CLIFFORD

CHANCE

Briefing note

June 2016

Restructuring in the UK: proposals for reform

On 25 May the Rt Hon Sajid Javid, Secretary of State for the Department for Business, Innovation and Skills announced his ambition "*to make Britain the best place in the world to start and grow a business.*" Part of his ambition includes looking at ways to improve the insolvency regime so that it allows entrepreneurs to restructure when times are tough. To this end a consultation has been launched seeking views on how to make such improvements. A copy of the consultation is available via this link: consultation.

Introduction

The proposals focus on four main themes:

1. The introduction of an automatic and standalone moratorium
2. Continuance of "essential contracts"
3. Flexible restructuring plan including cram down
4. Rescue finance

Looking at each in turn:

Automatic and standalone moratorium

Views are sought on the introduction of an automatic standalone moratorium that would prevent the enforcement of security and the commencement/continuance of formal insolvency proceedings or individual creditor claims. It is envisaged that the moratorium would come into effect before any formal proceedings are launched and would become operative by simply filing the requisite papers with the court (there would be no court scrutiny of the debtor's application for a moratorium at this stage). It would initially last for up to 3 months but may be extended further. Philip Hertz, Global Head of our restructuring and insolvency team comments *"The rationale behind the standalone moratorium is that it would provide debtors with time to negotiate either an out of court work out or court restructuring, without the threat of individual creditors taking any precipitous individual action. There are certain creditor safeguards which are suggested, that would go hand in hand with the availability of the moratorium, in particular the ability for individual creditors to challenge the moratorium. Also the prerequisites for eligibility to access the moratorium would have to be satisfied and reviewed by a supervisor (an independent insolvency practitioner, lawyer, or accountant)".*

Continuance of "essential contracts"

In addition, the consultation seeks feedback on proposed measures to facilitate businesses in distress allowing them to continue to trade without fear of contracting parties terminating arrangements that are vital to the business as it conducts its restructuring. There is already legislation in place which achieves this in the context of formal insolvency proceedings in relation to certain key supplies, such as energy and telecommunication supplies. These measures go even further, and allow the debtor to designate any contracts as "essential" and thereby preclude the counterparties to those contracts from terminating for up to 12 months. Again it is suggested that counterparties would be able to challenge such designation, and should not be prejudiced by the continuance.

Key issues

- UK consults on restructuring reforms, looking at:
  - the introduction of an automatic and standalone moratorium
  - continuance of "essential contracts"
  - flexible restructuring plan including cram down
  - rescue finance
- Responses due by 6 July

Flexible restructuring plan including cram down

Perhaps one of the less well defined areas of the proposals (the consultation seeks views on whether this should be by way of an amendment to the current company voluntary arrangement regime or another separate process) is the potential introduction of a flexible restructuring plan. This would include the ability to bind secured creditors, and also allow for a dissenting class of creditors to be crammed down, as long as they were no worse off than in a formal liquidation.

Rescue finance

Finally the consultation looks at options for encouraging rescue finance. Adrian Cohen, partner in our restructuring and insolvency team observes "*These include quite radical proposals which are a departure from the current status quo: with ideas around allowing existing secured creditors to be overreached by those providing rescue finance; and the ability to override any negative pledges in loan agreements. These aspects may often have the effect of restricting the ability of the debtor to raise new finance in distressed situations and so removing them may be seen as a positive step in the rescue process, of course from an existing lender's perspective any introduction of such proposals could be perceived as a further erosion of the lender's ability to influence the restructuring process.*"

Inspiration for the reform?

In putting forward these proposals it is not difficult to see that the Insolvency Service has drawn upon the general themes set out in the recent EU Commission's consultation on harmonising insolvency law across the EU. When it comes to the detail and the approach of the reforms, the proposals are largely based upon aspects of the US Chapter 11 Bankruptcy Code. In particular restrictions on the termination of contracts; cram down of creditors; and a regime for DIP finance are all familiar themes. Perhaps the only novelty comes in the form of the standalone moratorium, that on its face appears to offer a debtor significant and potentially up to a year's protection from creditors, and for the first 3 months at least is automatic unless challenged.

Power shift from creditors to debtors

While the focus of the proposals is clearly on offering the debtor greater opportunities to restructure, are the offerings too debtor friendly? If enacted, will they diminish the influence of creditors in a restructuring and perhaps potentially damage the UK's pre-eminence in terms of being a financial centre?

The consultation paper suggests that there are already techniques available in the UK that can be used to protect the debtor. For example, there is the small companies' moratorium, but this is seldom used. Likewise, there is already an administration moratorium, but administration rarely results in company rescue. For significant restructurings the ability to cram down secured creditors and leave out of the money creditors behind is already available by using a scheme of arrangement and pre-pack administration. Iain White, partner in the restructuring and insolvency team suggests "*One could say that in the latest proposals the Insolvency Service are seeking to formalise what can already for the most part happen in practice. However, in formalising the restructuring process in this way, will it undermine the culture of informal and consensual restructurings which seem to work so well especially for debtors of a significant size and complexity?*" Is the reason that small and medium size businesses do not succeed in restructuring, purely attributable to a lack of available formal techniques to facilitate the process? Or is the failure a result of the prohibitive costs of restructurings. If it is a question of cost, then informal workouts, which are currently available, may continue to provide the best solution.

John MacLennan, partner in the restructuring and insolvency team adds "*While the proposals may offer an incentive for creditors to arrive at a consensual deal, if they do not agree, creditors could find that a formal solution is imposed upon them. So whilst bringing certainty for debtors in distress, this may be achieved at the expense of creditors and counterparties. Creditors and counterparties may find themselves obliged to support distressed debtors when they may not wish to do so. Therefore the creditor and counterparty protections (including the fact that the debtor is supervised, by an independent insolvency practitioner, lawyer or accountant, who must consider the viability of the restructuring and ensure that the debtor is not abusing the protections) may ultimately offer little comfort*". In further challenging the favourable secured creditor environment, the suggested approach to make available more funding can also be seen as a move towards the debtor friendly environment. While this may potentially increase funding for businesses which are in distress, it is not difficult to see that it could have a direct impact on the cost and even the availability of funds outside of distress. This seems somewhat at odds with the overall intention of making Britain the best place to start and grow a business.

Need for change?

Initiating changes at a time when arguably we have one of the best insolvency regimes in the world could be seen as high risk. The UK's established regime benefits from a certainty and transparency and may not lend itself to bolting on ideas from other regimes. In taking much of the inspiration from the US Chapter 11 model, it is worth noting that Chapter 11 is essentially a court driven process, which is often perceived as expensive and time consuming. Introducing aspects borrowed from other regimes may have a negative effect on the predictability of the existing regime. For example France and German both adopted US style reforms a few years ago including cram down, the continuation of contracts, and certain aspects of DIP finance. The statistics there do not necessarily show an increase in successful restructurings and in fact in France, the availability of the more formal rescue procedures has resulted in more companies restructuring out of court! David Towers, partner in the restructuring and insolvency team concludes "*The Insolvency Service seems to acknowledge in the consultation paper that the mere existence of more debtor friendly protections being available in the UK, may encourage creditors to come to a consensual deal instead. If the intention is that by making the regime tougher on creditors, it acts as a deterrent to avoid formal restructurings altogether, it seems to be advocating the introduction of a legislative framework that it hopes will be little used!*"

Contacts

Adrian Cohen
Partner, London

E: adrian.cohen
@cliffordchance.com

Philip Hertz
Partner, London

E: philip.hertz
@cliffordchance.com

John MacLennan
Partner, London

E: john.maclennan
@cliffordchance.com

David Towers
Partner, London

E: david.towers
@cliffordchance.com

Iain White
Partner, London

E: iain.white
@cliffordchance.com