they consent, making CVAs less attractive to companies with large amounts of secured debt.

Once put to a vote, a CVA proposal will be implemented if:

*a* approved by 75 per cent or more (by value) of the company's creditors; and

*b* not rejected by more than 50 per cent (by value) of the company's creditors admitted for voting who are 'unconnected creditors'.[16]

Notice of the proposal and the vote must be provided to all known creditors of the company.[17] The proposal, once approved by the statutory majorities, will bind all unsecured creditors, known and unknown, regardless of whether the creditor was notified.[18]

A CVA may be used alongside, or to obviate the need for, other insolvency procedures. The advantage of a CVA is that it is quick to implement,[19] offering a flexible tool that requires minimal court involvement. For the reasons stated above, CVAs have proven to be a popular tool for the retail sector, both at the height of the 2008 global financial crisis and more recently. They have also been the focus of a significant amount of litigation, often supported by industry bodies (often landlords) seeking to protect against disadvantageous outcomes and precedent.

13 Jacqueline Ingram and Yushan Ng (ed), 'The Art of the Pre-Pack' (*Global Restructuring Review*, 2019) 11.

14 ibid., 9.

15 Statement of Insolvency Practice (SIP 16 – Pre-packaged Sales in Administration; Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021/427.

16 Insolvency Act, Section 5(2)(b); the Insolvency Rules, Rule 15.34.

17 Insolvency Act, Section 3(4).

18 The Insolvency Act and the Insolvency Rules set out various 'decision procedures' that may be used when creditors are required to make a decision. Challenges on the grounds of unfair prejudice are possible in some circumstances – see further under Section I.iv.

19 The CVA becomes effective immediately after the resolution to approve it has been passed (for which 14 days' notice is required).

***Moratorium***

Introduced in 2020 under CIGA, the new stand-alone moratorium is a debtor-in-possession process that protects a company from creditor action so it may explore its rescue options. The moratorium automatically ends 20 business days after coming into force, but may be extended in a number of ways, including for one further 20-business-day period by the company's directors unilaterally.[20] Where combined with other procedures, the moratorium will come to an end once the court sanctions a scheme or restructuring plan, the company goes into administration or liquidation or when a CVA is approved by creditors.

The stand-alone moratorium is similar to the moratorium available in an administration in that, for as long as it applies, no steps can be taken to enforce security, commence insolvency or other legal proceedings against the company or, in the case of landlords, forfeit a lease.[21] The company is restricted from making certain payments or disposals of property, granting security and entering into certain market contracts during the moratorium unless an exception applies.[22] While the moratorium is not an insolvency process per se, it can be combined with the CVA, scheme of arrangement or restructuring plan, a feature that was previously lacking in the English insolvency framework.

The strength and popularity of the moratorium is significantly undermined by the fact that it is not available to entities with a significant amount of public debt (see Section I.iv). As such, it is much less likely to constitute a safe harbour backdrop to a complex reorganisation of a large company – in contrast to certain other processes, such as Chapter 11 in the United States.

***Scheme of arrangement***

A scheme effects a court-sanctioned compromise or arrangement between a company and its creditors (or any class of them) outside a formal insolvency process.[23] A scheme may be used to vary a class of creditors' rights and can bind all creditors if the requisite majority or majorities of each class (at least 50 per cent in number and at least 75 per cent by value) vote in favour of the scheme. If approved by the requisite majorities, the court has discretion to sanction the scheme.[24] The scheme becomes effective upon the court's sanction, and subsequent filing of the sanction order with the Registrar of Companies. The process of

20 Note that beyond any one-time unilateral extension by the directors, the company would need (1) the consent of its pre- moratorium creditors; (2) to make a court application; or (3) to propose a CVA, scheme or restructuring plan (with the latter two requiring a court order), to have the moratorium extended. Insolvency Act, Sections A10-A15.

21 The payment holiday from pre-moratorium debts does not apply to debts or other liabilities arising under a contract or other instrument involving financial services, which includes lending contracts and guarantees. See the Insolvency Act, Section A18 and Schedule ZA2. However, as a practical matter, creditors under lending contracts and guarantees have limited rights in a moratorium: they are still barred from commencing insolvency proceedings or enforcing on collateral (other than certain financial collateral, including shares).

22 By way of example, the monitor may give consent to the company making payment of certain pre-moratorium debts or granting of security over the company's property. The company can continue to dispose of its property in the ordinary way of its business if the property is not subject to a security interest.

23 Note schemes are also available to effect an arrangement with shareholders.

24 Companies Act 2006 (Companies Act), Section 899.

obtaining sanction for a scheme takes time, but courts can be sympathetic to expedited timetables. It is possible to complete the scheme procedure in approximately six to eight weeks subject to court availability.

In contrast to a CVA (in which the creditors effectively vote as a single class), debates regarding the appropriate composition of creditor classes are common and will be considered at the convening hearing, a court hearing that takes place prior to the creditor vote. The scheme retains a crucial advantage over CVAs in that it can bind secured creditors.

A further advantage of schemes is the ability to release claims against third parties where necessary to give effect to the scheme.[25] For example, schemes are often used to release guarantors. If not released, the subrogated claims of those guarantors against the scheme company, often referred to as 'ricochet claims', would undermine the scheme.[26] As discussed in further detail below, this feature of schemes makes them an increasingly attractive tool for large corporate groups with complex capital structures and guarantors in several jurisdictions. It has also provided the impetus for a great deal of recent innovation in scheme, and by extension restructuring plan, practice.

Schemes have been used to bind creditors to amendments and extensions of outstanding loans, debt-for-equity swaps and, during the covid-19 pandemic, to facilitate approvals for pre-emptive 'baskets' for super senior or rescue financing (where it was impractical to use contractual thresholds to obtain consent).[27]

***Restructuring plan***

Introduced under CIGA and similar in many ways to a scheme, the restructuring plan is a court-sanctioned compromise or arrangement among a company and its creditors or members (or a class or classes of them). The restructuring plan differs from a scheme in two key respects:

*a* the company proposing the restructuring plan must show some level of financial distress; and

*b* the restructuring plan can be used to bind a non-consenting class of stakeholders (i.e., cross-class cramdown).

A restructuring plan will be approved by a given class if at least 75 per cent in value of those participating in the vote approve it.[28] Following the vote, at the sanction hearing, the court has discretion to sanction the restructuring plan if all classes approved the restructuring plan. If one or more classes did not approve the restructuring plan, the court still has discretion to sanction the restructuring plan where:

*a* none of the members of the dissenting class would be any worse off than they would be in the 'relevant alternative', which is the scenario the court considers most likely to occur in relation to the company if the restructuring plan was not sanctioned (generally referred to as the 'no worse off' test or 'Condition A'[29]); and

25 See *Re Lehman Brothers International (Europe) (In Administration)* [2010] 1 B.C.L.C. 496.

26 ibid.

27 See *Re Swissport Fuelling Ltd (No. 2)* [2020] EWHC 3413 (Ch).

28 In contrast to a scheme, there is no requirement that a majority in number must also vote in favour.

29 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).

*b* at least one class who would receive a payment, or have a genuine economic interest in the company in the event of the relevant alternative (referred to as being 'in the money'), approved the restructuring plan (generally referred to as 'Condition B'[30]).

Furthermore, if the court is satisfied that none of the members of a given class have a genuine economic interest in the company in the relevant alternative (they are 'out of the money'), then it may conclude that there is no purpose to be gained from requiring a meeting of that class. In other words, the plan may proceed absent any vote from an entire class of creditors.[31] The court has noted that given the draconian effect of such an exclusion, it is of 'considerable importance that the court should be entirely satisfied that it is appropriate to make [such] an order'.[32] A significant determinant of what constitutes appropriateness is scrutiny of the evidence that supports the conclusion that a given creditor would receive no economic benefit in the relevant alternative scenario.[33]

As with a scheme, it is possible to release claims against third parties (such as guarantors) where necessary to give effect to the restructuring plan.[34]

Case law relating to restructuring plans has been developing rapidly during the past few years. The principles that underpin the court's use of cross-class cramdowns and, in particular, the factors that contribute to the exercise of the court's discretion[35] in sanctioning a plan (such as its fairness[36] and operational effectiveness[37]) are an evolving and unconsolidated area of case law. Some significant recent cases are described in more detail below.

### iv Starting proceedings

#### *Liquidation*

A compulsory liquidation may be initiated by, among others, a creditor, the company or, in certain circumstances, a shareholder presenting a winding-up petition to the court for the compulsory winding up of a company.[38] The compulsory liquidation commences when the court enters a winding-up order in respect of the company.

An MVL commences with a special resolution passed by the members and requires a statutory declaration of solvency of the directors.[39] A CVL is also initiated by a special resolution of the members (other than as an exit from administration) but no statutory declaration of solvency is made.[40]

30 ibid.

31 Companies Act, section 901C(4) .

32 *Re Smile Telecoms Holdings Ltd* [2022] EWHC 740 (Ch).

33 *Re Smile Telecoms Holdings Ltd* [2022] EWHC 387 (Ch).

34 ibid.

35 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).

36 *Re Noble Group Limited* [2018] EWHC 3092 (Ch).

37 *Re DeepOcean 1 UK Ltd* [2021] EWHC 138 (Ch).

38 Insolvency Act, Section 124.

39 Insolvency Act, Section 89.

40 Insolvency Act, Sections 86 and 90.

***Administration***

A company can be placed into administration either in-court or out-of-court. The company, its directors or any creditor may file an application to the court for the appointment of an administrator via the in-court route. Alternatively, the company, its directors or, in certain circumstances, a holder of a qualifying floating charge (a QFC holder) may give notice to the court documenting the appointment of an administrator.[41] In some cases, it may be preferable to pursue the in-court route to, for example, give a proposed administrator comfort where a pre-pack sale is contemplated or to allay recognition concerns when there are cross-border issues at play. Either way, an interim moratorium shields the company from creditor action if there is a delay between an applicant filing for administration and the administration order taking effect (when the in-court procedure is used) or if the applicant is required to give advance notice of its notice of intention to appoint an administrator (when the out- of-court procedure is used).

Certain secured creditors retain pre-emptive rights over the commencement of an administration. A company pursuing the out-of-court route must provide notice of intent to appoint an administrator to certain persons, including secured creditors with the right to appoint an administrative receiver and QFC holders.[42] A secured creditor with the right to appoint an administrative receiver may then block the out-of-court appointment by appointing an administrative receiver during the notice period, or it may substitute its choice of insolvency practitioner as administrator. A QFC holder who does not have the power to appoint an administrative receiver may substitute its choice of insolvency practitioner as administrator (provided the appointment is not being made by a prior ranking QFC holder), although it cannot block the administration.

***CVA***

While governed by the Insolvency Act, CVAs do not require a company to be in financial distress or insolvent.[43] A CVA may be proposed by a company's directors if the company is not in administration or liquidation, or by the administrator or liquidator (as applicable) if it is.

***Moratorium***

A company is eligible for the protection of the moratorium unless it is excluded.[44] One significant exclusion is where a company has or can accrue debt of at least £10 million under a 'capital market arrangement'.[45]

The directors of an eligible company commence the moratorium by filing:

*a* a director's statement that the company is or is likely to become unable to pay its debts; and

*b* a monitor's statement that it is likely that the moratorium would result in a rescue of the company as a going concern.

41 Insolvency Act, Schedule B1 Paragraphs 14 and 22.

42 Insolvency Act, Schedule B1 Paragraph 26(1).

43 Insolvency Act, Section 1.

44 Insolvency Act, Schedule ZA1 Paragraph 1.

45 Insolvency Act, Schedule ZA1 Paragraph 13.

A court application is required where there is an outstanding winding-up petition or the company is an eligible overseas company.[46] The court may only make an order where the company has an outstanding winding-up petition if it is satisfied that a moratorium would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up without first being subject to a moratorium. The moratorium takes effect when the relevant documents are filed with the court or when the court makes a favourable order.[47]

***Scheme of arrangement***

A scheme is typically initiated by the company. Schemes are available to companies registered in England, but can (and often are) used by non-English overseas companies so long as they are liable to be wound up under the Insolvency Act and have a sufficient connection to England and Wales.[48] In practice, a foreign company is likely to satisfy the first limb of this test. The second limb has been found to be satisfied where, among other things, the company's finance documents are English law-governed (including where they have been amended to be so).[49] Recognition of schemes in foreign jurisdictions is a key element of the practical analysis of whether to pursue a scheme (or restructuring plan).

Increasingly, to reinforce the recognition analysis, scheme or plan companies are newly incorporated English entities that have assumed liability (as a co-issuer or guarantor) for the debts to be restructured.

***Restructuring plan***

Similarly to a scheme, a restructuring plan will usually be initiated by the company. It may be proposed in respect of the same types of companies as a scheme, subject to certain limited exceptions and subject to meeting the financial difficulty test. To be eligible to propose a restructuring plan, the company must:

*a* have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern; and

*b* have proposed a compromise or arrangement with its creditors or members (or any class of them) for the purpose of eliminating, reducing, preventing or mitigating the effect of such financial difficulties.[50]

There is no solvency criterion, thereby making the restructuring plan available to both solvent and insolvent companies.

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46 A company is excluded if its registered office or head office is outside the United Kingdom and its functions correspond with the functions of any excluded company registered under the Companies Act, such as a non-exempt company that carries on the regulated activity of effecting or carrying out contracts of insurance. Insolvency Act, Schedule ZA1 Paragraph 18.

47 See Insolvency Act, Section A6 for the full list of relevant documents.

48 Companies Act, Section 895(2); *Stocznia Gdanska SA v. Latreefers Inc (No. 2)* [1998] EWHC 1203 (Comm).

49 *Re Haya Holdco 2 Plc* [2022] 6 WLUK 66.

50 Companies Act, Section 901A.

### v Control of insolvency proceedings

Who exercises control in a plenary insolvency proceeding and how much control they have is largely a function of the rules of the proceeding itself. No matter the proceeding, directors of an English company must exercise caution when there is doubt as to a company's solvency. Directors may be liable for wrongful trading if they continued trading the business after they realised, or ought to have concluded, that the company had no reasonable prospect of avoiding an insolvent liquidation or insolvent administration, unless the court is satisfied they took every step with a view to minimising the potential loss to the company's creditors.[51] Directors may also be liable for fraudulent trading if they have carried on the business with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose.[52] If their conduct in the lead- up to an insolvency is found to make them unfit to be concerned in the management of a company, directors may also be required to pay compensation for the benefit of creditors or as contribution to the company's assets, and disqualified from acting as directors or from being involved in the management of a company, for a period between two and 15 years.[53] Even before insolvency, directors must be cautious. When there is doubt as to a company's solvency, directors must consider the interests of the company's creditors so as to minimise the potential loss to them.[54]

#### *Liquidation*

In all forms of winding up, the appointed liquidator or the official receiver manages the company's affairs and the liquidation, rather than the company's directors or officers. On appointment, the directors' powers to bind the company automatically cease, although in the case of a voluntary liquidation, the directors may retain some powers if approved by the liquidator or creditors.[55]

The court has minimal involvement in the conduct of a voluntary liquidation, whereas in a compulsory liquidation the court determines the application for a winding-up order.

#### *Administration*

Administrations are managed by an administrator, who must be a qualified insolvency practitioner. Once appointed, they are an officer of the court and must carry out their functions in the interests of creditors as a whole.[56]

In general, the administrator takes control of the company's business and assets from its directors.[57] Similarly to the liquidator, the administrator is empowered to seek a court order

51 Insolvency Act, Section 214(4).

52 Insolvency Act, Section 213.

53 Company Directors Disqualification Act 1986, Sections 6, 15A.

54 The primacy of the creditors' interests and precisely when the duty to consider creditors' interests arises are yet to be defined, but courts consistently state (without holding) that the duty arises some time prior to the time that the tests of insolvency are satisfied. *BTI 2014 LLC v. Sequana SA* [2019] EWCA Civ 112. The question of when directors must consider creditors' interests is currently awaiting judgment from the UK Supreme Court in *Sequana*. Note that considering creditors' interests was a common law obligation, codified by Section 172(3) of the Companies Act. See Explanatory Notes to the Companies Act, Paragraphs 331–332.

55 Insolvency Act, Sections 91(2) and 103.

56 Insolvency Act, Schedule B1, Paragraph 3(2).

57 See Insolvency Act, Schedule 1.

against directors for contributions to the company's assets if his or her investigations reveal instances of wrongful or fraudulent trading, and to set aside transactions at an undervalue, preferences and transactions defrauding creditors.[58]

Although the administrator generally takes control of the operation of the company's business, light-touch administrations (in which the administrator leaves some management powers and day-to-day operations with directors) have recently regained some popularity. Much like a hybrid between traditional administration and a US Chapter 11 debtor-in-possession process, the light-touch administration offers moratorium protection to the company, allowing the directors to focus on the long-term viability of the business, while the administrator supervises the directors and addresses immediate threats to the company's survival. Although not a new concept in English law, light-touch administration was not commonly used and a debtor's directors or management was traditionally wholly displaced by the administrator. Since April 2020, however, it has attracted support from prominent practitioners[59] and some respected members of the judiciary.[60]

The court has varying levels of involvement, depending on whether the administration is commenced by way of an in-court or out-of-court application and whether the administrator is likely to need directions owing to the complexity of the company's affairs. The court's involvement in an out-of-court and simple application may be limited to receipt and processing of the documents required to be filed at court.

### *CVA*

The appointed nominee (an insolvency specialist, generally an accountant) plays a significant role in a CVA and is appointed by the company's directors on proposal of the CVA.[61] The nominee reports to the court on whether, in his or her opinion, the proposal has a reasonable prospect of being approved and implemented, and whether it should be put to members and creditors. Following the report, the nominee seeks approval of the company's members at a meeting and the creditors by way of a qualifying decision procedure (e.g., correspondence or physical meeting).

A creditor or member can challenge the CVA within 28 days after notice of approval is filed with the court only on the grounds of unfair prejudice to them or material irregularity in the approval process (or both).[62] Objections based on unfair prejudice ultimately present a question of fact; for instance, a CVA that treats different unsecured creditors in different ways may be prejudicial to those creditors, but the question of fairness depends on the overall effect of the CVA.[63] Objections based on material irregularity are also a question of fact, but relate to how the decision procedure used to consider the CVA proposal was conducted. Issues that

58 Insolvency Act, Sections 238(1), 239(1), 243, 246ZA, 246ZB.

59 The Insolvency Lawyers Association (ILA) and the City of London Law Society have recently published a draft 'Consent Protocol', which aims to provide support and directional guidance for the light touch administration. See 'Joint administrators' consent under Paragraph 64 of Schedule B1 to the Insolvency Act 1986', www.r3.org.uk/technical-library/england-wales/technical-guidance/covid-19-contingency-arrangements/more/29356/page/1/the-consent-protocol-administration/, accessed 20 July 2021.

60 Snowden J's recent judgment in *Re Carluccio's (In Administration)* [2020] EWHC 886 (Ch).

61 Insolvency Act, Section 1. Where the administrator or liquidator proposes the CVA, he or she usually acts as the nominee.

62 Alternatively, if the applicant did not receive notice, within 28 days of the day on which they became aware that the qualifying decision procedure had taken place. See Insolvency Act, Section 6.

63 *Re Cancol Ltd* [1996] 1 All ER 37.

the courts have considered include valuation of creditor claims and whether creditors with claims likely to be settled by a third party can vote in favour of a CVA.[64] Upon a successful challenge, the court may revoke or suspend the approval of members or the decision by creditors and make any supplemental directions as it thinks fit.[65]

***Moratorium***

The directors remain in control of the company during the moratorium, and as such, their usual legal duties continue alongside additional duties imposed by the moratorium,[66] including obligations to notify certain of the company's stakeholders of the moratorium as soon as reasonably practicable.[67] The appointed monitor also has duties during the moratorium, including an ongoing duty to end the moratorium by filing a notice with the court if the monitor considers that the company is unlikely to be rescued as a going concern.[68]

Creditors may also challenge the actions of the directors or the monitor during the moratorium by applying to the court on the basis that their interests are unfairly harmed. Having regard to the need to safeguard the interests of the persons who have dealt with the company in good faith and for value, the court may make such order as it thinks fit, including bringing the moratorium to an end.[69]

***Scheme and restructuring plan***

The directors of the company remain in office when a scheme or restructuring plan is proposed. There are few restrictions on what can be included in the scheme or restructuring plan, and the company proposes terms that it thinks will be agreeable to creditors or members and capable of being sanctioned by the court.

Both the scheme and restructuring plan require court oversight at two junctures. At the first hearing (the convening hearing), the court considers the composition of creditor classes and summons the meetings of creditors or members to consider the scheme or restructuring plan. It will consider, among other things, any issues that may arise as to the constitution of meetings, any issues as to the existence of the court's jurisdiction to sanction the scheme, and any other issue not going to the merits or fairness of the scheme but that might lead the court to refuse to sanction the scheme.[70] After the classes vote and assuming the requisite majorities are reached, the court will then exercise its discretion to sanction the scheme or restructuring plan if certain requirements are met (and, in particular, the requirements referred to in Section 1iii).

64 See *Re Newlands (Seaford) Educational Trust* [2007] BCC 195; *HMRC v. Portsmouth City Football Club Ltd and others* [2010] EWHC 2013 (Ch)).

65 For example, the court may direct the company to hold another vote that attempts to cure the subject of the challenge. See Insolvency Act, Section 6.

66 See *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch); *Hunt v. Michie* [2020] EWHC 54 (Ch).

67 Failing to do so is an offence without reasonable excuse. See Insolvency Act, Section A24.

68 See Insolvency Act, Section A42. If the monitor fails to bring the moratorium to an end, a creditor can bring an application to bring it to an end.

69 Insolvency Act, Section A42(7).

70 'Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)' (*Judiciary of England and Wales*, 30 June 2020), paragraph 6 <https://www.judiciary.uk/publications/practice-statement-companies-schemes-of-arrangement-under-part-26-and-part-26a-of-the-companies-act-2006/> accessed 16 July 2021.

The court has drawn attention[71] to the fact that the legislature did not incorporate an absolute priority principle into the law regarding restructuring plans.[72] The absolute priority principle provides that a junior class cannot recover value through a restructuring process where a senior class is impaired without the consent of that senior class. This principle underpins other major restructuring regimes, notably Chapter 11 in the US. Some consideration of this principle has been given by courts in the exercise of their discretion in sanctioning restructuring plans through enquiry into the distribution of restructuring surplus. This is further considered in some of the cases outlined below.

### vi Special regimes

Certain businesses are excluded from general insolvency regimes and subject instead to special insolvency regimes that, depending on the type of business, may be based on the administration procedure in the Insolvency Act. Special rules apply to certain banks and analogous bodies,[73] insurance companies,[74] postal services,[75] water or sewerage companies,[76] certain railway companies,[77] air traffic control companies,[78] London Underground public–private partnership companies,[79] building societies[80] and bodies licensed under the Energy Act 2004,[81] among others. For example, a special administration regime was used to stabilise and sell electricity supplier Bulb Energy Ltd in 2022.[82] It is beyond the remit of this chapter to set out in detail the scope of each special regime, but it worth noting that at the time of writing, the highly levered position of water utility companies in particular presents a high profile political and environmental issue within the restructuring domain.

### vii Cross-border issues

Foreign corporate groups with complex cross-border operations regularly forum shop into English courts to use the United Kingdom's established and flexible insolvency and restructuring processes. Prior to the United Kingdom's exit from the European Union, a

71 *Re Houst Ltd* [2022] EWHC 1941 (Ch).

72 Sarah Paterson, 'Judicial Discretion in Part 26A Restructuring Plan Procedures' (SSRN, 24 January 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4016519.

73 Banking Act 2009 as amended by Financial Services (Banking Reform) Act 2013 and Bank Recovery and Resolution Order 2014, SI 2014 No. 3329; Bank Recovery and Resolution Directive and Section 17 of and Schedule 2 to the Financial Services (Banking Reform) Act 2013; and the Investment Bank Special Administration Regulations 2011, SI 2011/245 (supplemented by the Investment Bank Special Administration (England and Wales) Rules 2011, SI 2011/1301).

74 The Insurers (Reorganisation and Winding Up) Regulations 2004, SI 2004/353. Separate regulations apply to Lloyd's insurers: see the Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005, SI 2005/1998.

75 Postal Services Act 2011, Sections 68–88.

76 Water Industry Act 1991 and the Water Industry (Special Administration) Rules 2009, SI 2009/2477.

77 Railways Act 1993, Sections 59–65 and the Railway Administration order Rules 2001, SI 2001/3352.

78 Transport Act 2000, Sections 26–32.

79 Greater London Authority Act 1999, Sections 220–224 and the PPP Administration Order Rules 2007, SI 2007/3141.

80 Banking Act 2009, Parts 2 and 3 (as modified by the Building Societies (Insolvency and Special Administration) Order 2009, SI 2009/805).

81 Energy Act 2011 (supplemented by The Energy Supply Company Administration Rules 2013, SI 2013/1046).

82 *Re Bulb Energy Limited* [2022] EWHC 3105 (Ch).

foreign debtor's use of administration, CVAs or liquidation was regulated in part by the Recast Insolvency Regulation (EU) 2015/848 of 20 May 2015 (RIR), which required that the centre of main interests (COMI) of the debtor be in England for the English insolvency to be opened as a main proceeding and recognised by the courts of EU Member States.[83] Some foreign debtors historically availed themselves of this access and automatic recognition by shifting the COMI of the relevant debtor entity to England. In contrast, schemes were not listed as insolvency processes for the purpose of the RIR and, under English law, the ability of a foreign debtor to use the scheme is subject to the lesser standard of sufficient connection to England and Wales. English courts are fairly accepting of forum shopping into the English jurisdiction, delineating 'good forum shopping', where the forum is the best place to reorganise the corporate group for the benefit of creditors (and, possibly, other stakeholders), in contrast to 'bad forum shopping', where the company acts for selfish motives to benefit itself, its shareholders or directors, at the expense of creditors.[84]

The UK's exit from the EU on 31 January 2021 does not seem, so far, to have dented the UK's popularity as a forum for carrying out complex reorganisations involving multiple jurisdictions. While the pathway to achieving recognition in relevant jurisdictions may be less straightforward post-Brexit, in general the court's threshold test for being satisfied that recognition is likely to be achievable is being met. The *Adler* case (discussed below), involving a Luxembourg issuer and parent, German operating group and German law bonds, was an interesting example of the continued reach of English restructuring regimes.

Insolvency proceedings opened outside of the United Kingdom can generally obtain recognition in the United Kingdom under the provisions of the CBIR. The CBIR implements the UNCITRAL Model Law and applies it regardless of whether the relevant foreign country has enacted the UNCITRAL Model Law.[85] Moratorium relief on creditor action is automatically granted on recognition of a foreign main proceeding (where the debtor's COMI is in the foreign proceeding's jurisdiction). Other relief may be obtained at the court's discretion. The English courts are required to cooperate 'to the maximum extent possible' when recognition is granted. The English courts can also offer assistance and relief under Section 426 of the Insolvency Act, which provides for cooperation both between jurisdictions within the United Kingdom and between the United Kingdom and other designated (mainly Commonwealth) jurisdictions. Finally, if the CBIR and Section 426 of the Insolvency Act do

83 A company's COMI is the jurisdiction where a company administers its business. For the purposes of cross-border insolvency proceedings, the location of a company's COMI is a determining factor in establishing which Member State (if any) has jurisdiction to open and hear insolvency proceedings for that particular company. There is a rebuttable presumption that this is the jurisdiction where a company's registered address is, although other factors can be inluential. See Article 3(1) of the RIR, the Insolvency Rules and CBIR.

84 An early example of good forum shopping can be seen in the Schefenacker restructuring, where the holding company of a German automotive supplier moved ownership of its assets and liabilities to a new, English-registered holding company so that it could enter into a CVA. See 'Proposal for a Company Voluntary Arrangement' (*Schefenacker Plc*, 9 March 2007) https://www.bondcompro.com/schefenackercva/genDocumentStreamUS.asp?DocumentID=67, accessed 16 July 2021. See also *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch); *Re Gategroup Guarantee Ltd* [2021] EWHC 775 (Ch).

85 The English courts may refuse to provide assistance under the CBIR if it would be manifestly contrary to public policy. See CBIR, Schedule 1, Article 6.

not apply, the English courts have inherent jurisdiction to cooperate with foreign insolvency representatives and recognise foreign proceedings in instances where the relevant foreign office holder has satisfied the common law principles developed by the English courts.[86]

A number of restructuring plans that have been determined in the past year have also been brought as a parallel proceeding to a foreign insolvency process in order to address the Rule in *Gibbs*.[87] *Gibbs*, broadly, provides that a foreign insolvency process cannot compromise English law claims where the relevant creditor has not submitted to the jurisdiction of the foreign court. The parallel scheme or restructuring plan seeks to implement the same effect that the foreign proceeding would have.[88]

## II INSOLVENCY METRICS

National insolvency statistics for 2022 deteriorated as the effects of rising inflation and the Ukraine war were sharpened by the covid-related government relief being rolled off. In particular, according to the company insolvency statistics for 2022:[89]

*a* One in 202 active companies (at a rate of 49.5 per 10,000 active companies) entered insolvent liquidation in 2022. This was an increase from the 32.9 per 10,000 active companies that entered liquidation in 2021 and was higher than the 41.9 per 10,000 in 2019 (before the covid-19 pandemic).

*b* The liquidation rate in 2022 was the highest liquidation rate since Q3 2015, but was lower than the recession peak of 94.7 per 10,000 in 2009.

*c* The total number of company insolvencies registered in 2022 was 22,109, which was the highest number since 2009 and 57 per cent higher than 2021.

*d* The increase compared to 2021 was driven by the highest annual number of CVLs since the start of the series in 1960. The number of CVLs in 2022 was approximately 21 per cent higher than if the pre-pandemic trend had continued.

*e* The annual number of compulsory liquidations was higher than the record low number in 2021 but remained below pre-pandemic levels.

*f* Administrations were higher than 2021 but lower than pre-pandemic levels. CVAs were similar to 2021 but lower than pre-pandemic levels.

*g* Increases in insolvencies were seen across most industries in 2022 compared to 2021.

Q1 and Q2 2023 painted a similar picture with company insolvencies reaching over 6,300 for the first time since 2009 in Q2, and with the main increase being driven by CVLs but also a significant uplift in the number of compulsory liquidations, which rose 67 per cent year-on-year.

86 See *Rubin & Anor v. Eurofinance SA & Ors* [2012] UKSC 46. Those common law principles provide when a foreign court has jurisdiction to give a judgment *in personam* that is capable of enforcement or recognition as against the relevant judgment debtor in England and Wales. Jurisdiction exists if the judgment debtor: (1) was present in the foreign country when the proceedings were instituted; (2) claimed or counterclaimed in the proceedings; (3) voluntarily appeared in the proceedings and, therefore, submitted to the jurisdiction; or (4) previously agreed to submit to the jurisdiction.

87 *Antony Gibbs & Sons v. La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399)/.

88 A recent example is in *Re Cimolai SpA* [2023] EWHC 1819 (Ch)/.

89 National Statistics, Commentary - Company Insolvency Statistics October to December 2022 (31 January 2023).

Nearly one in five UK-listed companies issued a profit warning in the past 12 months, with 20 per cent citing tighter credit conditions – the highest level since 2008. EY commented that 'as we've seen with previous economic downturns, an increase in restructuring activity traditionally comes after a peak in profit warnings with many businesses looking to implement restructuring plans as a rescue solution rather than insolvency'.[90]

## III PLENARY INSOLVENCY PROCEEDINGS

### i Scheme: Veon[91]

***Rights between creditors on a solvent plan and sanctioned creditors***

This case was notable as it was a solvent scheme and because it required the court to consider the rights of sanctioned Russia-related creditors. The scheme related to two series of unsecured notes (due in February and April of 2023) issued or guaranteed by VEON Holdings BV. Veon operated a telecommunications business in Russia and Ukraine. Its business had been significantly impacted by the war in Ukraine and by western sanctions, which also affected a number of Veon's lenders. Despite the conflict, Veon remained financially healthy. It found itself in the unusual position of being in funds to repay maturing debt but not being able to do so due to sanctions imposed on a large proportion of its bondholders (such lenders could not receive funds, nor could they vote for an extension to maturities). A scheme was proposed to extend the maturities of both series of 2023 notes to a date by which time the company hoped to have divested its Russian business and novated certain of its Russian-held debt in the process. The company was not at risk of insolvency.

The scheme proposed to extend both series of notes by eight months and to standardise their amendment provisions from the unanimous consent threshold under one series (effectively, a veto) to the more standard majoritarian provisions under the other. The company stated that if the scheme failed then it would repay the notes, save for the blocked funds owed to Russian holders (which would have adverse effects for the Russian business).

The scheme was challenged by certain creditors who argued (1) that the different maturities meant that the creditors in each series had sufficiently different rights to require different voting classes and (2) that sanctioned creditors should be in a different class from non-sanctioned creditors. On the first point, the challenging creditors argued that while differences in maturity would be overlooked from a class perspective where the alternative was insolvency (insolvency being a leveller in this respect), this did have a material impact where the alternative was repayment in full as, in the case of an extension, the longer dated notes took more credit risk. On the second point, the challengers argued that the non-sanctioned creditors were in a different position from sanctioned holders because the latter, without the ability to receive a repayment, had little interest in an extension.

The court reiterated the well-established principle that even if there are differences in rights as between the groups of creditors, that is not necessarily fatal to them being placed in the same class. It is still necessary to consider whether the differences are such that it is impossible for them to consult together with a view to their common interest.

90 EY Parthenon Profit warning report, 24 April 2023.

91 *In Re Veon Holdings BV* [2022] EWHC 3473 (Convening Hearing) and [2023] EWHC 219 (Ch) (Sanction Hearing).

In the court's view, the question was whether the differences in maturity dates, and therefore the impact of their extension, was such that the holders of the notes had a materially different risk of full recovery. It was held that in the circumstances they did not. The court did find however that the amendments to the February series veto right was material so as to fracture the class, not least because such proposal was mutually exclusive from the maturity extensions so as to constitute a separate matter. By means of *obiter dictum*, the court noted that under different circumstances, where such an amendment is merely incidental to the overall scheme 'package', there would be a stronger argument to say it is not sufficiently material so as to fracture the class. To avoid having two classes, the company removed the proposal to amend the notes' voting rights.

On the question of the differences between sanctioned and non-sanctioned creditors, the court found that all creditors have against the company the same entitlement. The difference is the extent to which the creditors can, for external reasons, enjoy those rights. The court held that the differences could be categorised as a difference in interests rather than rights and that differences in interests should not, in and of themselves, fracture a class.

### ii Restructuring plan: Adler[92]

***Cramming pari passu creditors and contested valuation evidence***

The High Court sanctioned a restructuring plan for the German real estate group, Adler Group SA (a Luxembourg incorporated company). Adler's main financial creditors were holders under six issues of German law notes, with maturity dates ranging from 2024 to 2029. Through the restructuring plan, Adler sought an orderly wind down of the group, involving a disposal of all assets and liquidating all of its entities in 2027. The terms of the restructuring plan principally involved a maturity extension to the first series of notes only (with priority given to those 2024 noteholders), new money funding and an interest payment holiday. Changes were proposed to the terms of all the notes to allow for the provision of the new money on a secured basis.

At the plan meetings, each note issuance was placed in a separate class. Each class, other than the 2029 noteholders, voted in favour of the plan (ranging from 80 to 98 per cent approval). The class of 2029 noteholders failed to reach the requisite statutory majority of 75 per cent but obtained a numerical majority of 62 per cent voting in favour.

The court considered the conditions for cram down of a creditor class in a restructuring plan and in particular the 'no worse off' test. The court dealt with the issues in three stages, as had been set out in the earlier case of *Re Virgin Active*:[93]

*a* Stage 1: the relevant alternative. It was common ground that the relevant alternative to the plan was a formal insolvency process.

*b* Stage 2: the consequences for the dissenting class in the relevant alternative. The court found the most likely outcome was that the 2029 noteholders would receive 63 per cent of their principal in accordance with the valuation evidence prepared by the company.

*c* Stage 3: the outcome and the consequences for the dissenting class of creditors if the plan is sanctioned. The court held that it had to be demonstrated that, on the

92 *Re AGPS Bondco plc* [2023] EWHC 415 (Ch) (Convening Hearing); [2023] EWHC 916 (Ch) (Sanction Hearing).

93 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).

balance of probabilities, the dissenting noteholders would be better off under the plan than under an insolvency. Here, the court ultimately preferred Adler's assessment of projected returns under the plan and in the relevant alternative.

The dissenting creditors argued that by preserving the existing maturity dates of all the notes, except for the 2024 notes, the restructuring plan would violate the fundamental *pari passu* principle of English insolvency law. They argued that in the relevant alternative all noteholders would rank alongside each other, and the maturity dates would all be accelerated by virtue of a formal group-wide liquidation, whereas under the plan, the 2029 noteholders would retain their temporal subordination. The court held that the plan did not breach the *pari passu* principle because it was most likely that all noteholders would be repaid in full under the plan. Therefore, the court did consider it necessary to decide upon when an infringement of the *pari passu* principle might be justified.

It was notable that both the company and the dissenting 2029 creditors put forward their own valuation evidence. This was the first restructuring plan where valuation evidence was extensively challenged and countered.

Some other noteworthy findings of this case are as follows:

*a* the court noted that had it not been prepared to accept the company's evidence on valuation (that the 2029 notes would be repaid if the plan was sanctioned), then it might have held there was an unfair departure from the *pari passu* principle. In turn, this might have constituted a fundamental objection to sanctioning the plan;

*b* as the existing maturity dates would be preserved under the plan (save for a 12-month extension of the 2024 notes), the 2029 noteholders would face a greater element of risk. However, the court was not perturbed by this given the 2029 noteholders had assumed a greater degree of commercial risk when they purchased the longer dated notes;

*c* the court held that its role was not to determine whether the plan presented was the fairest outcome or whether better plans may have existed. It only needed to decide on the plan it had before it. This follows established case law for schemes as well;[94]

*d* to make the English process possible, the group incorporated an English subsidiary, which it substituted (in accordance with the terms of the notes) as principal debtor in respect of the notes; and

*e* the court considered matters of German law and in particular whether the substitution was permitted under the German law bonds.

The *Adler* case is the subject of an appeal to the Court of Appeal.

94 *Re Noble Group Limited* [2018] EWHC 3092 (Ch).

### iii Restructuring plans: Houst,[95] Nasmyth[96] and Great Annual Savings Company[97]

*Restructuring surplus and HMRC claims*

Houst, Nasmyth and Great Annual Savings Company (GAS) all proposed plans that compromised tax liabilities, specifically relating to HMRC. Whereas HMRC was successfully crammed down in Houst, the court declined to sanction the latter two plans. Nasmyth and GAS also considered the concept of the restructuring surplus, namely the distribution of plan benefits to stakeholders, its impact on the consideration of fairness and its effect on the court's discretion as to whether to sanction a plan.

In *Houst*, the court sanctioned a cramdown of HMRC – notwithstanding its status as a 'secondary preferential creditor' – by putting considerable emphasis on the failure of the tax authority to make any representations at the hearing. The absence of any alternative evidence or challenge to the company's valuation report of the 'relevant alternative', coupled with the statutory tests having been satisfied, ensured the plan's success. The court (1) emphasised that a lack of valuation evidence alternative to the company's would hamper a dissenting creditor's efforts to rebut the statutory tests; and (2) characterised HMRC as a 'sophisticated creditor able to look after their own interests'. By contrast to point (1), the court in GAS stressed that even in the absence of alternative evidence 'the evidential burden . . . plainly rests on [the company's] shoulders' to satisfy the no worse off test; indeed, here the restructuring plan failed because the valuation report did not stand up to scrutiny. By contrast to point (2), the court in Nasmyth characterised HMRC as a vulnerable creditor with tax collection 'easily open to abuse', such that the cramdown power should not be used by companies as a means to not pay their taxes.

In *Nasmyth*, while Conditions A and B of the statutory test were satisfied, the court used its discretion to hold that there was a 'blot'[98] on the plan that made it operationally ineffective and that the outcome was unfair for HMRC. The court considered that there may be circumstances in which 'out of the money' creditors have a legitimate interest in opposing the plan. HMRC was considered out of the money since its returns in the relevant alternative were predicted to be zero. However, in determining the fairness of how the restructuring surplus was apportioned, the judge found that HMRC made a significant contribution through its forbearance to date by giving the plan company and the wider Nasmyth group extended time to pay its tax liabilities. As such, and in light of the tax liabilities of the wider Nasmyth group, HMRC had a 'genuine economic interest' in the plan company in the event of its administration and it was appropriate to 'attribute weight both to HMRC's vote against the plan and to its interests' in the court's consideration of whether to exercise its discretion to sanction the plan. In particular, the court noted that HMRC's share of the restructuring surplus was 'both tiny by comparison with the [junior secured creditor] and in absolute terms'. Interestingly, this invoked the concept of the 'horizontal comparator' (the

95 *Re Houst Ltd* [2022] EWHC 1941 (Ch).

96 *Nasmyth Group Limited* [2023] EWHC 696 (Ch) (Convening Hearing); [2023] EWHC 988 (Ch) (Sanction Hearing).

97 *Re The Great Annual Savings Company Limited* [2023] EWHC 1026 (Ch) (Convening Hearing; [2023] EWHC 1141 (Ch) (Sanction Hearing).

98 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).

treatment of creditors *inter se*) as in CVAs.[99] Finally, the group's failure to agree a sustainable arrangement with HMRC in paying its outstanding liabilities going forward was a fatal blot. Nasmyth had assumed a vital condition of the plan's operational effectiveness.

In *GAS*, based on the company's evidence, the court was not satisfied that HMRC would be no worse off under the plan than the relevant alternative. However, even had Condition A been satisfied, the judge would have refused to exercise the court's discretion to sanction the plan. The judge found the company's evidence 'rather thin and unconvincing' and, as noted above, the absence of expert evidence from an opposing party did not bind the court to accept the company's valuation analysis. The judge considered whether there was a fair distribution of the benefits of the restructuring between those creditors that had agreed to it and those that had not. This required an examination of existing rights under the relevant alternative, any additional contributions or risk taken on by creditors (for example, by way of new money advances), and whether any disadvantageous treatment of creditors under the plan as compared to the relevant alternative was justified.[100]

While tax claims (preferred or otherwise) are not immune to cramdown (as in Houst), it is clear from both Nasmyth and GAS that the nature of a claim and its beneficiary (in this case, the taxpayer) may render certain determinants of the discretionary and fairness tests more pertinent than others. HMRC cramdowns will be likely subject to heightened scrutiny.[101]

## IV ANCILLARY INSOLVENCY PROCEEDINGS

### BTI 2014 LLC v. Sequana SA[102]

For the directors of an English company that is moving closer to insolvency, there is a point at which a director's fiduciary duties to the company (often taken to be equivalent to the interests of its members) shift or increase in scope so as to give proper consideration to the interests of its creditors as a whole, as well.[103] This modification to the company-member duty is referred to as the rule in *West Mercia*.[104] English legal practitioners and observers were anticipating that the outcome of this case would provide greater clarity as to the detail of what circumstances define and give rise to the point in time where this shift occurs.

This matter was brought before the Supreme Court by appeal from a judgment in the Court of Appeal[105] handed down by David Richards LJ relating to the payment of a dividend by Arjo Wiggins Appleton Limited to its parent company, Sequana SA. David Richards LJ

99 Although the horizontal comparator is not an explicit feature of the statutory tests for schemes and restructuring plans, it has been considered in the Part 26 and Part 26(A) case law under the discretionary limb – see *Re Houst, Re AGPS Bondco plc and Re Deep Ocean 1 UK Ltd* [2021] EWHC 38 (Ch).

100 Unlike in Nasmyth, the court found that HMRC was in the money and that other dissenting creditors were substantially out of the money; as such, little, if any, weight should be paid to the latter's views.

101 At the time of writing HMRC's claims in the restructuring plan of *Prezzo Investco Limited* [2023] EWHC 1679 (Ch) were crammed down in the face of opposition from HMRC. The court held that HMRC's recovery was significantly better (by circa 250 per cent) than it would in the relevant alternative (on both the preferred and unsecured elements of their tax claims).

102 *BTI 2014 LLC v. Sequana SA* [2022] 3 W.L.R. 709.

103 Companies Act, Section 172 (3).

104 *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

105 *BAT Industries plc and others v Sequana SA* [2019] Bus. L.R. 2178.

held that the dividend payment was a breach of Section 423 of IA 1986,[106] However, he also held that the directors did not breach the common law duty to creditors in authorising the dividend because that duty is triggered when the directors 'know or should know that the company is or is likely to become insolvent . . . where] 'likely' means probable', and the company had not reached this point when the dividend was paid.

The Supreme Court decision did not provide the watershed clarity that the English legal community was hoping for, as it consisted of multiple judgments containing a diversity of formulations. All the judgments engaged with the question as to the shift towards a creditor duty before insolvent liquidation or administration, but with different emphasis. Lord Reed appears to suggest a sliding scale on which the duty to creditors increases as the financial position of the company deteriorates. Lord Briggs focused on how near the company is to inevitable insolvency (what he calls the 'light at the end of the tunnel') but also focused on how likely the proposed course of action is to lead the company away from threatened insolvency, which 'may well depend on a realistic appreciation of who, as between creditors and shareholders, then have the most skin in the game'. Lady Arden recognised that a sliding scale provides assistance but cautions that 'the analogy with any such scale should not be taken too literally' and that 'progress towards insolvency may not be linear'. Similarly, Lady Arden considered that the duty is not limited to considering creditors' interests at all material times but is also a duty not to harm their interests.

The case made clear that a real risk of insolvency is not sufficient to cause the shift in directors' duties. It also establishes that an otherwise lawful dividend (if made in accordance with the requirements of the Companies Act) could still be in breach of directors' duties if the *West Mercia*[107] trigger point has occurred and the company's directors failed to act in accordance with their (modified) duties to creditors as well.

It is not surprising that no bright lines can be drawn from the judgment. The fact specificity of the case did not lend itself to more comprehensive, precedent-setting ratio. Generally, the uniqueness and idiosyncrasy of any given instance of a company's approach towards insolvency make universally applicable determinations in this area of directors' duties inherently elusive. At a minimum, the case re-emphasised the care that must be taken by directors when a company is in financial difficulty. The detailed judgments will likely provide fodder for broader consideration of directors' duties and tests of insolvency in future cases.

## V TRENDS

### i Consistency of principles and certainty

The statutory basis of schemes and restructuring plans is light on detail. As a result, common law and judicial interpretation is shaping the legislative terrain of Part 26 and Part 26(A) of the Companies Act. This is particularly pertinent where a court is directed to exercise its discretion to sanction a scheme or restructuring plan.[108]

Authorities are beginning to indicate factors that may be relevant to the exercise of the court's discretion in such cases, including levels of consent within the crammed class, levels

106 This provision relates to transactions designed to put assets outside of the reach of creditors.

107 *West Mercia Safetywear Ltd v. Dodd* [1988] BCLC 250.

108 In *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch), Snowden J notes in paragraph 213 that 'Section 901G contains no express test or identification of any factors that should be taken into account and leaves matters entirely at large'.

of overall support and, importantly, whether the plan provides for a 'fair distribution of the benefits of the restructuring'.[109] Case law has not been entirely consistent in relation to the latter point. For example, in *Virgin Active,*[110] *Houst*[111] and *Smile Telecom*,[112] the court held that little or no weight may be given to creditors who are out of the money in the relevant alternative (and who are accordingly considered to have no economic interest in the scheme or plan company). However, in *Nasmyth,* despite being out of the money in the sense of the relevant alternative, the proposed compromise being forced upon HMRC was seen to unfairly utilise a restructuring surplus to which HMRC had contributed; and render an outcome in which the tax authority had a genuine economic interest.

The courts have also contested the extent to which the distribution of restructuring surplus in a manner otherwise to the statutory priorities of a liquidation should impact on their discretion. Practically, the question might be whether it is appropriate to allow shareholders to retain an interest in the reorganised group despite unsecured or other creditors having been impaired. The general consensus is that, provided that the unsecured creditors are out of the money, then it is the prerogative of the in the money creditors to allocate (or agree to the allocation of) consideration through the rest of the capital structure.[113] There has been academic and market criticism of this position because it is not clear why the outcome in a liquidation scenario should dictate the allocation of value on a going concern basis. The argument goes that it is unfair for equity holders to benefit from a compromise in debt and recover value on an ongoing basis, when equity is valueless at the time of the reorganisation.[114] Case law is also inconsistent – whereas in *Adler*[115] the judge expressed concern that the shareholders remained in situ without providing any consideration, in other cases the justification for shareholders remaining in situ has related to consideration being provided.[116]

There is a risk that case law develops in a manner that is idiosyncratic, making its judgments difficult to apply consistently and commensurably across the restructuring spectrum. This may also have an adverse impact on market confidence and the propensity for market participants to select England and Wales as the appropriate jurisdiction to effect a restructuring. First instance judges are also not bound to follow the decisions of other first instance courts (although they have proven persuasive). It may be that the Court of Appeal decision in *Adler* acts to state some broad principles, which will act as binding precedent for the lower courts in future cases.

109 See paragraph 68 in *Re Prezzo Investco Limited* [2023] EWHC 1679 (Ch), also citing *Re Virgin Active* and *Re Houst Ltd.*

110 *Re Virgin Active Holdings Ltd* [2021] EWHC 1246 (Ch).

111 *Re Houst Ltd* [2022] EWHC 1941 (Ch).

112 *Re Smile Telecoms Holdings Ltd* [2022] EWHC 387 (Ch).

113 See *Re Smile Telecoms Holdings Ltd* [2022] EWHC 387 (Ch) and *Re Fitness First Clubs Limited* [2023] EWHC 1699 (Ch).

114 Corporate Insolvency and Governance Act 2020 - Final Evaluation Report November 2022, Professor Peter Walton and Dr Lézelle Jacobs.

115 *Re AGPS Bondco PLC* [2023] EWHC 916 (Ch).

116 See *Re Virgin Active* and *Re Prezzo Investco Limited.*

### ii Pressure on courts and timing

A number of restructuring plans are being proposed where a 'burning platform' – the potential insolvency of the plan company – drives timing. The court is aware that the scarcity of time for distressed companies can be exploited by stakeholders intending to extract value from expedited court processes. In circumstances that would not normally be countenanced for commercial cases, the courts may find themselves having to hear complex cases involving granular valuation disputes and on abridged timetables.

Much of this pressure arises because the legislative framework around schemes and restructuring plans does not incorporate a moratorium or standstill,[117] unlike regimes in Europe and the US. This tends to make the restructuring process in the UK an implementation tool, commercially speaking, *ex post facto.* In other words, the court's role is to legally implement a transaction that has already been agreed commercially, as opposed to the commercial parameters being meted out during the process itself (thereby allowing greater scope for challenge). The corollary is that these processes can be quicker and cheaper than in other jurisdictions, and certainly when compared to the US.

### iii Schemes and restructuring plans for small to medium-sized enterprises

Finally, there has been long-standing concern that the costs of a scheme or restructuring plan make them prohibitive for small to medium-sized enterprises (SMEs). The cost of some restructuring plans will run into the millions, and for a SME in distress, that is not viable. There is a related concern that SME schemes or restructuring plans are more likely to be criticised by the court for shortfalls in standards of disclosure compared to those being managed by larger companies with much larger expenditures on advisers.

The recent review of the legislation that implements restructuring plans proposed measures to make it a more universal tool.[118] It remains to be seen if any of the recommendations of the report will be implemented.

117 Corporate Insolvency and Governance Act 2020 - Final Evaluation Report November 2022, Professor Peter Walton and Dr Lézelle Jacobs.

118 Corporate Insolvency and Governance Act 2020 - Final Evaluation Report November 2022, Professor Peter Walton and Dr Lézelle Jacobs.