*R&I IN*

# UNITED KINGDOM

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Prior to joining Paul Hastings, Mr Ereira was a partner at magic circle firms.

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*GTDT: In the last year, have you seen any developments or trends in the nature and volume of insolvency filings?*

*David Ereira:* The past year has been dubbed the year of the CVAs (company voluntary arrangements) as, to date, a record number of retailers such as New Look, House of Fraser, Carpetright, Mothercare and Homebase and casual dining chains (eg, Prezzo, Jamie's Italian, Byron and Carluccio's) have sought to implement a CVA to compromise unsecured debt. This wave of CVAs was caused by weak consumer confidence and rising costs due to political uncertainty over Brexit, rising inflation and the falling value of the pound. It is expected that the use of CVAs will continue in 2019 as costs increase from the weaker pound since the Brexit referendum and the National Living Wage rises, scheduled for April 2019, continue to put pressure on the struggling consumer focused sectors.

CVAs are a flexible restructuring tool as they allow retailers to close loss-making stores, reduce rental payments and cut costs in a bid to keep the business in operation and avoid administration. CVAs can be used as part of a restructuring involving all unsecured creditors or as 'landlord-only' CVAs, which only compromise a company's leasehold liabilities to its landlords (often used by companies with large property portfolios).

In a CVA, the landlords will generally have the option to terminate the lease. However, termination of the lease might not be the best option if it is challenging to find a new tenant at a better rent than that offered under the CVA. Despite some criticism of CVAs, most recent CVAs have been approved with landlord support. A well-drafted CVA will balance fair compensation to landlords, calculated by reference to the current market value of their lease and their likely recovery in an insolvency scenario. To secure creditors' support, the company will need to demonstrate to landlords and its other stakeholders that it has a robust business plan going forward and that it has a realistic expectation of meeting its revised leasehold obligations during and following the CVA.

Paul Hastings advised New Look on their CVA in 2018. This was not only the largest retail CVA but was distinctive because the company was not in or facing an imminent insolvency.

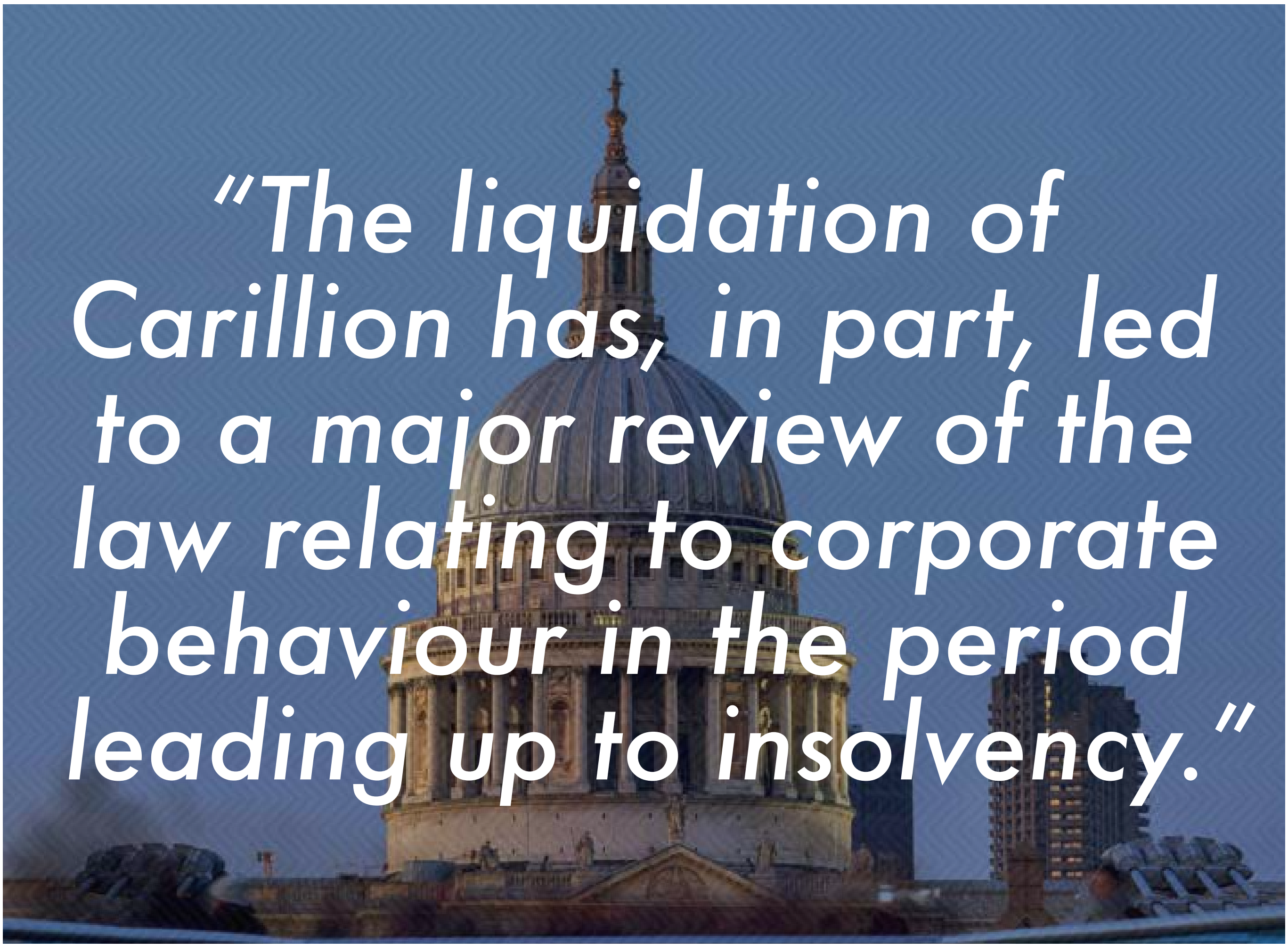
In terms of sectors affected by insolvencies in the last year, the construction and outsourcing industry stands out and it is worth mentioning, in particular, the sudden compulsory liquidation of Carillion. The insolvencies in the construction industry were followed by retail, casual dining and other consumer focused sectors. The commodities sector is also experiencing a rise in distressed situations caused by a high degree by falling prices of commodities such as oil, copper and zinc. Finally, outsourcing generally and providers of services that are dependent upon public sector payments are sectors under some stress, which has led to greater concern and scrutiny.


David Ereira

*GTDT: Describe the one or two most notable insolvency filings in your jurisdiction in the past year.*

*DE:* The compulsory liquidation of Carillion, formerly the second-largest construction company in the United Kingdom, immediately stands out due to its size and the speed of its dramatic collapse. Carillion was a listed company and undertook a range of construction projects in a variety of sectors including aviation, central government, retail, defence, education, oil and gas and transport. Most of its business was in the United Kingdom, but it also operated in several other regions including Canada, the Middle East and Caribbean. Carillion also provided services to a number of government departments, agencies and local government.

Carillion collapsed because it accepted too many projects that turned out unprofitable while the margins on its service contracts were in some cases too low. The market was surprised by the fact that the construction giant went straight into liquidation given that Ernst & Young was being lined up to handle a potential administration of Carillion in case the refinancing talks failed.

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When it went into liquidation, the company had in the region of £5 billion of liabilities and just around £29 million left in cash. Its weak cash position and potential exposure on its contracts meant that no administrator was willing to take on the role and the company fell into compulsory liquidation with the official receiver appointed. The UK government has had to relet many of the contracts causing a significant loss to the public sector.

There has also been considerable political fallout, including investigations into the causes of the failure, the conduct of the board and its advisors, its accounting policies and reporting and the unexpected speed of its demise. It seems that Carillion's lenders did not believe in Carillion's business plan so were not prepared to provide emergency financing. In fact, one of Carillion's lenders, HSBC, has used credit derivatives to reduce its lending exposure to Carillion as early as 2015, with the investors who bought these derivatives facing losses. HSBC has packaged the derivatives into a US$5 billion 'synthetic securitisation', which allowed it to offset the risk associated with 152 loans made mainly to the UK companies. HSBC sold the riskiest slice of this collateralised loan obligation (CLO) of credit default swap to a series of hedge funds. Pension funds have been big buyers of the safest triple-A rated tranches of these CLOs.

The liquidation of Carillion is significant because not only were the losses significant both to creditors and the public sector but it has, in part, led to a major review of the law relating to corporate behaviour in the period leading up to insolvency.

Elsewhere, House of Fraser's administration has been dubbed as the biggest failure on the high street since BHS. The upmarket department store group was in trouble as it has not made sufficient investment to ensure that its online operations were successful, had too many stores and failed to entice enough shoppers. Following a period of financial difficulty, House of Fraser tried to restructure its liabilities by way of a CVA and scheme of arrangement. In June 2018, House of Fraser agreed a CVA with its unsecured creditors to close half its stores and agree significant rent cuts on other stores. However, some landlords argued that the CVA treated them unfairly compared with the owners and other creditors and applied to challenge the CVA in the Court of Session in Scotland, since the CVA was proposed under Scottish law where the company had its centre of main interests (COMI).

The legal challenge has been settled out of court. To continue its operations, the retailer needed to raise external finance and Chinese investment firm C.banner promised an investment of £70 million, which was conditional on the implementation of the CVA, but was subsequently withdrawn. House of Fraser proposed inter-conditional schemes of arrangement in order to permit up to £50 million of new secured financial indebtedness to be incurred and to extend the maturity profile of some of the group's debt. The schemes have been sanctioned by the applicable court in July. But, the retailer was unable to secure sufficient funding and went into administration on 10 August. Sports Direct International plc (Sports Direct) owned by Mike Ashley (who also owns almost 30 per cent of Debenhams) purchased the business and effectively all of the assets of House of Fraser for £90 million out of administration less than two hours after the retailer has been placed in administration. Sports Direct was able to buy the business free of all liabilities, which remained with the old House of Fraser. Through the use of a pre-packaged sale, House of Fraser's future as an entity has been assured though the impact on its operations and scale is still unclear.

*GTDT: Have there been any recent legislative reforms? Is there a perceived need for reform?*

*DE:* Legislative reforms appear to be on the horizon. In the wake of the high profile collapses of Carillion and BHS, the UK government is assessing what reforms are needed and issued a consultation on insolvency and corporate governance reforms in March 2018 in order to gauge opinion from stakeholders. In August, the government published its response to the consultation and now extensive drafting of the legislation will need to follow, but this might be delayed by the Brexit negotiations. The government's proposals have some similarity with US Chapter 11 and include a new restructuring plan, a new moratorium and a ban on ipso facto clauses and potential limitations on corporate distributions.

The new restructuring plan would be a new tool in the UK restructuring toolbox, which already includes the scheme of arrangement and the CVA. In particular, the voting threshold for each class will be 75 per cent by value to vote in favour and there will be no majority in number test (unlike a scheme), plus more than half of the total value of unconnected creditors would need to vote in support. Unlike in a scheme of arrangement, cross-class cramdown will be permitted if at least one class of impaired creditors vote in favour of the plan and the absolute priority rule is followed (dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution). The court can also sanction the scheme if the absolute priority rule is not met where non-compliance is just and equitable and necessary to achieve the aims of the restructuring.

The main purpose of the new moratorium is to prevent creditor enforcement action against the company while it considers options for rescue. The new moratorium would be available to companies that meet certain eligibility criteria (eg, financially distressed but not yet insolvent, has sufficient funds to meet current and new obligations due during the moratorium) and qualifying conditions. Initially the moratorium will last 28 days, but extensions will be possible. The directors would remain in control of the company subject to a moratorium. A qualified insolvency practitioner would monitor the company's compliance with the qualifying conditions throughout the moratorium.

Another important proposal is the prohibition of enforcement by a supplier of termination clauses in contracts for supply of goods and services on the grounds that the company has entered a formal insolvency procedure, the new moratorium or the new restructuring plan. However, counterparties would be able to apply to court to terminate these contracts if they can demonstrate undue financial hardship.

> *"There is still a lot of uncertainty in respect of the coordination of cross-border cases following Brexit."*

*GTDT: In the international insolvency field, have there been any legislative or case law developments in terms of coordination of cross-border cases? What jurisdictions are you most likely to have contact with?*

*DE:* There is still a lot of uncertainty in respect of the coordination of cross-border cases following Brexit. At the time of writing it is unclear what transitional arrangements, if any, will be in place affecting civil and commercial cooperation between the EU and the UK after Brexit, in the event of a 'no-deal Brexit', where the UK leaves the EU on 29 March 2019 without a transition period in place the relationship between the UK and the 27 remaining member states of EU will change to become equivalent to those between any two unconnected nations. In particular, the current arrangements under EU law for mutual recognition of insolvency processes and judgments will cease to apply. These include the Recast EU Insolvency Regulation, the Insurers (Re-organisation and Winding Up) Regulation and the Bank Resolution and Reorganisation Directive, the Recast Brussels Regulation. Existing English law will remain in place including the Cross-Border Insolvency Regulations (which implement the UNCITRAL Model Law) but these are not generally relevant to other EU member states, and section 426 of the Insolvency Act 1986 is relevant to recognition of proceedings in commonwealth jurisdictions and common law recognition.

> *"As the United Kingdom is an attractive forum for a restructuring, foreign companies often move their centre of main interests to the UK."*

Non-EU based treaties and conventions will also continue to apply. These include the 1968 Brussels Convention on jurisdiction and enforcement of judgments in civil and commercial matters. This will become the governing instrument in respect of the allocation of jurisdiction and the reciprocal enforcement of judgments between contracting states. The Brussels Convention is an international instrument, which is not part of the EU legislation. The UK became a contracting party in 1978. If Brussels Convention does not apply to a certain country, the national law of that country will determine whether a foreign UK judgment can be recognised and enforced in that jurisdiction.

In addition to the Brexit-related legislative developments, there have been a couple of important cross-border cases this year. The first one is a ruling on 16 August by Mr Justice Richard Snowden at the English High Court in relation to an advertising company, Videology. The judge refused recognition of Chapter 11 proceedings in relation to the UK subsidiary of Videology Inc as a foreign main proceeding under the UK Cross-Border Insolvency Regulations 2006. Instead, the judge recognised these proceedings as a foreign non-main proceeding on the basis that Videology Ltd's COMI was in the UK (not in the US). The English court noted that the company's registered office in London gave rise to a presumption under the UNCITRAL Model Law that its COMI was in England, and that under the recast European Insolvency Regulation, a debtor's COMI should be where it "conducts the administration of its interest on a regular basis and which is ascertainable by third parties". Videology Ltd was not able to rebut this presumption, especially given that Videology Ltd's loan agreement stated that its COMI is situated in England. This case shows that it might be challenging to rebut the registered office presumption as English judges are carefully looking into the facts of each case.

As the United Kingdom is an attractive forum for a restructuring, foreign companies often move their COMI to the UK to benefit from a well-established and predictable legal framework. However, a foreign company does not need to move its COMI if it can prove that there is a sufficient connection between that company and the UK. Recently two foreign companies, Noble Group Limited (the holding company of the Noble Group, a major global commodities trader) and Stripes US Holding Incorporated (a subsidiary of the retail group Steinhoff International Holdings) have used a UK scheme of arrangement to restructure their debt. Noble Group Limited (registered in Bermuda) has moved its COMI from Hong Kong to the UK. The company took certain steps to ascertain that its COMI is in the UK (eg, moving its head office and the head office functions to London, informing the Singapore Exchange, customers, suppliers, creditors and counterparties about the change in location of the head office, registering an establishment in the UK and ensuring that the majority of the board meetings take place in London). In case of Stripes US Holding Incorporated, some creditors were domiciled in the UK, which was sufficient to entitle the UK court to find a jurisdiction on the basis of article 8 of the Recast Judgment Regulation. The UK High Court has sanctioned each scheme of arrangement on 12 November.

Another important case from January 2018 is *Bakhshiyeva v Sberbank of Russia* and relates to an English common law rule that a debt governed by English law cannot be discharged or compromised by a foreign insolvency proceeding (the so-called Gibbs Rule). In the *Bakhshiyeva* case, the English court considered an application by a foreign representative for a permanent stay on a creditors' enforcement of claims in England under an English law governed contract. However, the English High Court found that the Gibbs rule did apply to prevent the court granting a permanent stay on the enforcement of creditors' English law governed contractual claims. The judge ruled that any stay granted by the English court would go to the substance of creditors' claims and, effectively, the English court would be ordering the discharge of the creditor's claim. The English court was prohibited from doing this, following the Gibbs rule. As the rule has been often criticised as not being relevant in modern day cross-border insolvency proceedings, given the continuing trend towards recognition of foreign insolvency proceedings, the principle of modified universalism and the Brexit-related legislative developments, it is advisable to continue monitoring any future developments regarding this well established rule.

The Paul Hastings restructuring and insolvency team is often involved in cross-border cases and we work closely with our colleagues based in Asian, European and US offices. We are also very much focused on group structures and cases that have a nexus with the Channel Islands, BVI and the Cayman Islands.

*GTDT: In your country, is there a particular court or jurisdiction that sees a higher concentration of insolvency filings? What is the attraction of that forum?*

*DE:* Insolvency filings are dealt with by the English High Court that has jurisdiction to wind up any company registered in England and Wales.

The sophisticated nature of the English High Court system, the breadth of developed case law and the experience of its judges to deal with highly complex insolvency cases are just some of the reasons why England is a highly attractive forum for businesses. The English High Court has a dedicated 'Insolvency and Companies List'. This is a specialist court that handles insolvency matters, including applications and petitions initiating insolvency procedures and a wide range of claims, such as proceedings relating to schemes or arrangement. The judges specifically chosen to handle insolvency cases are selected from a very knowledgeable pool of experienced barristers and are well equipped to deal with the demands of such cases.

*GTDT: Is it fair to describe your jurisdiction as either 'debtor-friendly' or 'creditor-friendly' in terms of how insolvency filings proceed?*

*DE:* The UK has, historically, been seen as the most predictable and creditor-friendly European jurisdiction for conducting debt restructurings. However, over recent years the UK government has been attempting to make the UK jurisdiction more debtor-friendly. English courts are the forum of choice for major international contracts because the system is seen as flexible and commercially-oriented while also offering certainty and predictability.

In the United Kingdom, the main approach to treatment of companies in financial difficulties has been to try to achieve a consensual solution to save the company as a going concern. However, sometimes achieving a consensual outcome is not possible due to the complexity of the capital structure or conflicting interests of stakeholders and the following restructuring tools are used instead – schemes of arrangements (which are not an insolvency mechanism) or CVAs and pre-packaged administrations (both regulated by the English insolvency rules).


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## THE INSIDE TRACK

***What two things should a client consider when choosing counsel for a complex insolvency filing in this jurisdiction?***

Clients need to consider both relevant experience and a firm's ability to adapt when choosing counsel. Typically complex insolvency filings are influenced by a number of fast-changing factors and given that the situation is constantly developing, counsel cannot be rigid. Flexibility is incredibly important and, of course, prior experience is essential in order to understand how to adapt to the changing situation to best protect the client's interests.

***What are the most important factors for a client to consider and address to successfully implement a complex insolvency filing in your jurisdiction?***

The importance of understanding the stakeholder dynamic – knowing the identities and objectives of each of the main stakeholders and their skin in the game cannot be overstated. Having a clear picture of the respective rights and powers of the stakeholders under transaction documents, applicable laws and regulations is also a crucial step in planning a consensual solution or in fact in the enforcement planning if a consensual route is impossible or undesirable. Valuation is also important to ascertain whether respective stakeholders are in the money or out of the money. Lastly, it is important to understand who controls the situation and to make the enforcement or another solution predictable for the client which involves setting out the likely outcome.

***What was the most noteworthy filing that you have worked on recently?***

Paul Hastings advised leading clothing retailer New Look and its owner, the listed South African group Brait SE, on its successful CVA, announced in March 2018.

One of the key challenges for New Look was that many of its 600 leasehold shops had leases above market rents, some of which could not operate profitably at any rent. Further, the New Look Group was neither balance sheet nor cash flow insolvent and while it has substantial bond liabilities, these have many years to run and all payments are current.

We designed and executed a CVA outside of an insolvency, and on the basis that it, together with the other key operational changes, aimed to reduce the risk of a future insolvency. Despite the failure of previous CVAs, the New Look CVA proved a dramatic success and has shown that CVAs can be an important part of a successful rescue for a business. New Look is now operating under the leases revised by the CVA, and their results show that it is undergoing a successful business transformation.

Our work on this project led to Paul Hastings winning the Restructuring Team of the Year award at the 2018 British Legal Awards hosted by *Legal Week*.

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*GTDT: What opportunities exist for businesses wanting to purchase assets out of insolvency, and how efficient is the process? What are the best ways to take advantage of opportunities in this area?*

*DE:* A pre-packaged administration, also known as a pre-pack, allows interested parties to purchase assets out of an insolvency. The pre-packaged sale is an arrangement under which the sale of all or part of a company's business or assets is negotiated with a potential purchaser before an administrator is appointed (eg, House of Fraser). The administrator effects the sale of assets immediately on, or shortly after, its appointment. The administrator acts in the interests of the company's creditors as a whole and its conduct is regulated by the Statement of Insolvency Practice 16 (SIP 16).

In the recent years, the pre-packs have been criticised for their lack of transparency, particularly where the purchaser was the management team, or owners or connected parties to the company subject to a pre-pack. In these cases, creditors often felt that they were left without a remedy, while the management responsible for the failure of the business, or connected parties, acquired the same business, free of legacy creditors (a phoenix company). A pre-pack pool, which is an independent body of experienced business people, has been introduced in order to improve fairness and transparency especially where a pre-pack sale occurs to a connected party. A pool member can provide an opinion on the purchase of a business or its assets by connected parties to a company subject to a pre-pack. If viewed favourably, the pool member will issue a response to the effect that it is not in his or her opinion unreasonable to proceed with the sale.

Pre-packs are a useful restructuring tool in terms of the retention of jobs and returns to secured creditors. The speed with which pre-packs can be implemented is crucial in maintaining value in a distressed company, which would otherwise be diminished as knowledge of financial difficulties enters the public domain and employees, suppliers and customers began to lose confidence. Many types of businesses in the United Kingdom have been pre-packaged, but mostly those in the service and construction sectors.

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