Debt Restructuring: an alternative to insolvency proceedings

Debt Restructuring: an alternative to insolvency proceedings is the essential reference guide for financial institutions, legal professionals and investors. Covering 20 major jurisdictions worldwide, it provides a clear overview of the law and regulation governing debt restructuring in each one, and is structured to allow easy comparisons between jurisdictions.

- Offers a well-organised starting point for international reference
- Covers the law in 20 major jurisdictions
- Includes contributions from leading local practitioners who are experts in the field
- Uses a reader-friendly Q&A format that enables quick and easy cross-jurisdictional comparisons
- Addresses the key questions of multinational organisations
- Provides straightforward, practical commentary on each jurisdiction and the respective legal systems

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Jurisdictional comparisons **First edition 2015**

General Editors:
Ole Borch & Lars Lindencrone Petersen, Bech-Bruun
Alessandro Varrenti, CBA Studio Legale e Tributario
Founding Editor:
Jacques Henrot, De Pardieu Brocas Maffei

THE EUROPEAN LAWYER REFERENCE

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Contents

Foreword

Alessandro Varrenti, CBA Studio Legale e Tributario
Lars Lindencrone Petersen & Ole Borch, Bech-Bruun

The financial crisis that started quite dramatically with the bankruptcy of Lehman Brothers in 2008 has been historic. Several other financial crises have been confined to a certain area and have been quite short lived, but the one that started in 2008 has affected all parts of the world to varying degrees and is not fully over more than eight years later. It has not only stress-tested undertakings and banks; it has also tested countries and the entire way of perceiving the financial structure.

At the outset of the financial crisis, quick fixes were desperately needed. During this phase, countries had to ensure that their banking sectors did not collapse. At the same time, undertakings in crisis had to be handled, and in this process an adjustment of the set of rules available to such situations has taken place. These sets of rules could be said to have many similarities, but if you look at the finer details quite a few differences become apparent. As an experienced specialist in the law of your own country, you have not been able to rely on your experience and judgement to figure out how a specific situation would be handled in another country.

With this in mind, Thomson Reuters asked one of the grand old men of the world of insolvency, Jacques Henrot of De Pardieu Brocas Maffei, to lead a project in which Jacques and we – Alessandro Varrenti of CBA Studio Legale e Tributario (Milan), and Lars Lindencrone Petersen and Ole Borch of Bech-Bruun (Copenhagen) – were to work together to prepare an easily accessible yet detailed presentation of the sets of rules applicable to restructuring and distressed undertakings in a number of countries.

Jacques undertook the task and was a driving force during the start-up phase, and this in spite of the fact that Jacques was quite seriously ill. Sadly, Jacques passed away in the summer of 2014 and thus before the book was ready for publication. We are dedicating this book to Jacques in honour of his huge effort with the book and a number of similar projects in the past.

We hope that the readers of the book will share our enthusiasm about the finished project and that the book may contribute to understanding and decision-making in cross-border situations where there is a need to understand at least the fundamental principles of the rules of other countries.

We would like to extend our thanks to all the contributors for their efforts on the project. The dialogues we have had with the contributors from the various countries in the course of the project have confirmed the great expertise involved as well as the high level of enthusiasm for the project. We would also like to take this opportunity to express our respect – which is perhaps done too rarely – for the legislators of the many countries. Restructuring legislation is quite difficult to draft as it requires decisions according to which some parties are to relinquish rights to the advantage of other parties for the sake of the bigger picture. It is the quality of such legislation which determines the possibilities of obtaining successful restructuring – and this applies to both in-court and out-of-court restructuring. Out-of-court restructuring will typically reflect the possibilities of the in-court options, as the rights holders will hardly be willing to contribute to an out-of-court solution providing them with a poorer result than an in-court process. At the same time, in-court restructuring is presumably still the very last thing you want. Professor Lawrence P King was quoted as saying that the American rules on restructuring, Chapter 11, may well be effective, but for him they are the equivalent of using a hammer to put out the fire in your hair. We believe that this book will demonstrate that it is not quite that bad, either in the US or in other countries.

1 November 2014

Jacques Henrot

1952–2014

As mentioned in the foreword, this book has been dedicated to our partner, Jacques Henrot. No better tribute could be paid to Jacques, who, until the very end of his long fight to overcome his terminal illness, remained strongly committed to ensuring the publication of what he considered to be a significant contribution to the merging into a single instrument an analysis and description of the complexities of a wide variety of policy and legal issues in the work-out and restructuring areas across many countries.

Our partner and friend Jacques passed away late this summer. Above all, Jacques was a very talented lawyer, dedicated to the long tradition of the practice of law rooted in the old cultural values of a general practitioner and combining those values with a remarkable understanding of the diversity of legal cultures and conceptual diversities between the continental legal tradition and the common law approach. Often those skills turned out to be material in bridging the gap between the different cultures prevailing in those different environments, paving the way to consensual approaches to resolving difficulties in complex matters.

He combined unequalled expertise in the property area with a unique practice in the insolvency sector and a strong understanding of the needs of the financial services industry. Moral integrity and compliance with the highest ethical standards were among his key attributes.

Jacques had a great sense of human relationships, and was most sensitive to the needs and aspirations of our younger professionals. He was a great team builder, dedicated to training his assistants and colleagues towards excellence and achievement of the highest standards in the practice of law.

In the pursuit of that goal, he has paved the way to the emergence of a younger generation to develop a practice based on those values.

Before leaving us, Jacques has passed the torch on to that new generation sharing those values to continue to develop a practice rooted in the high standards he advocated.

For those accomplishments he will be forever remembered.

Antoine Maffei
De Pardieu Brocas Maffei

UK

Macfarlanes Jatinder Bains, Paul Keddie & Simon Beale

1. WHAT COURT-MONITORED RESTRUCTURING PRE-INSOLVENCY PROCEEDINGS OR SCHEMES HAVE BEEN DEVISED BY THE LAW OF YOUR COUNTRY TO LIMIT VALUE DESTRUCTION FOR FAILING BUSINESS ENTITIES?

There are two types of pre-insolvency proceedings available to companies under English law; a company voluntary arrangement, or CVA, and a scheme of arrangement, or Scheme.

CVAs were introduced by the Insolvency Act 1986 (the Act), which is the main piece of primary insolvency legislation in England and Wales, as an alternative to liquidation for companies experiencing financial difficulties. A CVA must involve either a *'composition in satisfaction of a company's debt'* (ie that creditors will receive a payment of a sum of money in place of the entirety of an existing debt) or a *'scheme of arrangement'* (not to be confused with a Scheme), which involves some form of arrangement of the company's affairs but does not necessarily need to involve a compromise of claims (although usually will).

A Scheme involves a compromise or arrangement between a company and its creditors (or any class of them) and/or its members (or any class of them). Unlike a CVA, when voting on a Scheme, creditors must be divided into different classes, with each class comprising creditors whose *'rights are not so dissimilar for it to be impossible for them to consult together with a view to their common interest'* (*Sovereign Life Assurance Co v Dodd* [1892] 2 QB 753). Further, a CVA can only affect the right of a secured creditor to enforce its security with its consent, whereas a Scheme may bind secured creditors provided that the requisite number of creditors (75 per cent or more, together with a majority in number) vote in favour of the Scheme (and secured creditors are likely to form a separate class for voting purposes).

CVAs are usually initiated by the company's directors, but can also be used as a way of agreeing creditors' claims as part of an administration or liquidation (described in more detail below). A Scheme may also be proposed by a creditor or shareholder of a company, although, in practice, it will usually be the directors who propose the Scheme.

1.1 What is the objective of the proceedings?

In both cases, the company proposing the CVA/Scheme is usually able to pay its debts in the short term, but is facing financial difficulties which have got to the stage where a compromise with creditors is needed to ensure that the company avoids a formal insolvency process in future. For example, in recent years CVAs have been used as a means for companies in England and Wales to exit over-rented premises or come to a binding compromise regarding rental payments with landlords (even where those landlords do not vote in favour of the CVA, they can still be bound if the requisite majority of creditors – 75 per cent or more in value and more than 50 per cent of 'unconnected' creditors – vote in favour). Consequently, the overriding objective of a Scheme or CVA is usually to reduce a company's debt burden to a level which will allow it to avoid a formal insolvency process, but not by so much that creditors are unlikely to vote in favour of the CVA or Scheme.

1.2 Do all kinds of businesses qualify?

Yes – there are no thresholds in relation to a company's assets or turnover in a CVA or Scheme.

Recent years have also seen a number of overseas companies using English law Schemes as a means to come to a compromise with creditors. This is on the basis that a Scheme does not fall within the remit of Council Regulation (EC) 1346/2000 on insolvency proceedings (EC Regulation), so even where a company does not have its centre of main interests (COMI) in England or Wales, it may still utilise a Scheme where the requirements under section 221 of the Act, which governs the winding up of unregistered companies, are met. A foreign company can be deemed to be an unregistered company for these purposes (and, therefore, be subject to a Scheme) if:

- it has a sufficient connection to England and Wales;
- there is a reasonable possibility of benefit to the company applying for the Scheme; and
- one or more persons interested in the distribution of the company's assets (ie creditors) are persons over whom the court can exercise jurisdiction (*Real Estate Development Co* [1991] BCLC 210, applied in *Stocznia Gdanska SA v Latreefers Inc (No 2)* [2000] EWCA Civ 36).

A 'sufficient connection' for these purposes has included the company's finance documents being governed by English law and, recently, a Scheme was sanctioned in respect of a company which had amended the governing law clause of its documentation to English law, with the requisite lender consent, in order to propose a Scheme.

CVAs, on the other hand, fall within the procedures which are covered by the EC Regulation so, in order to propose a CVA, a company's COMI must be in England or Wales.

1.3 What are the necessary approvals?

The company's board will have to resolve that the company proposes a Scheme or CVA (other than where proposed by an administrator or liquidator).

A Scheme requires that 75 per cent in value and a majority in number of each class of creditor votes in favour of the Scheme. Unlike a CVA, the court will also have to sanction the Scheme at a hearing specifically for that purpose, and will do so provided that the Scheme satisfies three requirements as to fairness, which are discussed in more detail below.

In respect of a CVA, 75 per cent in value of the company's unsecured creditors, and at least 50 per cent of unconnected creditors who are present (in person or by proxy) and voting at a meeting of creditors held to vote on the CVA, will need to vote in favour for it to be approved (as well as any secured creditors whose rights of enforcement are affected by the CVA). Whilst the CVA proposal (and a report on the outcome of the meetings to approve the CVA) will be filed at court, the court does not sanction a CVA as it does a Scheme, although any creditors who wish to challenge the CVA must do so at court.

1.4 What is the procedure?

In respect of a CVA, the directors of the company prepare a proposal for the CVA, which will include certain information prescribed by the Insolvency Rules 1986. The directors will also provide a statement of the company's assets and liabilities, known as a statement of affairs, and file such statement along with the CVA proposal at court. In practice the proposal and the statement of affairs will be prepared with the assistance of a licensed insolvency practitioner, termed, at this stage, the nominee, who will act as the supervisor of the CVA and administer its implementation if it is successfully voted through.

Once the CVA proposal is filed, the nominee must lodge a report on the contents of the CVA proposal at court and then call a meeting of creditors to vote on the proposal on 14 days' notice. Provided the requisite number of creditors vote in favour of the proposal, the nominee becomes the supervisor of the CVA and will file a report of the outcome of the creditors meeting at court within four business days.

A CVA proposed by an administrator or liquidator differs in that the liquidator/administrator will normally act as nominee and will file the proposal at court, but will not be required to report on it.

A Scheme will involve the proposer preparing the proposal for the Scheme and then making an application to court to obtain two hearing dates for the Scheme. At the first hearing the court will make orders requiring that the proposer convenes meetings of the requisite classes of creditors/shareholders to vote on the Scheme and will provide directions as to how the proposer should give notice of the meetings to creditors/shareholders. The proposer will then give notice of the meetings and advertise the meetings in the manner directed by the court, together with an explanatory statement concerning the contents of the Scheme. The meetings are held and, if the requisite voting majorities are obtained, the proposer reapplies to court for a hearing, at which the Scheme is sanctioned.

1.5 Is there recourse against the opening judgment?

A CVA may be challenged by a creditor making an application to court on one of two grounds: that the CVA unfairly prejudices the interests of that creditor or that there was some form of material irregularity during the CVA process. An unfair prejudice challenge will only succeed where the prejudice arises from the unfairness of the proposal itself – for instance, by treating different types of creditors differently as regards distributions.

Material irregularity involves a challenge based on procedural matters, eg a valid vote being rejected at the creditor's meeting.

As above, a creditor may challenge the fairness of a Scheme at the second, sanction hearing on the basis that:

- the meetings of creditors/shareholders were not properly convened and held (ie that the procedural requirements in respect of the Scheme were not complied with);
- each class was not fairly represented (ie that a majority of each class was not acting bona fide when voting on the Scheme); or
- the proposal for the Scheme is, itself, unfair and unfairly prejudices any creditor or class of creditors.

1.6 What are the substantive tests/definitions?

Insolvency is not a pre-requisite to a Scheme or CVA, although may well be the outcome if the Scheme or CVA is not voted through. There is no concept of insolvency in the Act – instead, the Act introduces a concept of a company being *'unable to pay its debts'* in section 123. The two most prominent definitions of a company being unable to pay its debts are where it is *'deemed to the satisfaction of the court that the company is unable to pay its debts as they fall due'* in section 123(e) (generally known as the cash-flow test) and where it is proved to the satisfaction of the court that *'the value of the company's assets is less than the value of its liabilities, including contingent and prospective liabilities'* in section 123(2) (generally known as the balance sheet test).

1.7 What is the role of a court-appointed agent?

In a CVA, the nominee will assist the company's directors in preparing the CVA proposal and statement of affairs, and will then file a report on the proposal at court. Once the CVA has been approved at the meetings called to vote on the CVA, the nominee will act as supervisor and administer the CVA in accordance with the terms of the CVA proposal. This will usually include putting the company into liquidation or administration if the CVA fails (ie the company breaches the terms of the CVA), and the supervisor may then act as administrator or liquidator if creditors approve.

There is no supervisor or court-appointed agent in a Scheme, which will be administered by the company itself (even though, as stated above, the court is involved).

1.8 What protection is there from creditors?

Once a CVA is approved (and the proposal will usually contain restrictions on enforcement by those bound by the CVA), it will bind every person who had notice of and was entitled to vote at the meeting to approve the CVA and every person who would have been had he had notice of it (section 5(2) of the Act). However, there is no protection from creditor enforcement before the CVA is approved. Certain companies may apply for protection if they meet the criteria for a 'small company' set out in section 382(3) of the Companies Act 2006 by way of a 'small company moratorium' but, in practice, this is rarely used due to the criteria for obtaining such a moratorium being quite strict.

A Scheme will also bind all persons who were entitled to vote on it, including creditors who did not vote or voted against. Again, the Scheme will usually restrict creditor enforcement once approved, and it is common for the proposer of the Scheme to seek contractual protection under 'lock-up' agreements from creditors to ensure that they vote in favour of the Scheme, and to refrain from enforcement action until the Scheme is approved.

1.9 What is the usual duration of the restructuring process?

Assuming that no application for a small company moratorium is involved, a CVA will usually take around two to three months to implement. The proposal will need to be drawn up and then, once filed at court, the nominee has 28 days to file his report. The nominee will call meetings of creditors at the date and time specified in his report (usually on 14 days' notice), and a creditor may challenge the decision of the meeting within 28 days of it. The CVA itself will vary in duration depending on the number of distributions to creditors, complexity, type of assets which may be sold to realise funds for creditors and so on, but will usually last for anything up to five years.

A Scheme will usually take longer than a CVA to implement due to the increased involvement of the court. The proposer will need to draw up the Scheme proposal, determine the composition of each class of creditor, apply to court, hold meetings as prescribed by the court to vote on the Scheme and attend the two court hearings. Consequently, the Scheme could take as long as six months to implement.

1.10 Who prepares the restructuring agreement and what are the available tools?

Absent a company fulfilling the conditions for a small company moratorium in a CVA, lock-up agreements may be used to bind creditors to vote in favour of the CVA or Scheme proposal and to refrain from selling their debt in the period covered by the lock-up agreement. In larger cases, creditors may also appoint a committee of three to five members to represent them at meetings held during the term of the CVA or Scheme to vote on certain matters.

1.11 Are subordination agreements necessarily given full effect?

Generally yes. Because the CVA or Scheme is essentially a contractual arrangement between a company and its creditors, distributions will follow the order of priorities set out in any subordination agreements. It is also likely that any CVA or Scheme proposal which sought to reorder priorities amongst creditors could be challenged on unfair prejudice grounds if any affected creditor did not consent.

1.12 How is exit managed?

If a CVA comes to an end in accordance with the terms of its proposal, the supervisor will send notice to creditors that the CVA has terminated. This includes if the CVA has failed, whereby the supervisor is usually authorised by the proposal to put the company into administration or liquidation.
A Scheme would usually involve the same process and, normally, where the CVA or Scheme has been a success, the company will return to solvent trading.

1.13 Who are the necessary parties?

The proposer of the CVA or Scheme and, in the case of a CVA, the nominee/supervisor will need to ensure that the requisite number of creditors will vote in favour of the CVA or Scheme. Consequently, it is unlikely that a proposal will be made absent the proposer being assured that sufficient creditors will vote in favour. The proposer will also want to ensure that the proposal itself is not unfair to avoid any creditor challenge.

2. POST-INSOLVENCY PROCEEDINGS

2.1 What is the objective of the proceedings?

There are, effectively, two types of insolvency proceedings in England and Wales: administration and liquidation. In administration, a company is placed under the control of a licensed insolvency practitioner, known as an administrator, who must pursue one of three statutory objectives, in a hierarchical order:

1. the rescue of the company as a going concern;
2. failing which, achieving a better result for creditors than would be likely if the company were to enter liquidation; and
3. failing which, realising the company's property to make a distribution to one or more secured or preferential (essentially the claims of company's employees, up to certain prescribed limits) creditors.

In contrast, in liquidation, the objective of an insolvency practitioner appointed to the company (in this case termed the liquidator) is to collect in the company's assets, realise those assets and distribute the proceeds to the company's creditors in accordance with their claims.

2.2 Do all kinds of business entities qualify?

Generally yes, subject to certain prescribed exceptions where some types of company are made subject to their own slightly different form of administration process (such as investment banks).

2.3 What are the necessary approvals?

There are three routes into administration for a company:

- an appointment made under paragraph 14 of Schedule B1 to the Act by the holder of security over all or substantially all of a company's assets, known as a 'qualifying floating charge' or QFC (which can be made out of court by a simple filing of forms at the court office, without the need for a court hearing);

- an appointment by the company's directors or members pursuant to paragraph 22 of Schedule B1 to the Act, which can also be made out of court subject to notice of the directors'/members' intention to appoint an administrator being first served on the holder of any QFC; and
- an appointment made by certain other prescribed persons, including an unsecured creditor, by way of a court application and hearing pursuant to paragraph 12 of Schedule B1 to the Act.

In respect of an appointment by the company's directors or members out of court, or any person via a court application, certain qualifications apply. These include that the company must be unable to pay its debts within the meaning of section 123 of the Act and is not already in liquidation. An appointment by the holder of a QFC requires that the QFC has become enforceable in accordance with its terms and the company is not already in liquidation.

There are two types of liquidation; voluntary liquidation and compulsory liquidation. Voluntary liquidation can be broken down further into two types: members' voluntary liquidation (MVL) and creditors' voluntary liquidation (CVL). MVL differs from CVL in that it requires that the company's directors swear a declaration that, having made a full enquiry into the company's affairs, they believe that the company will be able to discharge all of its liabilities (including contingent and prospective liabilities) in full within the following 12 months. Knowingly swearing such a statement where there are no reasonable grounds to do so can lead to civil or even criminal penalties.

Both CVL and MVL are initiated by the company's shareholders passing a special resolution (ie a resolution of the holders of 75 per cent or more of its shares) to initiate the process. CVL differs from MVL in that a separate meeting of the company's creditors will be held to vote on the identity of the liquidator.

Compulsory liquidation results from the court making an order, known as a winding up order, upon the presentation of a petition by one or more prescribed persons, including a creditor owed more than £750. Section 122 of the Act sets out the grounds on which the court can wind up a company, and include that the company is unable to pay its debts or that it is just and equitable to do so.

2.4 Is it valid and binding to agree that such proceedings be a default/termination event?

Broadly, yes: financing documents, as well as other contracts such as leases and commercial agreements will usually contain a provision whereby a borrower or guarantor under the agreement, or another company in the same group, going into administration or liquidation triggers a default or termination right (which English law will give effect to). Further, several 'pre-insolvency' events may also be included as defaults, including the company becoming insolvent on either a cash-flow or balance sheet basis, even where a liquidator or administrator is yet to be appointed. However, in respect of defaults caused by balance-sheet insolvency, recent case law, including, most notably, the decision in *BNY Corporate Trustee Services Limited v Eurosail 2007 3BL plc (Eurosail)*, requires that the party relying upon a default caused by balance-sheet insolvency first performs a commercial assessment of a company's situation, taking into account its prospective future liabilities and assets. Consequently, it is not merely enough that a company's liabilities exceed its assets at any given time, but an assessment must be made of the company's future liabilities and assets to determine whether it will be able to meet those liabilities when they fall due before a default can be called. This, in practice, makes relying upon defaults caused by balance-sheet insolvency incredibly uncertain.

2.5 What is the procedure?

Administration, if by way of the out-of-court route, simply requires a filing of forms at court. For a directors' appointment, notice of intention to appoint administrators must be filed at court before the appointment is made and served on any holders of a QFC. The holder of the QFC is then given five business days to agree to the appointment or appoint its own choice of administrator. Where a QFC holder is making the appointment, it must serve notice on any holder of a prior-ranking QFC, which then has two business days to consent or seek to appoint its own choice of administrator.

A court application for an administration requires that the applicant files notice, together with a witness statement and other documents in support at court, and then serves at least five business days' notice on certain prescribed persons, including the holder of any QFC. The court will then make an administration order if it is satisfied that the company is, or is likely to become, unable to pay its debts and the administration would be likely to achieve one of the statutory purposes described above. As above, voluntary liquidation is commenced by the company's shareholders, who must resolve to put the company into liquidation. In a CVL, a creditors' meeting is then called within 14 days of the shareholder resolution being passed (on at least seven days' notice) to vote upon the identity of the liquidator.

A compulsory liquidation commences when the petitioner files a winding up petition at court and serves it on the company. The court will set a date for the hearing of the petition (usually within six weeks of filing) and the petitioner will be required to advertise the petition no less than seven business days before the hearing.

2.6 Please provide information about voluntary filings

In an out-of-court administration appointment, the filings required are, if notice is to be served on any QFC holder, a 'notice of intention to appoint administrators', which is filed at court, and, once the relevant notice period expires or consent is obtained, a further notice, known as a 'notice to appoint administrators'. If there is no QFC holder in a directors/members appointment or no prior-ranking QFC in a QFC appointment, then there is no need to file a notice of intention to appoint administrators prior to filing the notice to appoint administrators. The proposed administrators are also required to file a statement confirming that, amongst other things, they accept the appointment and reasonably believe that the purpose of the administration can be achieved.

A voluntary liquidation will require that the relevant shareholder resolutions (and the statutory declaration of solvency in respect of an MVL) are all subsequently filed at the company registry and that the liquidation is advertised in the London Gazette.

Only compulsory liquidation and a court application to appoint an administrator require a court hearing. Notice of the hearing will be served on a number of prescribed parties, including the holder of any QFC, the company itself and certain types of creditor. Whilst those parties may attend the hearing (and make submissions), if the applicant can satisfy the conditions for an administration/winding up order contained in the Act (and described above), the court is unlikely to refuse to make the order sought.

2.7 How are creditors' representatives chosen?

In an administration, creditors may appoint a committee of between three and five members. This will usually be at the first meeting of creditors, which will be held by the administrator within 10 weeks of his appointment, where the administrator's proposals for the conduct of the administration will be considered for approval by creditors. Any creditor of the company can sit on the committee (and whilst it is normal that different types of creditor will be present on the committee, there is no legal requirement for any given class to be represented), provided that their claim has not been rejected by the administrator and is not fully secured. A committee may also be appointed in a CVL and compulsory liquidation, either at the creditors' meeting held to vote for the appointment of the liquidator in respect of a CVL or at the first meeting of creditors in a compulsory liquidation.

Once the requisite number of creditors agree to act on the committee, the administrator or liquidator will issue a 'certificate of due constitution', at which point the committee comes into effect.

2.8 Is there recourse against the opening judgment?

In an out-of-court administration, the holder of a QFC in a directors' appointment or a prior-ranking QFC in a QFC appointment may appoint their own choice of administrator during the notice periods described above. An interested party (most feasibly the company's directors or shareholders) may also apply to court to challenge the appointment of the administrator if it can prove that the conditions for the appointment were not met (ie that the company was not unable to pay its debts in respect of a directors' appointment or that the QFC had not become enforceable in respect of a QFC appointment or on COMI grounds). In a court-appointed administration, the court hearing to appoint the administrator would be the most appropriate forum to challenge the need for the appointment (and, on the basis that the application will be before a considered hearing, the courts are generally reluctant to allow appeals at a later date).

An MVL (provided that all procedural formalities have been complied with) will not be open to challenge but, if it turns out that the company will not be able to pay its creditors in full, the liquidator will need to convert the MVL into a CVL. There may also be civil and criminal consequences for the directors who swore the false declaration. In a CVL, any creditor's concerns as to the appointment may be voiced at the meeting to appoint the liquidator and, in a compulsory liquidation, at the hearing of the winding up petition.

2.9 What are the roles and powers of committees?

Generally, the committee will act as a sounding board for the administrator/liquidator, vote upon certain issues, approve the administrators'/liquidators' remuneration and call upon the administrator/liquidator to answer questions raised about the conduct of the process. A liquidation committee has an additional role in sanctioning or approving powers of the liquidator (certain powers can only be exercised by a liquidator if he has obtained sanction), which is not required in respect of an administrator (whose powers are freely exercisable).

In terms of voting, each committee member has one vote and any resolution put to the meeting, provided that it is quorate (ie at least three members are in attendance and able to vote, either in person or remotely), will be voted through upon a simple majority. In certain cases individual members may be prohibited from voting on matters put to the committee, such as where there is a conflict of interest or the committee member concerned will obtain a personal benefit from the transaction or matter being voted upon. Creditors may also be disqualified from acting on the committee in certain scenarios.

2.10 What are the consequences of opening judgments for creditors?

An administration causes an automatic stay on creditor action, known as a moratorium, which prevents court proceedings against the company or enforcement action without the consent of the administrator or an order of the court. A similar moratorium does not apply to secured creditor enforcement in liquidation, whereby a secured creditor may enforce its security freely (although there is still a moratorium on court proceedings).

An unsecured creditor is required to file a written notice of its claim, known as a proof, in order to have a valid claim in the administration or liquidation. The ultimate responsibility regarding whether the proof should be admitted, and in what amount, lies with the administrator/liquidator, and there are guidelines regarding how to treat, for example, claims in a foreign currency or claims for future debts.

2.11 What is the duration of the restructuring process?

An administration automatically ends after 12 months unless extended. An extension can be obtained either from creditors (which may be given once, and for a maximum period of six months) or by way of a court application (which usually extends the administration for individual periods of up to 12 months, provided that there is good reason for the extension).

There is no set -time limit for liquidation – the liquidation will end when the liquidator has dealt with all of the company's assets and claims.

2.12 How do creditors vote?

At the initial meetings of creditors described above (ie the meeting to consider the administrator's proposals – although such meeting can be bypassed where the administrator needs to act quickly – or the meeting to vote upon the choice of a liquidator), or where no creditors' committee has been appointed, votes are based upon the value of each creditor's claim. As above, where a committee has been appointed, its members vote by simple majority.

2.13 What are the rules on clawback/voidability?

There are three main types of voidable transaction that can be attacked by an administrator or liquidator if certain conditions are met. These are:

- **Transaction at undervalue:** pursuant to section 238 of the Act, where the company enters into a transaction for a consideration at a value which is significantly less in money or money's worth than the consideration provided by the company, or makes a gift for no consideration at a relevant time, the transaction may be challenged. The 'relevant time' for these purposes is during the period of up to two years prior to the administration or liquidation, and the company must be insolvent at the time of, or become insolvent as a result of, the transaction which is being challenged. Where the companies which are party to the transaction are connected, insolvency is presumed (ie it must be rebutted by the company rather than proved by the administrator or liquidator).
- **Preference:** pursuant to section 239 of the Act, where during the relevant time the company does anything or suffers anything to be done that has the effect of putting a creditor or guarantor in a better position upon the company entering administration/liquidation than it would have been, the transaction can be challenged. The relevant time for these purposes is up to six months prior to the company entering administration/liquidation or two years if the party to the relevant transaction was connected with the company, and the company must be insolvent at the time or as a result of it. There is an additional condition that the company must be 'influenced by the desire to prefer' the recipient of the preference, although such desire is presumed where the companies are connected.
- **Invalid floating charges:** pursuant to section 245 of the Act, where a company grants a floating charge during the relevant time, the charge shall be invalid to the extent that no 'new value' was received by the company. Essentially, this prevents companies from securing pre-existing debts with a floating charge.

The relevant period is 12 months prior to the company entering administration or liquidation as regards unconnected companies, and the company granting the charge must be insolvent at the time, or as a result of, the transaction. In respect of connected companies, the period is extended to two years, and insolvency need not be proven.

It should, however, be noted that the charge will only be invalid as regards the 'old' consideration it secures. Consequently, to the extent that the charge is granted to secure a pre-existing debt as well as new debt advanced after the charge was granted, it will still validly secure the new debt.

2.14 What are the rules on set-off/netting?

Where a contract between a creditor and the company in liquidation or administration contains contractual provisions as to set off, the administrator or liquidator will honour these provisions when making distributions to creditors who are also debtors of the company (or collecting amounts due from them).

There is also a form of statutory set-off applicable in liquidations and administrations where the administrator has declared his intention to make a distribution to unsecured creditors (which, in an administration, requires a court order; liquidators can make a distribution without court consent). This allows the administrator or liquidator to set-off amounts due from the creditor to the company against amounts due to that creditor before making a distribution to it.

2.15 How is exit managed?

An administration must be brought to an end by way of a method of exit prescribed by the Act. In rare cases, the company will be restored to trading on a solvent basis and the administrator can simply file a notice to bring the administration to an end. Otherwise, an administrator may put the company into liquidation as a means to wind down the company's affairs and make a distribution to unsecured creditors.

A CVA or scheme may also be used as a means to agree claims with creditors and make distributions to them. However, this form of exit is fairly rare.

The company will simply be struck off the register of companies and dissolved once the liquidation comes to an end. This can be achieved by a simple filing of forms by the liquidator.

2.16 Are 'prepackaged' plans, arrangements or agreements permissible?

Yes – prepackaged administrations are a common restructuring tool in the English market and involve an administrator negotiating a sale of a company or its assets and then executing the sale immediately upon his appointment. The fact that an out-of-court appointment can be made without the need for a court hearing further streamlines the process, and has the benefit of avoiding value erosion due to creditors and other stakeholders only becoming aware that the company entered administration after the sale has completed.

2.17 Is a public authority involved?

As above, the court will be involved in compulsory liquidations or court-appointed administrations. Other than that, certain government departments will be involved in respect of certain aspects of the administration or liquidation (for example, a government-established insurance fund is available to meet certain claims of former employees of the company), but there is no public authority whose responsibility is to oversee either process.

2.18 What is the treatment of claims arising after filing/admission?

Distributions to unsecured creditors are based upon the amounts due at the date on which the company entered administration/liquidation. If the administrator or liquidator incurs liabilities during their appointment (such as liabilities to suppliers, or rental payments for properties occupied during the administration or liquidation), then such liabilities are payable as ‘expenses’ of the administration or liquidation and rank ahead of normal, unsecured, claims and certain claims of secured creditors.

2.19 Are there ongoing contracts?

There is no provision under English law whereby a contract will automatically terminate due to insolvency. An administrator or liquidator will, generally, continue to perform any contracts to which the company is a party, although certain of those contracts may enable the counter-party to terminate the contract upon the company entering an insolvency process. A liquidator, but not an administrator, also has the power to ‘disclaim’ any onerous contract (essentially, a contract which is costing the company money to maintain), which has the effect of determining the rights of the parties to the contract at the date of the disclaimer.

2.20 Are consolidated proceedings for members of a corporate family/group possible?

No, each company must be put into a separate process and the duties of the administrator or liquidator will be owed to that company’s creditors, rather than the creditors of the group as a whole (although creditors may include other group companies as regards inter-company debts).

2.21 What are the charges, fees and other costs?

As above, the general costs of an administration or liquidation will be paid as expenses, including the administrator/liquidators remuneration (which are usually charged on a time-costs basis). The costs of the petitioning creditor in a compulsory liquidation are also generally recoverable as expenses of the liquidation, although the costs of shareholders meetings/creditors meetings and court filings in voluntary liquidations or out-of-court administration appointments are generally borne by the applicant/company (although the court costs are generally quite low).

3. LIABILITY ISSUES

3.1 What is the liability of managers/directors *vis-à-vis* creditors?

There are three key areas where directors can be held liable to contribute to the assets of a company in liquidation. Each of these apply to directors who have been appointed and act as directors of the company, as well as directors who have been appointed but the appointment has not formalised and those acting as 'shadow directors' (ie persons in respect of whose instructions the board is accustomed to act).

Wrongful trading

Pursuant to section 214 of the Act, a director can be required to make such contribution as the court thinks proper (usually determined by the amount by which assets have been depleted by their conduct) if the liquidator can show that, before the commencement of the winding up, that person knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation.

This does not merely cover 'trading' activity: any act, or failure to act, unless it minimises losses to creditors, may attract personal liability. There is no requirement to prove intent or dishonesty.

The only defence open to a director is that he took every step that he ought to have taken with a view to minimising the potential loss. This assumes knowledge that insolvent liquidation was unavoidable, and a director is deemed to know facts which ought to have been known or ascertained by a reasonably diligent person having:

- the knowledge, skill and experience reasonably expected of a company director; and
- the knowledge, skill and experience that he in fact possesses.

To that end, the courts will often impose a higher standard of care upon a finance director or managing director than upon a non-executive or part-time director.

Misfeasance

Pursuant to section 212 of the Act, if any of the directors (or other persons involved in the promotion, formation or management of a company) has misapplied, retained or become liable or accountable for any money or property of the company, or has been guilty of a misfeasance, a breach of fiduciary duty or any other duty in relation to the company, the liquidator is able to recover money or damages for the benefit of the company in question.

Such conduct will cover, amongst other things, improper payments of dividends, application of monies for unauthorised purposes and any unauthorised loans or remuneration to directors.

A court may grant relief from liability if the director acted honestly and reasonably and, if having regard to all the circumstances, he ought fairly to be excused. Relief from liability for misfeasance is a discretionary remedy.

Fraudulent trading

Pursuant to section 213 of the Act, if the business of a company is carried on with the intent to defraud creditors or for any other fraudulent purpose prior to its winding up, the liquidator can apply to the court for a contribution from any person who was knowingly a party to the carrying on of the fraud.

This provision is rarely invoked since it requires evidence of actual dishonesty. However, where the directors allow a company to continue to trade and incur liabilities when they know there is no real prospect that these will be repaid, they risk personal liability under this provision. Fraudulent trading has wider application than wrongful trading in that:

- it applies to any persons (not just directors) who were knowingly parties to the carrying on of the business in question;
- it attracts a criminal penalty of up to 10 years' imprisonment or an unlimited fine, or both, as well as civil liability; and
- there is no defence of taking steps to minimise loss to creditors.

3.2 What is the liability of the lender?

Lenders are largely free from risk, other than in certain circumstances. First, lenders could be deemed as shadow directors if they provide instructions to the board of the borrower and upon which the board acts. This would mean that they could be liable for, for example, wrongful trading. Lenders are, however, alert to this and will take steps to avoid giving specific instructions to a borrower's directors (and will instead phrase any requests as conditions to continued funding).

Secondly, lenders who enforce security as 'mortgagee' (which, effectively, means the lender takes possession of the relevant secured assets and sell them itself) run the risk of being liable for liabilities and outgoings which attach to the assets during the period in which they are in possession. These can include environmental liabilities and unfunded pension liabilities (which can be extensive) and, consequently, lenders are generally reluctant to enforce security in this manner.

Lastly, lenders who enforce security or accelerate a loan where they are not entitled to do so under the terms of the underlying loan or security documentation can be liable for 'wrongful acceleration'. This is, essentially, a claim for breach of contract, so if the borrower suffers loss as a result of the wrongful acceleration it will be entitled to pursue a damages claim against the lender.

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