**Restructuring procedures**

This element covers formal restructuring options for companies in financial difficulties.

**Order of coverage of topic**

The topic of restructuring and insolvency is covered in the following order:

· Introduction to legislative framework;

· Pre-insolvency moratorium under CIGA 2020;

· Formal restructuring arrangements;

· Insolvency procedures; and

· Statutory order of payment of creditors.

These slides cover the topic of formal restructuring arrangements for companies in financial difficulties. The next set of slides cover insolvency procedures and the final set of slides cover the statutory order of priority for payment of creditors in an insolvency.

**Restructuring and insolvency: a background**

Corporate restructuring and insolvency law relates to companies that are in or facing distress. The underlying aim of corporate restructuring and insolvency law is to mitigate that distress and put the company on a sustainable footing so it can continue as a going concern, while protecting and balancing the interests of competing creditors to promote a culture where distressed businesses are rescued and can recover if possible. One of the reasons for this is that creditors are likely to recover more money if businesses can be rescued or restructured than if they are closed down and the assets sold off piecemeal.

The main relevant statute is the Insolvency Act 1986 (the ‘**IA 1986**’).

The IA 1986 has been substantially amended over the years by theInsolvency Act 2000, the Enterprise Act 2002 (‘**EA 2002**’), the Companies Act 2006 (‘**CA 2006**’), the Deregulation Act 2015, the Small Business Enterprise and Employment Act 2015 and the Corporate Insolvency and Governance Act 2020 (‘**CIGA 2020**’)

The IA 1986 is supplemented by the Insolvency (England and Wales) Rules 2016 (the '**IR**

The Companies Act 2006 (as amended, including by CIGA 2020) also contains key restructuring procedures.

**Summary of the EA 2002 reforms**

The EA 2002 came into force on 15 September 2003 (the ‘**Relevant Date**’).

The aims of the EA 2002 for companies were:

· to promote the rescue culture; and

· to increase entrepreneurship by giving prominence to *collective insolvency procedures* over *enforcement procedures.*

The focus of the EA 2002 was on streamlining the *administration* procedure to encourage company rescue and to restrict the use of *administrative receiverships* by holders of *qualifying floating charges*.

**Summary of the CIGA 2020 reforms**

CIGA 2020 introduced three new restructuring and insolvency tools:

(1) the **pre-insolvency moratorium**

(2) the new **restructuring plan** for companies

(3) restrictions on the enforcement in supply contracts of termination clauses (and other contractual rights) triggered by restructuring and insolvency processes.

These tools are intended to provide companies in or facing distress with a breathing space and security of supply so that they have time to explore enhanced restructuring options to maximise the prospects of rescue.

**Restrictions on insolvency related contractual terms**

CIGA has introduced restrictions on the enforceability of termination (and other) clauses in most types of supply of goods and services contracts. A supplier may not terminate or rely on a contractual provision allowing it to do any other thing on grounds that:

· the counterparty has obtained a pre-insolvency moratorium, or

· the counterparty has entered into administration, liquidation or administrative receivership, or

· the counterparty's creditors have approved a company voluntary arrangement (CVA), or

· the court has sanctioned a restructuring plan or a scheme of arrangement in relation to the counterparty.

There is also a prohibition on suppliers making it a condition of any future supply that pre-insolvency debts owed to them must be paid. The effect of this prohibition is that suppliers must continue making supplies under the terms of the contract notwithstanding the company has entered into one of the procedures listed provided that the company pays for any supplies made after the counterparty becomes subject to the relevant procedure.

The prohibitions referred to above do not:

· apply to loans and most other types of financial contracts,

· prevent termination of a contract on other grounds, for example if the counterparty commits a default after it becomes subject to a restructuring/insolvency procedure, or where the supplier is entitled to terminate the contract pursuant to a contractual clause allowing termination by the giving of a notice (e.g. a three months’ notice termination provision).

**Pre-insolvency Moratorium**

The standalone pre-insolvency moratorium was introduced with the intention of allowing a company in financial distress a short breathing space in which to explore its options to restructure free from creditor action.

It is overseen by an Insolvency Practitioner ('IP') (who acts as monitor), but the directors of the company remain in control.

However, the entry requirements and widely drafted exclusions make it difficult for companies to use without the support of financial creditors.

Entry requirements include that:

· directors must believe that the company is/likely to become unable to pay its debts; and

· the monitor must be of the view that rescue of the company as a going concern is likely.

The key feature of the pre-insolvency moratorium introduced by CIGA 2020 is that the company benefits from a payment holiday in relation to certain liabilities, but there are widely drafted exclusions including liabilities relating to goods and services supplied during the moratorium, rent for the period of the moratorium, wages and salaries, and debts and liabilities arising under financial services contracts.

Creditors' rights are delayed or suspended while the moratorium exists and the creditors cannot exercise those rights unless the court or the monitor allows. This includes the following:

· no creditor can enforce its security against the company’s assets;

· there is a stay of legal proceedings against the company and a bar on bringing new proceedings against it;

· no winding up procedures can be commenced in respect of the company (unless commenced by the directors) and no shareholder resolution can be passed to wind up the company (unless approved by the directors);

· landlords cannot forfeit leases;

· retention of title creditors and lessors cannot take possession of their assets;

· no administration procedure can be commenced in respect of the company (other than by the directors); and

· no action can be taken to crystallise a floating charge (that is, turn it into a fixed charge).

**Pre-insolvency Moratorium – Lender perspective**

In practice, it is envisaged that companies will only obtain a pre-insolvency moratorium with the support and prior approval from their lenders and even then, may only do so if lenders agree not to exercise their contractual and security rights for a specified period (for example using waivers or some form of agreement).

This is because (1) the company will still be obliged to pay financial creditors and if a payment is missed, this will almost certainly be an event of default, (2) obtaining a moratorium is also likely to be an event of default, and (3) the financial creditors' contractual rights to terminate and demand repayment are not affected by the pre-insolvency moratorium. If lenders did exercise their contractual rights to accelerate and make demand for repayment, the company would almost certainly not be able to pay what was then due. In these circumstances, the monitor is obliged to bring the moratorium to an end. Following termination of the moratorium, the lenders may enforce their security.

If the company cannot pay a debt which must still be paid during the moratorium, when due, the monitor is under an obligation to bring the moratorium to an end.

If the company enters into a liquidation or administration within 12 weeks after the end of the moratorium, certain debts are given a ‘super priority’ status in the statutory order of priority. These two protections are available in respect of debts that are pre-moratorium debts not subject to the statutory payment holiday (such as debts owed to lenders under loan agreements) but the debts will not receive super priority status if they fell due during the moratorium as a result of acceleration or early termination of a loan agreement.

A pre-insolvency moratorium is intended to help a company implement a permanent solution to its financial problems. There are various potential outcomes or exits from a pre-insolvency moratorium. The most important are: (i) the company enters into a consensual restructuring agreement with those creditors needed to enable the company to continue as a going concern, (ii) it seeks to restructure its liabilities using a company voluntary arrangement, scheme of arrangement or restructuring plan, (iii) the directors initiate an administration or liquidation, (iv) the moratorium expires or (v) the monitor brings the moratorium to an end.

**Restructuring Arrangements**

Three possible types of formal arrangement can be made between a company facing distress and certain of its stakeholders, usually proposed by the company with support having been obtained from at least some categories of creditor in advance.

These procedures can be proposed alone or in combination with a liquidation, or more commonly, an administration:

· Scheme of Arrangement under ss.895 - 901 (Part 26) CA 2006

· Restructuring Plan under Part 26A CA 2006 (introduced by CIGA 2020)

· Company Voluntary Arrangement under ss.1-7 IA 1986 (‘CVA’)

**Scheme of Arrangement**

A scheme of arrangement is a formal arrangement or compromise made between the company and one or more classes of creditors and/or members. The basic procedure for a scheme is that (i) permission must be sought from the court to convene meetings of each relevant class of the company’s creditors or members to vote on the scheme proposal; (ii) if the court gives permission the class meetings are held. The scheme proposal must be approved by at least 75% in value and a majority in number of each class of creditors and/or members at the meeting and (iii) the court must then approve (or ‘sanction’) the scheme. The scheme becomes binding on all the company’s creditors affected by it (including those who voted against it) when the court order sanctioning the scheme is delivered to the Companies Registry.

What we see in (ii) above is the ability of a majority of a class to bind a minority of that class. This is an example of **‘intra-class cramdown.’** Restructuring plans also share the feature of intra-class cramdown but they have an additional feature which schemes lack, known as **‘cross-class cramdown’** where, subject to certain safeguards, a court may sanction a plan where one class has voted against a plan, but another class has approved it. We explain cross-class cramdown in more detail later.

We have referred to classes of creditors and members. What constitutes a class is a complex and often contentious matter. The basic rule is that a class is made up of those creditors whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. One basic class distinction would often be between secured and unsecured creditors.

Because of the cost and complexity, in part due to the court’s involvement, schemes of arrangement have tended to be used to restructure debt obligations of companies with significant secured liabilities and/or complex funding arrangements with tiers of secured and/or unsecured debt, including by foreign companies which have borrowed money from lenders or other creditors under English law financing agreements.

Although there is no automatic moratorium on creditor actions or legal proceedings when a scheme is proposed, companies often succeed in obtaining formal/informal support from financial creditors before the scheme process begins. It is also possible to seek protection from the court against individual creditor action in certain circumstances**.**

**Restructuring plan**

CIGA 2020 has introduced a new formal restructuring plan very closely based on the scheme of arrangement, but with significant distinguishing features. The plan is a court driven process and it becomes binding on all creditors and members following the court sanctioning the plan. Like schemes, creditors and members must be divided into classes and each class that votes on the plan must be asked to approve it.

Key distinctions are that:

· **Restructuring plans can only be used by companies which have or are likely to encounter financial difficulty.** Restructuring plans must consist of a compromise or arrangement used to eliminate prevent or mitigate the impact of financial difficulties that a company is facing.

· **The plan must be approved by at least 75% of each class voting, but there is no majority in number requirement (as there is for schemes).**

· **It may be possible to impose a restructuring plan on a dissenting (or, in some cases, disenfranchised) class in certain circumstances due to the cross-class cramdown mechanism (see below).**

Disenfranchisement

The court may exclude classes creditors and members from voting even if they are affected by the plan if they have no genuine economic interest in the company.

Cross-class cramdown

The court may still sanction a plan if the requisite majority is not obtained in one or more classes if (i) none of the dissenting class would be worse off than in the relevant alternative (usually a liquidation); and (ii) at least one class who would have a genuine economic interest in the relevant alternative, votes in favour. If a court is to sanction a plan where a class has not approved it, the court must be satisfied that the plan provides a fair distribution of benefits generated by the restructuring between the classes that approve the plan and those that do not. This means if the relevant alternative to a plan is formal liquidation or administration under which the approving and dissenting creditors would be treated on a pari passu basis, the plan should do so as well unless there is some good reason to justify some other treatment e.g.; the approving creditors are providing new loans to assist the restructuring for the benefit of creditors as a whole.

A restructuring plan has one important advantage over a CVA: it can compromise the rights and claims of secured creditors and shareholders. A CVA cannot do this.

The restructuring plan has an advantage over a scheme in that a scheme is only binding on those classes of creditors or shareholders who vote in favour of it. Schemes of arrangement do not have a cross-class cramdown mechanism.

Schemes of arrangement can be used by companies not facing distress. Restructuring plans can only be used by companies facing actual or prospective financial difficulty. In contrast, a scheme can be used by any company, solvent or otherwise.

An administrator and liquidator have the power to propose a restructuring plan (or a scheme) but in most cases it will be the directors who will do so. In certain circumstances, the directors might consider obtaining a pre-insolvency or going into administration as an initial step to commencing the restructuring plan procedure in order to obtain the protection of a moratorium but, as with schemes, this rarely happens in practice.

**Company Voluntary Arrangement**

A CVA is another procedure for achieving a compromise or arrangement between a company and its creditors but can only bind non-preferential unsecured creditors. A CVA is usually less costly and quicker than a scheme of arrangement or restructuring plan, mainly because it does not require the sanction of the court.

Often, the purpose of a CVA is to seek to put in place a timetable for the repayment (usually only in part) of liabilities owed to (usually) non-preferential unsecured creditors. Alternatively, where rescue is not feasible, CVAs can be used to achieve a more efficient asset realisation and distribution to creditors than would be the case in a *winding up*.

To implement the CVA, the directors of the company, usually advised by an insolvency practitioner acting as a nominee, formulate a written proposal for the repayment or restructuring of the company’s liabilities. The proposal will include a term that the nominee will act as supervisor of the CVA once it has been approved.

Note that a liquidator and administrator have the power to propose a CVA. If they do so, they will be the nominee and supervisor of the CVA.

**CVA - approval**

Once the proposal has been finalised the nominee will seek creditors’ approval for the CVA using one of a number of permitted decision-making procedures provided for under the IR 2016.

Once the creditors’ decision has been made, the nominee must call a separate meeting of the company’s shareholders.

**Two creditor majorities are required if the CVA proposal is to be approved:**(1) at least 75% in value of those creditors who vote on the CVA proposal vote in favour of it. There is no requirement for a majority in number of creditors to vote in favour (in contrast to a scheme). (2) Those voting against the proposal must not be more than 50% in value of unconnected creditors (e.g. the claims of related companies must be ignored for this purpose). The members approve the CVA by passing an ordinary resolution.

For voting purposes, a debt of an unliquidated or unascertained amount is valued at £1 unless the chairperson overseeing the voting procedure places a higher value on it. This has been key to allowing CVAs to be used to restructure leasehold liabilities.

**CVA - effect**

If approved by the requisite majorities of creditors and members (or if the members vote against, by the creditors alone), the CVA proposal binds all creditors: those who voted for the CVA, those who voted against it, those who did not vote at all and those creditors who did not receive notice of the decision-making procedure adopted to approve the CVA. All those creditors’ claims are then dealt with in accordance with the terms of the CVA.

A CVA cannot compromise the rights of a secured creditor (including the right to enforce security) or the rights of a preferential creditor without that creditor’s consent**.** In practice, secured creditors rarely agree to be bound by a CVA. In order to achieve a restructuring of secured liabilities a company would have to (i) seek a consensual agreement with its secured creditors (which may be conditional on unsecured creditors voting in favour of a CVA on certain terms) or (ii) seek approval of a scheme of arrangement or a restructuring plan.

A creditor can challenge a CVA within a 28-day period(commencing with the date of filing at court of the nominee’s report on the approval of the CVA, or within 28 days of the day on which the creditor became aware of the decision procedure having taken place) by making an application to court on grounds of:

**'unfair prejudice':** i.e. one creditor has been treated unfairly under the CVA (compared to another creditor or to what the creditor’s position would have been if the company had entered into an insolvency process; and/or

**'material irregularity':** relating to the procedure which the company has followed in seeking the approval of the CVA (such as the way that creditors’ votes were calculated).

Subject to the court’s decision on a creditor challenge, a CVA becomes binding on all creditors at the end of the 28-day challenge period.

**The supervisor’s role**

Where the directors propose a CVA, the directors remain in place during the CVA and will be able to exercise their usual powers unless the CVA proposal provides otherwise. The supervisor’s role will be to agree creditors’ claims, collect in the funds which the company is to use to pay dividends to the creditors on their agreed claims and generally ensure that the company complies with its obligations under the CVA.When a CVA has been completed, the supervisor will send a final report on the implementation of the proposal to all members and creditors who are bound by the CVA, then step down from his/her role and the company will carry on under the management of its directors in the normal way.

**CVAs used in conjunction with other pre-insolvency and insolvency procedures -** A company may consider obtaining a pre-insolvency moratorium or going into administration or liquidation before proposing a CVA because an administrator and liquidator have the power to propose a CVA. A company would do this in order to receive the benefit of a moratorium to prevent creditors from taking hostile action during the period between the sending out of notice to the creditors of the CVA decision-making procedure and the holding of the procedure itself which will be at least 14 days. This has not been a frequent occurrence in practice to date.

**Summary**

· We have seen how CIGA has introduced the new pre-insolvency moratorium and restructuring plans.

· The pre-insolvency moratorium is designed to give a company a temporary respite from hostile creditor action in order to give it time to implement a permanent solution to its financial problems. Before obtaining this moratorium, the company will need the prior approval of its lenders.

· Formal restructuring procedures include a company voluntary arrangement, scheme of arrangement and a restructuring plan.