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New restructuring tools

With the threat of COVID-19 to businesses, the UK Government has introduced new restructuring measures, having consulted on various options for several years. The accelerated introduction of new regimes in the UK is in direct response to concerns that many businesses would enter insolvency processes if a more flexible regime was not made available. The direction of travel in EU and UK restructuring regimes is to take on aspects of the US Chapter 11 model and other "restructuring plan" regimes worldwide. This paper analyses the key changes and their impact on creditors, counterparties and debtors.

The collapse of Carillion

On 15 January 2018, the UK construction and services group Carillion collapsed into compulsory liquidation, a court mandated terminal insolvency process supervised by the Insolvency Service (a UK Government department). All work on Carillion's construction sites ceased and many of its services contracts were terminated on the basis of insolvency. The value in profitable contracts was lost or diminished. Carillion was forced into compulsory liquidation because the costs of an alternative insolvency process were too high and none of the lenders to Carillion were willing to fund that cost.

In the Parliamentary scrutiny that followed, through the joint UK Government Department for Business, Energy and Industrial Strategy/Department of Work and Pensions committee, Alan Bloom of EY made a persuasive argument that Carillion's liquidation represented a failure of UK insolvency legislation to devise a sensible rescue process for businesses. He recommended that the UK should look to the alternative of US Chapter 11 to create a more sensible model for business rescue. He stated that, if such a restructuring process had been available, it may have been possible to use it in summer 2017 to save Carillion's business. Whether or not that would have proved true, it is correct to say that an insolvency process relying on state intervention is a far from ideal outcome.

Key considerations

- Creditors should make sure that all information required under finance documentation is being provided and retain good visibility on the state of the business by maintaining a good dialogue with borrowers.
- Counterparties should assess any corporate and contractual structures in light of new restrictions on termination by reason of insolvency.
- Debtors should consider the opportunities the new regimes present as well as which jurisdictions provide the best outcome for their stakeholders.

Key changes

Just two years after Carillion and with the threat of COVID-19 to businesses, the UK Government has introduced a new regime that responds to some of the criticism raised in response in the Carillion crisis. In particular, it addresses concerns that many businesses would enter insolvency processes if a more flexible regime is not made available. In this regard, the changes are very welcome.

The key changes are the introduction of the "moratorium" and "restructuring plan" regimes. It is not Chapter 11 – in particular it is missing the ability to include super-senior debtor-in-possession finance – but it represents a very significant step in that direction. It brings the UK more closely in line with jurisdictions including the Netherlands, South Africa and Brazil.

The key features of the new UK regimes are:

- Director led moratorium (stay/block) procedure preventing hostile creditor action, security enforcement and other steps while a restructuring proposal is put together.
- A block on "ipso facto" (termination solely by reason of insolvency) supplier termination provisions taking effect.
- A restructuring plan that can result in the "cram down" of dissenting creditor classes, provided creditors with an economic interest have voted in favour.

The new Dutch regime, the WHOA (Wet homologatie onderhands akkoord), in force from January 2021, has a very similar effect:

- Debtor led restructuring process.
- General stay available on request from the court.
- "Ipso facto" and change of control provisions may not be invoked against the insolvent party.
- Cram down of creditor classes available subject to a 20 per cent dividend floor.

Both regimes combine elements of US Chapter 11, UK Schemes of Arrangement and the EU Restructuring Directive, which seeks to introduce a minimum standard for EU restructuring regimes. While the UK will not have an obligation to implement the Directive following Brexit, unless agreed as part of ongoing negotiations, it is the UK Government's stated aim to have a world-class restructuring regime which takes into account international practice.

Impact on creditors, counterparties and debtors

Creditors

For creditors of UK entities, the biggest change is a loss of control over pre-insolvency steps such as the creation of a moratorium. Debtors can now propose and obtain a moratorium without notice to creditors. In practice, discussions may be ongoing with the key secured creditor groups but that may not be the case in every circumstance. Creditors should therefore ensure that all information required under finance documentation is being provided and that a good dialogue is being maintained, with a view to having good visibility on the state of the business. In the context of a restructuring plan, minority dissenting creditors have lost some of the power of their "hold-out" positions due to the ability to effect a "cram down" and so they may need to be more willing to negotiate at an early stage.

Counterparties

For counterparties, especially those involved in arrangements with layers of sub-contracting or complex contractual arrangements, the most important point is to review those in light of the impact of the restrictions on "ipso facto" termination. Numerous corporate and contractual structures rely on termination by reason of insolvency to bring inter-linked contracts to an end. Where these rights are affected, contracts may need to be re-drafted or the relevant risk tackled in a different way.

Debtors

For debtors the new regimes represent an opportunity. The moratorium is a useful tool for SMEs as well as large businesses, although doubts continue about how often it will be used. The restructuring plan is likely to be of use to larger businesses. The first restructuring plan has been completed by Virgin Atlantic and others are likely to be proposed in the coming months. Debtors will also want to consider which jurisdiction provides the best outcome for its stakeholders: the European regimes have the benefit of cross-border recognition within the EU; the UK restructuring plan has the benefit of being based on the well-tested scheme of arrangement regime and has a clear path to US Chapter 15 recognition.

Conclusion

Overall, the direction of travel in EU and UK restructuring regimes is to take on aspects of the US Chapter 11 model and other "restructuring plan" regimes worldwide. The effect of this should be to give a debtor a greater ability to lead a restructuring, moving away from the creditor-led processes more common in the UK in the past. In the context of COVID-19, this should enable debtors to propose restructurings at an earlier stage with the benefit of a moratorium in place, and prevent more good businesses from entering an insolvency process.

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