# The role of the court in debt restructuring

## 1. Introduction

Companies in financial distress face a number of options, including immediate liquidation, trading out of their difficulties, or a disposal of the assets or the business. Either of the latter options is likely to be preferable to liquidation, at least where the underlying business is sound and the company is merely financially, as opposed to economically, distressed.[1] A sale of the business to a new owner in an auction process will not always be possible or desirable, however, especially in times of financial crisis, where markets are illiquid, leading to a loss of value if assets are sold at 'fire sale' prices or, worse, if sales can only occur on a break-up basis.[2] In such circumstances, a restructuring of the company's debts can allow the company, liberated from its debt burden, to return to its business activities. A debt restructuring can be beneficial for companies, who need to be able to reshape their capital structures if they are no longer fit for purpose. It can also be beneficial for creditors and other stakeholders in the company, if they allow a company to continue and flourish rather than fail. It is not a coincidence that in the post-crisis period there has been a focus in both the EU and the UK on reforming the law in order to promote more effective restructuring options for distressed but viable companies, and it is this form of corporate rescue that will be the focus of this paper.

There are risks attached to restructuring, however, with the possibility of abuse and oppression of some parties by others during the process of restructuring. This raises the question whether and to what extent the law should be involved, and in particular what role the court should play in these issues. There are different approaches to this issue. The recent EU draft Directive regarding restructuring processes, and the EU Recommendation on which it is based, both aim to minimise court involvement.[3]

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[1] For a discussion of the distinction between financial and economic distress see DG Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 Yale Law Journal 573.

[2] See eg A Shleifer and R Vishny, 'Liquidation Values and Debt Capacity: A Market Equilibrium Approach' (1992) 42 Journal of Finance 1343. There may also be other reasons to why sales will not be possible, such as where the transfer of crucial assets to a new entity is not feasible. Outside these scenarios, sales can have some advantages over restructuring as they avoid the need for potentially costly bargaining between the company and its stakeholders: D Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Legal Studies 127.

[3] Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures designed to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final, 22 November 2016, recital 18 and Art 4(3); European Commission, Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C (2014) 1500 final, Recommendation no 8.

The English debt restructuring options include some with minimal court involvement, such as Company Voluntary Arrangements, and some with a significant role for the courts, most notably schemes of arrangement. In the US, Chapter 11 relies heavily on the role of the court. The recent debt restructuring reform proposals of the UK Insolvency Service envisage a number of changes, but, if introduced, they will undoubtedly involve an increased role for the court in order to provide protection against the additional constraints on creditors rights that are proposed.[4]

There are three different issues which raise concerns for creditors in a debt restructuring and which will be discussed in this paper. The first is the imposition of a restructuring on dissenting creditors, which introduces the potential for abuse of the dissenting minority, and, in particular, of wealth transfers between creditors. Second is the imposition of a moratorium while a restructuring is negotiated, which might lead to misuse of the process by managers wishing to prop up companies which are not viable, or may allow managers of a viable business to 'shake off' liabilities that it is capable of servicing.[5] Third, the imposition of debtor-in-possession arrangements that prefer the providers of new finance to existing creditors in this period raises concerns for the existing creditors regarding the level of their protection. The role of the court regarding oversight of these constraints on creditors' rights requires careful thought. This oversight is already well developed in relation to the first issue, particularly where the restructuring takes place by way of a scheme of arrangement. However, the court has relatively little role to play at present in the second and third issues, in part because these issues have not been significantly developed in the UK to date. This may be set to change. The Insolvency Service's reform proposals would, if implemented, make significant changes to all three areas, expanding the extent to which debt restructuring proposals can be imposed on dissenting creditors, widening and expanding the reach of the moratorium, and introducing statutory debtor-in-possession financing for the first time. The current role of the court is key to protecting creditors in a restructuring, and if these reform proposals go ahead, the court's role will need to be further developed to deal with the additional constraints on creditors' rights that these changes will entail.

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[4] Insolvency Service, *A Review of the Corporate Insolvency Framework: a consultation on options for reform*, May 2016 and see Insolvency Service, *Summary of Responses – A Review of the Corporate Insolvency framework*, September 2016.

[5] S Paterson, 'Rethinking the role of the law of corporate distress in the twenty-first century', LSE Law, Society and Economy Working papers 27/2014, 16.

2. Why is court intervention needed in debt restructuring?

Although there are many advantages to debt restructuring through contractual means, court intervention may be needed to deal with difficulties that can arise, particularly where creditors seek to disrupt the restructuring by exercising hold up rights or by seeking to enforce their claims in this period. The court's intervention may therefore be needed to promote an agreement between the parties, although the involvement of the court may then introduce difficulties of its own.

Financial restructuring is at its heart a private matter between the parties, who need to renegotiate an agreement which no longer reflects the risks against which they agreed terms. This can be beneficial to the parties, and also to the company, particularly where the company is financially distressed and the restructuring enables the company, or at least its business, to continue, unburdened by the crippling debt that had previously hung over it.[6] Courts do not need to be involved in debt restructuring. Indeed, until relatively recently, the law played little or no role in facilitating restructuring. Instead, stakeholders (creditors, and perhaps shareholders) bargained for the reorganisation that they wanted via a contractual workout. Creditors can agree ex ante on a procedure to enable a prescribed majority of creditors to bind others to any reorganisation of a company's debt, but if no such procedure is in place any change in the scope or terms of the debtor's liabilities will require the consent of all creditors whose claims are to be affected.

Given this inherent feature of contractual workouts, they operate best when the lenders comprise a small group of like-minded individuals or organisations. It is easy for a contractual workout to be disrupted by the actions of one or more creditors, even, potentially, a single creditor holding a very small amount of the company's debt. This can be done either through the creditor refusing its consent, in order to extract additional value from the company (the exercise of hold up rights), or by the creditor seeking to enforce its debt while the restructuring is being negotiated, and potentially petitioning for the company to be wound up if the debt remains unpaid. These forms of behaviour can allow individual creditors to delay or even prevent the successful agreement of a contractual workout. This may well be value destructive for the company concerned, and may have an effect on the availability and cost of

[6] See eg *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch).

capital for a company ex ante.[7] Furthermore, a process of prolonged informal negotiation, while the debtor seeks to satisfy the requirements of all creditors, can be disadvantageous, and indeed may be completely impractical if the debtor is facing an acute liquidity crisis.[8]

The law can help to deal with these difficulties, and indeed the state has an inherent interest in getting involved in these matters and seeking to promote an agreement between the parties that they are unable to reach amongst themselves, in order to promote economic growth. There are three particular mechanisms that the state may utilise to promote an agreement, namely enabling the restructuring to be imposed on dissenting creditors, imposing some form of moratorium, and facilitating debtor-in-possession financing. These mechanisms are introduced here and will be discussed at more length in sections 4-6.

First, to deal with the hold out problem, the law can put in place some mechanism by which dissenting creditors can be bound to the restructuring plan. This mechanism could be structured in various ways. For instance, it might involve the restructuring being imposed only on dissenting creditors of a particular class if the majority of that class consents, or alternatively it might allow the restructuring to be imposed on whole classes of dissenting creditors (or shareholders) in some circumstances.

Second, to deal with the possibility of one or more creditors petitioning for a winding up or otherwise seeking to assert their contractual rights against the company during the period of negotiation, some form of stay can be put in place. The need for creditors to be constrained from such action is well understood in the context of insolvency law.[9] A stay on creditor action of this kind can promote the survival of the company, or its business, maximising returns for creditors, and benefiting other stakeholders, such as employees, who depend on the continued operation of the business. In the same way that a stay is regarded as central in insolvency law, as a means of keeping the business and assets together so that they can be sold for the highest possible price, a stay can also be regarded as beneficial as a way of keeping the business and assets together long enough for a reorganisation to be effected, although such an outcome is also likely to require other elements to be present, such as the continued

[7] Ibid.
[8] S Chatterjee, US Dhillon, and GG Ramirez, 'Resolution of Financial Distress: Debt Restructurings' (1996) 25 Financial Management 5.
[9] See eg T Jackson, 'Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' bargain' (1982) 91 Yale Law Journal 857; TH Jackson and RE Scott, 'On the Nature of bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Virginia Law Review 155.

existence of adequate working capital, as discussed below. At its simplest this might simply prevent the creditor from asserting its debt claim again the company for the period of negotiation. More valuable is likely to be a stay on the initiation of insolvency proceedings and other legal process, given the impact of the commencement of such proceedings on the position of managers, on counterparties, and on the company's goodwill. The stay could even be extended further, to include a constraint on the ability of the creditor to terminate its contract with the company in this period. A stay can provide a company with a breathing space within which to try to conclude a restructuring agreement with its creditors.

Third, the law can facilitate the provision of new finance in this period by providing that such finance has priority over existing creditors' claims so as to overcome the debt overhang problem that can otherwise act as a deterrent to the extension of working capital to the company. This is another issue that the parties can arrange contractually between themselves, by way of contractual subordination, without the law's intervention.[10] Such an arrangement can also be subject to delays while negotiations occur, and the use of hold up rights to extract value, and so the intervention of the law can be, potentially, beneficial.

It is notable that the US Chapter 11 procedure, sometimes regarded as the gold standard of debt restructuring mechanisms, contains all three of these features, namely the opportunity for the restructuring to be imposed on dissenting creditors (a cramdown whereby the restructuring can be imposed on a whole dissenting class), a broad stay of proceedings while the restructuring is negotiated, and super-priority for new finance. Moreover, the 2016 European Commission Proposal for a Directive dealing with restructuring, and the 2014 EU Restructuring Recommendation on which it is based, set out minimum standards for the frameworks which Member States should have in place to enable to efficient restructuring of viable companies and these three features are at the heart of these proposals. Chapter 11 is acknowledged to have been an important influence on these proposals, although the scope of the three features is not always identical to the equivalent provisions under Chapter 11.[11] By contrast, this package is noticeably absent from English law at present. English law contains no specific

[10] See *Re Maxwell Communications Corporation plc (No 2)* [1994] 1 All ER 737.

[11] See n 3. For example, the DIP financing proposals are noticeably weaker than those under Chapter 11. For discussion of the EU's 2014 Restructuring Recommendation see H Eidenmueller and K van Zwieten, 'Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency' (2015) 16 EBOR 625, 632.

statutory provision for debtor-in-possession financing[12] (although English law does not actively prevent such provisions)[13] and no single mechanism provides the opportunity for the restructuring to be imposed on a whole class of dissenting creditors or members and has the benefit of a statutory stay. Administration provides a statutory stay,[14] but does not allow the restructuring to be imposed on dissenting creditors, while schemes of arrangement allow the restructuring to be imposed on dissenting creditors/members within a class (although not on a whole dissenting class) but provides no statutory stay.[15] Company Voluntary Arrangements have an even more limited opportunity to impose the restructuring on dissenters, as they cannot bind secured or preferential creditors without their consent, and no statutory stay for any but the tiniest companies.[16] The lack of a single mechanism offering the benefits of all three of these features, akin to US Chapter 11, has not gone unnoticed. The May 2016 proposals of the Insolvency Service regarding restructuring mechanisms recommended the introduction of precisely these three devices into English law.

The intervention of the law in these three ways can be potentially beneficial in terms of facilitating a restructuring of the company which may allow it, or at least its business, to continue. These interventions bring with them the possibility of abuse or misuse of the restructuring regime to the disadvantage of creditors. This issue is discussed next.

## 3. The need to protect creditors

Once the law steps in to provide one or more of these features, this raises the possibility of abuse or misuse of the restructuring regime to the detriment of certain constituencies. Potentially different forms

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[12] It has been suggested that section 19(5) and schedule B1 paragraph 99 of the Insolvency Act 1986 provides a potential route to post-petition financing: G McCormack, 'Super-priority New Financing and Corporate Rescue' [2007] JBL 701-732; V Finch, 'The Dynamics of Insolvency Law: Three Models of Reform' [2009] Law and financial Markets Review 438-448, although this option has not been fully explored.

[13] Indeed, options for superpriority do exist, for example, in administration, administrators have statutory powers allowing them to borrow funds and grant security over the property of a company (Insolvency Act 1986, Sch 1), and the costs of finance rank highly in the hierarchy of administration expenses (Insolvency Rules 1986, rule 2.67). However, such options are rarely used in practice, perhaps because new funding in administrations is typically provided by the existing floating charge holder, who has no need to vary their existing security, and any assets not covered by the floating charge will already be subject to fixed charges.

[14] Insolvency Act 1986, Sch B1 paras 42-43.

[15] See Companies Act 2006, Part 26, especially s 899(1) which sets out the option to impose the scheme on dissenting creditors/shareholders. These difficulties can be solved to some extent by combining schemes and administration, as occurred in *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch) as this allows for a de facto cramdown of a whole dissenting class and the addition of administration allows access to a statutory stay should that be required.

[16] Insolvency Act 1986, Part I and Sch A1.

of abuse arise in response to the different constraints on creditors' rights that the law can impose, namely the imposition of the restructuring on dissenting creditors, the imposition of a stay and the support of DIP financing. This section will examine the forms of potential abuse and then consider possible response of the law to these difficulties.

## 3.1 Potential abuse

### 3.1.1 The imposition of the restructuring on dissenting creditors

The ability of the restructuring to be imposed on a dissenting group leads to the possibility of abuse of that group by the majority and of wealth transfers between creditors as a result of the restructuring process.[17]

A wealth transfer will not arise merely because creditors dissent. There are mechanisms that can be put in place in order to protect dissenting creditors and if these operate properly, wealth transfers should not occur. For example, in schemes of arrangement, there are two protections for dissenting creditors: the fact that creditors meet in classes of those holding the same rights (and all classes must agree to the restructuring) and the oversight of the court to ensure, inter alia, that the classes are correctly constituted. As long as the classes are correctly constituted then there should not be wealth transfers from dissenting to assenting creditors since all those within the same class will get the same deal. However, once it becomes possible for a restructuring to be imposed on whole classes of dissenting creditors, the possibility of wealth transfers from the dissenting creditors to the assenting creditors arises. Take a simple scenario of a heavily indebted company which is viable but financially distressed. The senior creditors may decide to restructure the company's capital structure, perhaps by writing off the claims of the junior creditors, or by transferring the business of the company into a new entity and exchanging their debt claims for equity in the new company, leaving behind both the junior creditors and the equity holders in the old company. In such a situation, wealth transfers from the (dissenting) junior creditors (and shareholders) to the senior creditors are possible, and likely. While a cramdown of

[17] Various problems flow from wealth transfers of this kind. One is that a redistribution of wealth between the creditors might be problematic in terms of investment costs. It is difficult to fully predict, and thus price in, unconstrained wealth transfers ex ante, and consequently the control of such oppression ex post is important in terms of the cost of capital for companies.

whole classes is not possible using a scheme along, such an outcome can be de facto achieved using a scheme combined with administration, as occurred in *Re Bluebrook Ltd*.[18]

The facts of this case illustrate the potential for wealth transfers to occur. Bluebrook Ltd and two of its indirect subsidiaries were balance sheet insolvent. Rather than go into liquidation three schemes of arrangement were devised between the companies and the senior lenders. Effectively the business of the group would be transferred to a new corporate structure using a pre-pack administration and the senior lenders substituted their debt for shares in the restructured group. This would mean that the business of the group could continue, unencumbered by its debt burden. This would be beneficial for the senior lenders: as equity holders in the new structure they would benefit if the company flourished as planned. However, the junior lenders and the shareholders would be left behind in companies whose assets had all been transferred to the new group, and cut off from the possibility of participating in any future growth in the business. On the one hand, this restructuring may be regarded as enabling the rescue of a group that would otherwise fail, but at the same time this might be regarded as an inappropriate wealth transfer from the junior creditors (and shareholders) to the senior lenders? The junior lenders certainly claimed it was the latter: they sought the court's involvement, to protect them from this perceived abuse. The desire for the company to cast off these liabilities is understandable, but equally it can readily be appreciated that there may be circumstances in which this is inappropriate and an abuse of those being cut out of the opportunity to participate in the company's future growth.[19]

3.1.2 The imposition of a stay

As regards the imposition of a stay, there is a potential for this mechanism to be used by managers in circumstances in which the business is not viable, but the restructuring is being used as a way for the managers to postpone the inevitable, dissipating assets that would otherwise be available for creditors in the process. An alternative concern might be that managers of a viable business, in alignment with the senior creditors, use the restructuring to 'shake off' liabilities which it is capable of meeting, ie the restructuring might potentially be used as a means of allowing unscrupulous managers and senior lenders to benefit themselves at the expense of others (for example, imagine the scenario in *Re Bluebrook Ltd*, but where the company is not financially distressed). This might be as a result of writing off some or all of existing claims against the company, or alternatively excluding or diminishing equity

[18] [2009] EWHC 2114 (Ch).
[19] For discussion of how the court responds to this scenario see 4.2.

claims (including those with rights to convert their claims into equity) from a future stake in the "upside" of a successful company.

### 3.1.3 The facilitation of DIP financing

The provision of super-priority for new finance inevitably raises issues about the position of existing creditors. The new creditors are likely to want some assurance that they will be repaid. Of course, if there are unencumbered assets available, they can take security over them, but this is unlikely to be the case. Most likely, the desire of the new creditors for security will need to be at the expense of existing secured creditors, ie for the DIP financing to be valuable it will need to allow existing security to be overridden. The law traditionally seeks to protect those with proprietary rights and DIP financing therefore inevitably raises the issue of how the rights of the existing secured creditors are to be balanced against the need for the company to secure adequate working capital during the period of restructuring.

## 3.2 The law's response

Just as the law can solve the difficulties that can arise in a contractual workout scenario by providing these features, the law can also act to ameliorate the difficulties to which these mechanisms can give rise. There are a number of tools that the law can utilise in this regard, which are not mutually exclusive. The first is to place limits on the extent of this intervention. So, for example, the law might provide that any stay should generally only operate for a certain, relatively short space of time, in order to limit the ability of managers to misuse this tool to keep a non-viable business in existence. Second the law can set out the process to be followed, and this process can include measures intended to deter abuse. So, for instance, as in a scheme, the law might require that creditors should meet in classes of creditors with similar rights when deciding whether the approve the restructuring plan. Courts can perform an important role in mediating between these groups. The extent of the court's role may depend to some extent on the extent of the cramdown and stay. The broader the cramdown, and therefore the greater the opportunity for dissenting creditors to be bound, the greater the potential role for the court in protecting the minority from abuse. Third, the law can put in place some external party to have oversight of the restructuring in order to deal with these concerns about abuse and oppression. The courts are an obvious candidate for this role, but it is also possible for other options to be put in place,

either instead of or alongside the courts, most obviously this might involve the use of insolvency practitioners.

In insolvency procedures, such as administration, the appointment of an insolvency practitioner is crucial and it is this person, rather than the court, that is central to the process. The insolvency practitioner occupies a very particular role in such circumstances, however, displacing the managers of the company. In restructuring, there are good reasons to leave the directors in charge of the company while the restructuring takes place. In particular, directors may be expected to know the company well, and have good relationships with existing creditors which will be useful in the negotiations. In addition, leaving the directors in charge incentivises them to commence a restructuring at an earlier stage and thus potentially increases the chance of success. In a restructuring a third party is needed, not to displace the directors, but to have oversight of the process of the restructuring to ensure that abuse and oppression are avoided. The question arises whether a court or an insolvency practitioner is best suited to this role. There are some disadvantages to using courts to perform this oversight role. Use of a judge as an arbiter in such matters is expensive and potentially time-consuming. The expertise of the court may be problematic in jurisdictions which lack a level of specialisation within the judiciary. Insolvency practitioners can potentially solve these issues. However, a major potential problem with the use of insolvency practitioners in this context is a concern about conflict of interest. It is crucial for whichever external body has oversight of the restructuring process to have the confidence of the stakeholders and for all participants to have confidence that the external overseer is unbiased. Given that a crucial element of the role is to manage the conflicts that can arise between the different stakeholder groups, this perceived lack of bias is key to their satisfactory performance of this role. In this regard, academic commentators have raised the fact that there are inherent problems of conflict and bias apparent in the role of insolvency practitioners, who are repeat players in the market.[20] An insolvency practitioner is a "commercial animal hunting work"[21] and this has the potential to impact on the decisions they make. Much will depend on who has control of the appointment decision. In other contexts, we see that the senior lenders often have effective control of the appointment of the insolvency practitioner as a consequence of complex provisions in place in the inter-creditors agreements.[22] Furthermore, the directors may be aligned with the senior lenders, particularly if they are to receive equity in the

[20] See eg J Armour and RJ Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act' (2003) 1 LMCLQ 28, 36-37; V Finch, 'Insolvency practitioners: The Avenues of Accountability' (2012) JBL 645.
[21] S Paterson (2014) JCLS 359.
[22] For discussion see *Saltri III Ltd v MD Mezzanine SA Sicar* [2012] EWHC 3025 [25]-[26].

restructuring. If the senior lenders de jure or de facto have control of the appointment process, then this creates real concerns about the role of the insolvency practitioner. At the very least it impacts on the perception that they are unbiased, and thus can undermine their role in this context. No such doubts attach to the role of the court.[23] Although there are some disadvantages to utilising the courts in this context, therefore, it is suggested that the benefits outweigh the disadvantages.

Once it is determined that the court should have a central role in overseeing this process, the nature of that role still needs to be determined, as the court can potentially fulfil a number of different roles. The lightest touch position would involve the option of creditors or other parties have the right to apply to court to challenge the restructuring in certain circumstances. The court's role would thus not be a mandatory aspect of the restructuring, and may be utilised relatively rarely.[24] The second would make the court's role mandatory but only at the end of the process, by way of a decision whether to sanction the restructuring.[25] The downside of such a role is that by that stage there have been many sunk costs in the restructuring process, and the court may only have a blunt tool (to sanction/not sanction) at that time which may mean that the only option for courts facing problems of oppression is to refuse to sanction and for companies to thus have to start the negotiations again. A third option is to require the court's involvement both at an early stage in the process and at the sanctioning stage, much as happens in a scheme of arrangement,[26] enabling court oversight of the plan both at an early stage, to prevent oppression of members and creditors at that point (for example, by ensuring that they have sufficient information about the plan, and sufficient notice of the meetings, as well as ensuring that meetings are properly constituted) as well as having final say as to whether the plan should be sanctioned.

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[23] An alternative option would be to put in place a neutral third party (see eg H Eidenmueller and K van Zwieten, 'Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency' (2015) 16 EBOR 625). The difficulty with such a suggestion is that this would be a very expensive option, if the third party is not in a repeat game with any player.

[24] An example of this kind of role in practice is the right of creditors subject to a Company Voluntary Arrangement to apply to the court to challenge the CVA on the ground of unfair prejudice or material irregularity (see Insolvency Act 1986, s 6). Such applications are rare (for an example, see *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch)).

[25] See eg the European Commission's draft Directive COM(2016) 723 final which envisages a limited role for "judicial or administrative" authorities (ie not necessarily courts)(Art 4(3), namely to have oversight of any stay (Art 6) and to confirm the restructuring plan at the end of the process.

[26] It is notable that even though the European Commission's Restructuring Recommendation promotes the view that restructuring should be achieved with minimal court involvement, in order to reduce costs, it is accepted that certain aspects of its proposed restructuring regime (such as the cramdown of dissenting creditors) raise the prospect of the restructuring being used oppressively and that the court has a central role in protecting minority creditors against this eventuality: recital 19.

The nature of the court's role will potentially differ according to the nature of the potential oppression. Three different forms of potential oppression are identified in this section: (i) oppression by the majority of the minority where a restructuring can be imposed on dissenting creditors/members; (ii) misuse of a moratorium by directors to the disadvantage of creditors; and (iii) oppression of existing creditors as a result of the application and effect of debtor-in-possession financing, particularly super priority offered to new lenders in this period. Of these three issues, the first is the most familiar to English courts at present, as this is an issue with which the courts already have to grapple, most obviously in schemes of arrangement where dissenting creditors, including secured and preferential creditors, can be bound where the majority of their class approve the scheme, and whole dissenting classes may be de facto crammed down where a scheme is twinned with administration. The next section will discuss whether the courts are effective at dealing with the issues of potential oppression that arise in this scenario, and whether therefore the courts will be in a position to deal with de jure cramdown of whole classes if the Insolvency Service's proposals are introduced. The second and third issues have not been significant issues for the English courts to date, but this will change if the Insolvency Service's proposals are effected. These issues are discussed in the following sections and the need for the court's intervention to ensure creditor protection is assessed.

## 4. Role of the court in preventing oppression of the minority

Where the law allows a restructuring to be imposed on dissenting stakeholders, this raises the possibility of abuse, and in particular of wealth transfers from the minority to the majority. The broader the scope of such imposition, potentially the greater the need for the courts intervention to control potential abuse. The broadest form of such imposition in English law arises where a scheme is combined with administration, the major benefit of which is to enable a de facto cramdown of whole classes to be possible, as occurred in *Re Bluebrook Ltd*.[27] Indeed, the facts of this case illustrate the challenge for the courts, namely the need to rescue a financially distressed company that is encumbered with huge debts on the one hand, but without that rescue being at the expense of the junior creditors, and shareholders.

[27] Schemes of arrangement also lack a statutory stay and the twinning of a scheme with administration can also be used as a way of accessing the statutory stay attached to administration. However, in general schemes are twinned with a pre-pack administration, and this benefit of administration cannot be said to be the major advantage of this structure.

The law requires the court's involvement at two points in order for a scheme to go ahead: at the convening stage in order to ensure that, inter alia, the creditors and members are divided into the correct classes to decide on the scheme, and at the sanctioning stage in order to decide, ultimately, whether the scheme will go ahead. A clear role for the court to protect the minority is built into the Act: [p]arliament has recognised that it is for the court … to hold the ring between the different interests."[28] However, the legislation contains few details as to the court's role at these two stages, and much of the detail has been left to be determined by the courts themselves. This section will examine the way in which the courts have developed their role in schemes in order to determine whether the role is appropriate or needs to be re-thought.

### 4.1 The court's role at the convening hearing

The first opportunity for the court to protect creditors arises from the requirement for the court to order the meetings of creditors and members to consider the scheme.[29] The court is not concerned with the merits of the scheme at this stage.[30] Instead, the only issues that are generally appropriate to be considered at the convening hearing are the proper class composition of the scheme meetings, together with any other essential issue which, if decided against the scheme company, would mean that the court simply had no jurisdiction or would unquestionably refuse to sanction the scheme.

There is a role for the court at this stage, and recent cases have demonstrated a willingness on the part of the courts to intervene, but the role is a relatively limited one. In large part it involves ensuring that creditors receive adequate notice[31] and adequate information[32] in order to enable them to attend the relevant meetings and to vote on the scheme, and oversight of the organisation of creditors (and shareholders, if appropriate) into the correct classes.[33] There is no doubt that providing full and accurate disclosure to creditors is crucial to enable them to decide whether to attend the scheme meetings and

[28] *Re BTR plc* [2000] 1 BCLC 740, 748 per Chadwick LJ.
[29] Companies Act 2006, s 896(1).
[30] *Re Telewest Communications plc (No.1)* [2004] EWHC 924 (Ch),[2005] 1 BCLC 752, [14] per David Richards J.
[31] Adequate notice is required, but what this means in practice will vary. In *Indiah Kiat International Finance Co BV* [2016] EWHC 246 (Ch) Snowden J stated that "The more complex or novel a scheme, and the less consultation that has taken place with creditors as a whole beforehand, the longer the notice should generally be unless the matter is of great urgency because the company is in real financial distress" (at [ ]).
[32] See Companies Act 2006, s 897.
[33] For the requirement for creditors and members to meet in classes see Companies Act 2006, s 899(1).

how to vote.[34] Recent cases have emphasised that the court is not bound to accept at face value bare assertions in the evidence in relation to class composition or any other matter: "the company proposing a scheme of arrangement has a duty to make full and frank disclosure to the court of all material facts and matters which may be relevant to any decision that the court is asked to make. The scheme jurisdiction can only work properly and command respect internationally if parties invoking the jurisdiction exhibit the utmost candour with the court."[35] The court can therefore have an important and valuable role in ensuring that creditors are provided with adequate information in advance of class meetings, which can help them to spot abuse and can help them to determine whether to oppose the scheme at the convening hearing.[36]

Arguably, however, the predominant device that courts can utilise to protect creditors at this stage is to ensure that they are in the correct classes, and indeed this is vital if we wish to avoid intra-creditor wealth transfers. The requirement for creditors and members to meet in classes is one of the mechanisms by which minorities are protected in a scheme. As discussed further below, although the court has discretion to sanction a scheme, the court cannot sanction it unless all of the classes have approved it.[37] Meeting in classes of like-minded creditors or members is therefore one form of protection against intra-creditor wealth transfers. The legislation does not set out how classes are to be determined, and this has been left to the courts to develop. The starting point is the classic statement of Bowen LJ that classes should comprise those "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".[38] This statement leaves a large amount of leeway, however, depending on how broadly or narrowly the concept of "interests" is defined. It is easy to see that the greater the number of classes, the more power this provides to minorities, and by contrast the fewer the classes the more likely it is that schemes will be approved, but

[34] Further, the courts have emphasised the need for creditors to be provided with sufficient information to decide whether to attend the convening hearing. In *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch) Snowden J noted that where the proponents of the scheme wish to raise the issue of jurisdiction of the scheme at this first hearing, rather than at the sanctioning hearing, fair warning of that fact needs to be given to the creditors in order to enable them to make an informed decision about whether to attend the hearing to contest this issue.

[35] *Indiah Kiat International Finance Company BV* [2016] EWHC 246 (Ch), [39]-[40] per Snowden J.

[36] To the extent that jurisdictional issues are to be dealt with at the convening hearing, creditors will need to know about this in advance of the hearing in order to determine whether to turn up and oppose the scheme on that basis: *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch). This may require a redrafting of the Practice Statement on this issue (see *Practice Statement (Ch D: Schemes of Arrangement with Creditors)* [2002] 1 WLR 1345).

[37] See Companies Act 2006, s 899(1).

[38] *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573, 583 per Bowen LJ.

the greater the possibility that wealth transfers may occur. The trend in recent years has been towards fewer, larger, classes: "[i]f one gets too picky about potential different classes, one could end up with virtually as many classes as there are members of a particular group."[39] This approach does not deny that there may be different constituencies within a single broad class but instead envisages that the court will take account of these issues, together with other relevant factors, when deciding whether to sanction the scheme, ie it shifts the issue of protection towards the later, sanctioning hearing.

This raises the question whether this shift is supportable. On the plus side this approach provides the court with maximum flexibility at the sanctioning stage, and allows the courts to focus on the real merits of the scheme rather than allowing them to be bogged down, or fail, on the basis of "unmeritorious, technical objections."[40] On the downside, this flexibility comes with a risk that the rights of members and creditors might not be protected, and courts may be reluctant to reject a scheme late in the day, particularly where the alternative is said to be liquidation. In essence, whether this shift in scrutiny maintains creditor protection will depend on the level of scrutiny that the courts give to schemes at the sanctioning stage. This is discussed further below. Even if the level of scrutiny is appropriate, a separate issue is whether this approach increases the cost of schemes.

In considering whether creditors/members can meet as a class, one of the issues which the court will consider is the relevant comparator, which will enable it to judge the similarity/dissimilarity of creditors' and members' rights. Where the company is insolvent, for example, the starting point for determining separate classes will be the rights of creditors and members on winding up.[41] This tends to mean that the classes are relatively large and few. In *Re Hawk Insurance*, for example, the Court of Appeal held that all of the unsecured creditors had the same rights in a winding up (namely to submit their claims and have them accepted or rejected) and therefore they were treated as comprising one class, despite the fact that some had vested claims and some had contingent claims, in contrast to Arden J at first instance who thought that the vested and contingent unsecured debt should comprise separate

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[39] *Re Anglo American Insurance Co Ltd* [2001] 1 BCLC 755, 764 per Nourse J. See also *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241. For recent examples see: *Public Joint-Stock Company Commercial Bank "Privatbank"* [2015] EWHC 3299 (Ch), *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch*), Indiah Kiat International Finance Company BV* [2016] EWHC 246 (Ch).
[40] See G Moss, "*Hawk* triumphant: a vindication of the modern approach to classes in section 425 schemes" (2002) Insolvency Intelligence 41, 43.
[41] See eg *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241. By contrast, where the company is solvent, this comparator is not likely to be appropriate. In *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch), for example, Lewison J held that in such circumstances the correct comparator was a continuing solvent run-off.

classes.[42] This is likely to lead to a more classes, and thus more power for minority stakeholders, including shareholders.

It may seem surprising that a liquidation measure is adopted in a restructuring scheme situation, where the rescue of the company is being attempted, since, if the particular scheme in question is not successful, it is likely that some other form of rescue will be attempted. Accordingly, a going concern valuation might felt to be be more appropriate. This would be likely to result in a higher valuation, and therefore potentially more classes, which might help to protect creditors from wealth transfers as discussed in this section. This is an issue that is also relevant to the issue of creditor protection at the sanctioning stage and is discussed in more detail there. The courts do appear to be prepared to push the proponents of schemes on the reality of claims that the only alternative to a proposed scheme is liquidation.[43] If other rescue options are available then this may be reason to doubt the liquidation measure used to determine class composition, which might have the effect of increasing the number of classes, and thus creditor protection, at this first court hearing. A level of scrutiny on this issue might also be a means of addressing the concern that managers and senior lenders of viable companies might attempt to use the restructuring to shake off liabilities.[44]

The court can therefore have a valuable role at this first stage, in ensuring that creditors have adequate information, and ensuring that class meetings are appropriately constituted. This latter point, in particular, can have an important function in protecting creditors from wealth transfers, but in recent years the courts have reduced their role in this regard, as discussed in this section, and have instead shifted the focus of creditor protection to the sanctioning hearing. In addition, the threat of wealth transfer facing the junior creditors in *Bluebrook*, cannot be tackled using the mechanisms discussed here. The junior creditors were not parties to the schemes in *Bluebrook*, so the questions of whether they had sufficient information, or of which classes they should be participants, did not arise. The starting position in a scheme is that only those whose rights are being affected by the scheme need to be part of it. Companies do not need to include all members and/or creditors in a scheme, and are

[42] [2001] BCC 57.
[43] See eg *Indiah Kiat International Finance Co BV* [2016] EWHC 246 (Ch).
[44] Notably, and in contrast to the current position in English schemes, the EU Restructuring Recommendation envisages a restructuring only being available where the company is "in financial difficulties when there is a likelihood of insolvency": Restructuring Recommendation, recommendation 6(a) and recital 16.

generally free to decide with whom they propose any particular compromise or arrangement.[45] It is common for companies to exclude certain creditors from a scheme, such as the trade creditors. Where members or creditors are excluded from a scheme, their rights are unchanged by it. In a situation, such as that in *Bluebook*, the junior creditors were being left behind in the original group companies. Their rights against those companies were identical before and after the schemes in formal terms, and therefore their rights were unaffected by the scheme. The view could be taken that the transfer of the business and assets of the old group companies to the new group structure could be regarded as impacting on the position of the junior creditors in a material sense. Nevertheless, the judge in *Bluebrook* agreed that the exclusion of the junior creditors from the scheme was appropriate in these circumstances. The issue of whether the junior creditors had been treated unfairly as a result of this transfer of the business and assets to the new group companies via the schemes depended on whether the junior creditors had any remaining economic interest in the group before the scheme occurred; if not, then the transfer of the business and assets in this way cannot be said to worsen their position. However, this was a matter to be dealt with not at the convening hearing but at the sanctioning hearing, where questions of fairness are decided and those affected by a scheme, such as the junior creditors in *Bluebrook*, have the right to appear.[46]

Consequently, the convening stage is not toothless as a protective device for minorities,[47] and the EU Commission's desire to minimise court involvement in restructuring, in particular at an early stage in the process, should be resisted. Nevertheless, the court's protective effect at the convening hearing, certainly post-*Hawk Insurance*, is relatively limited, and its usefulness as a mechanism to provide meaningful protection for creditors concerned about wealth transfers as a result of a cramdown across classes, is doubtful. Instead, the tendency has been to encourage these issues to be debated and considered at the sanctioning stage. As discussed, this can have advantages in terms of maximising the court's flexibility, but this then requires the courts to exercise their scrutiny function at the sanctioning stage appropriately.

### 4.2 The court's role at the sanctioning hearing

[45] *Re British & Commonwealth Holdings plc (No 3)* [1992] 1 WLR 672.
[46] See eg *MyTravel Group plc* [2004] EWCA Civ 1734.
[47] See eg *Indiah Kiat International Finance Co BV* [2016] EWHC 246 (Ch) in which concerns regarding, inter alia, lack of notice and deficiencies in the evidence provided prompted Snowden J to grant a dissenting creditor's application for the hearing to be adjourned, and the scheme did not subsequently proceed.

The court is concerned with two distinct issues at the sanctioning stage. The first is practical and procedural: does it have jurisdiction to sanction the proposed scheme? The court will wish to ensure that the statutory provisions have been complied with, so that the correct class meetings were in fact held, and each class approved the scheme by the requisite statutory majority.[48] The court will also be concerned to ensure that the scheme falls within the proper scope of Part 26 of the Companies Act 2006, so that, for instance, where the company involved in the scheme is a foreign company, the court will want to determine whether there is a sufficient connection between the scheme and England.[49] While this scrutiny is valuable, it is the second limb of the court's role at the sanctioning stage that is the focus when considering the avoidance of oppression via wealth transfers for creditors such as the junior creditors in *Bluebrook*, namely whether the court considers it appropriate to exercise its discretion and sanction the scheme.

The court's sanctioning role is not a rubber-stamping exercise. The mere fact that the court has jurisdiction and that the statutory requirements have been fulfilled, and the class meetings have approved the scheme by the requisite majority, does not mean that the court will necessarily sanction it. The fairness of the scheme is a relevant factor here. So, the court might examine issues such as the size of the turnout and whether the result of the vote might have been affected by collateral factors, such as where members or creditors have special interests, distinct from those of the class as a whole.[50] These matters are particularly important given the tendency towards fewer classes, so that classes might well contain those whose rights are identical, but whose interest in the outcome of the scheme diverge considerably. These issues can be taken account of by the court at the sanctioning stage in order to determine whether the majority fairly represented the class on a vote in a scheme meeting. This can operate as an important protective device for minority members and creditors. Although we don't observe the courts failing to sanction schemes, this fact may underplay the role of the court. In practice, there are a number of ways in which the court can play a role, perhaps by providing a clear steer of

[48] Companies Act 2006, s 899(1). Unless these requirements are in place the court cannot sanction the scheme. There have been recommendations for this to be amended, so that courts could sanction a scheme despite technical defects of this kind (Company Law Review, Final Report, para 13.7) but the government has not followed these suggestions. The explanation for this appears to be a concern to protect the rights of minority creditors and shareholders: Hansard, HL, col GC 326 (28 March 2006) (Lord Goldsmith).
[49] See eg *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) [add other refs].
[50] *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch).

difficulties at an early stage, such that a scheme does not proceed to the sanctioning hearing,[51] or possibly the deficiencies are corrected before sanctioning is sought,  and the very clear steers provided by the court as to the requirements that are necessary before a scheme may be sanctioned may act to deter schemes which do not fall within these parameters.[52]

These issues, though, do not directly address the concerns raised by the junior creditors in *Bluebrook*, who were not parties to the scheme at all. However, the court can and does take account of third party interests at the sanctioning stage, and it was determined in *Bluebrook* that the sanctioning hearing was the right time for the concerns of the junior creditors to be aired. The junior creditors are not left without a remedy: they are able to attend the sanctioning hearing and to assert that the scheme is not fair to them. The extent to which their concerns about wealth transfers are addressed depends, however, on the willingness of the court to take account of their concerns when determining whether to sanction the scheme.

The approach adopted by the English courts at this point is to determine whether the junior creditors (and presumably anyone subordinated to them, such as the shareholders) have any remaining economic interest remaining in the company or group. In general, the focus in English company law is on protecting the interests of the residual claimant at any given point in time. So, for example, directors are required to act to promote the success of the company "for the benefit of its members as a whole"[53] when the company is solvent, but must take account of the creditors' interests when the company is insolvent, or verging on insolvency.[54] Where the company is insolvent, the shareholders have no economic interest left in the company and therefore they should not be able to block a restructuring scheme, or be able to extract value from the senior creditors as a result of this blocking power. Similarly, where the subordinated creditors are clearly out of the money, they should not have an ability to block the scheme. In other words, the current approach of the courts is correct in tackling the issue of the economic interest of the dissenting class as a sanctioning stage issue, and broadly discounting the dissent of those without a remaining economic interest in the company. Conversely, where the creditors and members do retain an economic interest the court will be able to take account of their views in determining whether to sanction the scheme, even if they are not parties to it (and this is a further way

[51] *Indiah Kiat International Finance Co BV* [2016] EWHC 246 (Ch).
[52] *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch).
[53] Companies Act 2006, s.172(1).
[54] *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

in which courts can deal with the concern about companies shrugging off their liabilities at too early a stage). However, this relies on the courts being able to discern clearly whether the creditors or members in question have a remaining economic interest, and this in turn relies on an effective system of valuation.

The approach of the English courts to the issue of valuation is still in its infancy. The starting point for the English courts in deciding whether to sanction the scheme against the wishes of the junior creditor is to consider the counterfactual, namely what each creditor would get if no restructuring were agreed.[55] This is necessarily a more conservative approach that considering what each creditor would receive if the restructuring were to be successful. Often, the view is that if the scheme does not go ahead, the company's only alternative is liquidation, and consequently a liquidation valuation is applied to the company to determine whether the junior creditors (and shareholders) have any remaining economic interest.[56] In the same way, as discussed, when determining classes in schemes the courts also tend to concentrate on a liquidation model when determining the similarity or dissimilarity of creditors rights where the company is financially distressed.

This issue is important as it goes to the central question of what level of protection creditors can expect in a restructuring. The court's criteria for intervention at the sanctioning stage is based on a fairness criterion, but determining what is fair in this context depends to a large extent on the courts approach to this issue. A going concern valuation should generally be higher than a liquidation valuation.[57] An approach that uses the liquidation comparator will provide less protection for junior creditors concerned about wealth transfers as compared to a going concern valuation which acknowledges that there are likely to be alternatives to the scheme other than liquidation in many cases.

Indeed, for many companies the alternative to a restructuring via a scheme will be an administration sale of the business and assets as a going concern, or possibly some other form of reorganisation, rather than a liquidation sale of the assets on a break-up basis. In *Bluebrook* Mann J did value the company on

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[55] *Re Marconi Corp plc* [2003] EWHC 1083 (Ch).

[56] A liquidation methodology was used in *Re Tea Corporation* [1904] 1 Ch 12, *Re Telewest Communications Plc* [2004] EWHC 924, *MyTravel*.

[57] See M Crystal and R Mokal, "The Valuation of Distressed Companies- A Conceptual Framework" (2006) 3 International Corporate Rescue 63 (Part 1) and 123 (Part 2); J Westbrook, "The Control of Wealth in Bankruptcy" (2004) 82(4) Texas Law Review 795, 811.

a going concern basis. However, Mann J's decision on this point should be treated with care, since the liquidation valuation was not argued before the court[58] and, moreover, the judge did not state that the going concern basis was the correct valuation methodology to be applied whenever a debt restructuring of this kind occurs, merely that it was appropriate in the case before him. It is unfortunate that a more rigorous discussion of these issues did not take place in *Bluebrook*. In a situation where the company is only financially distressed, a going concern valuation will generally be more appropriate than a liquidation valuation. The latter will be most relevant where the company is economically distressed. Where the assets have a higher value if kept together as a functioning unit than if sold off piecemeal, a going concern valuation will more accurately reflect the reality of the situation.[59] The going concern approach was therefore the correct approach to adopt in *Bluebrook*, and should similarly be used in the future where the restructuring involves an economically viable entity.[60]

There is an opportunity here for the senior lenders (with whom the management of the business being reorganised may be aligned if they are being offered equity in the new entity) to press for a liquidation valuation which will reduce the possibility that junior creditors will be judged to have any remaining economic interest in the business, and therefore make it more likely that the restructuring can go ahead without their consent. There is another potential effect of such an argument, namely that being told that unless the scheme is sanctioned the business will necessarily fail puts significant pressure on the courts to sanction the scheme. Courts need to be prepared to resist this pressure and to determine whether this rhetoric is really justified, in order to protect the interests of junior creditors (and shareholders). There is some evidence that the courts are starting to do this.[61]

Even once this issue is resolved, a further issue arises in relation to valuation that can have an important effect on the court's ability to protect minorities, namely how the going concern valuation is to be determined. One option is a market price valuation of the business. This is arguably the most accurate measure of a company's worth at a given time.[62] The benefit of this option is that it can be established

[58] Counsel for the senior creditors did not need to argue for a liquidation basis for valuation, because the other valuations were sufficient to justify their arguments.
[59] See, eg J Westbrook, "The Control of Wealth in Bankruptcy" (2004) 82(4) Texas Law Review 795.
[60] It has been argued that the going concern valuation is likely to be the correct methodology to apply in all these debt restructurings: M Crystal and R Mokal, "The Valuation of Distressed Companies- A Conceptual Framework" (2006) 3 International Corporate Rescue 63 (Part 1) and 123 (Part 2) who argue, therefore, that a going concern value should also have been adopted in *MyTravel.*
[61] *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch) per Snowden J at [24].
[62] See DG Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 Journal of Legal Studies 127, 136.

through a properly conducted sales process and thus avoids the subjectivity inherent in the other major option, namely market valuation opinions provided by a valuer. Such market valuation opinions often lead to costly and lengthy valuation fights which each party hiring their own valuer to provide an opinion that supports their position. This is also messy and difficult for the courts to mediate, unlike a market testing process which provides a clear benchmark for the court. The market valuation approach has many advantages, but comes with one significant problem from the point of view of junior creditors, namely that if the market is depressed at the time of the valuation then it may be difficult to establish a genuine auction process and this is likely to reduce the valuation and allow the senior lenders to recover more than they deserve once markets recover. If senior lenders are able to take advantage of a temporary dip in market conditions, then this risk becomes all the more concerning. Cutting out the junior creditors (and shareholders) from the picture at the bottom of the market is therefore a risk. This danger was recognised by Mann J in *Bluebrook*.[63] In the event, this was not an issue in *Bluebrook*, as all of the valuations Mann J looked at fell well short of the senior debt, including where the market valuation stripped out the "alpha factor" so that the valuation was not linked to current market conditions. It is an issue for the future, however.

It is suggested that the courts are the right body to determine this issue of valuation[64] but that a more structured approach is needed, and courts will need to oversee this process carefully in order to ensure that wealth transfers do not occur between stakeholders, particularly from the senior to the junior lenders.

### 4.3 Introducing a de jure cramdown into English law

Combining schemes and administration, as in *Re Bluebrook*, allowed a de facto cramdown of the junior creditors. There are some disadvantages to having to utilise these combined mechanisms to achieve this end, however. In particular, this compromise solution requires a transfer of the business of the company or group, something which is costly and cumbersome, may have tax implications and can be problematic if the creditor agreements impose constraints on the ability of the company to transfer. It is notable that the Insolvency Service's May 2016 proposals envisage a de jure cramdown option within a single mechanism, whether that is achieved via an adjustment to an existing restructuring mechanism or the

[63] *Re Bluebrook*, [49].
[64] Cf S Paterson, 'Bargaining in Financial restructuring: Market Norms, legal rights and regulatory standards' (2014) JCLS 333, who argues that insolvency practitioners should play a more prominent role in this regard.

introduction of a new standalone restructuring plan.[65] Such an innovation is to be welcomed, but this would cement into English law the most significant opportunity for intra-creditor wealth transfers to take place and therefore the issues highlighted above will need to be tackled.

The courts have a developed role in this regard, and the Insolvency Service's proposals envisage the court having a very similar role in relation to a de jure cramdown as exists in the de facto cramdowns that exist at present, both overseeing the organisation of creditors and members into classes, and then, determining whether the restructuring should be sanctioned. Issues of valuation will be key. This is an issue about which the Consultation Paper has relatively little to say,[66] and it adheres to the liquidation valuation as the minimum valuation test which, as discussed, will not be appropriate in all circumstances.[67] The Insolvency Service's proposals do not adequately address the concern about wealth transfers, therefore. This is an issue which respondents to the Consultation Paper have highlighted as a contentious topic, with over a quarter suggesting that liquidation is not the right comparator, and that a 'next best alternative' value should be used instead. [68] Further clarity and guidance on this issue would be valuable. Considering the counterfactual is the right approach, namely what each creditor would get if no restructuring were agreed, but there should be a movement away from a liquidation valuation in all circumstances, towards some "next best alternative" or equivalent model, and the courts need to be prepared to challenge companies and senior lenders on this point. It is also suggested that a market valuation is the right approach, for the reasons set out above, although this needs to be utilised with sensitivity to take account of situations where the market is depressed, and to avoid senior lenders taking advantage of sudden and temporary dips in the market valuation of a company.

5. Role of the court where a stay is proposed

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[65] Insolvency Service, Consultation Paper, May 2016. One option contemplated by the Insolvency Service is an amendment to CVAs to make this possible (para. 9.14). However, the Consultation Paper envisages the introduction of various creditor protections to accompany this cramdown and these are very similar to those that currently exist for schemes (creditors grouped into classes to vote on the restructuring, the same majority approval level as in a scheme, two court hearings, to approve the classes and then to sanction the plan). These don't fit within the CVA model and it is suggested that the introduction of a de jure cramdown would be preferable as an adjustment to the current scheme jurisdiction, or as a new standalone mechanism.

[66] Paras 9.33-9.35.

[67] Para 9.20. This may be contrasted with the EU Commission's proposals in COM(2016) 723 final which advocate the use of a going concern valuation where a cross-class cramdown takes place: Art 13.

[68] Insolvency Service, Summary of Responses: A Review of the Corporate Insolvency Framework, September 2016, para 4.10.

As discussed in section 2, a stay of some kind can be very beneficial to a company undergoing a debt restructuring, to provide it with a breathing space within which to negotiate the reorganisation with its creditors, but the introduction of any such stay needs to be balanced with the need to protect those whose rights are being suspended. The reduction or removal of contractually-bargained for rights requires justification. If the moratorium results in a rescue for a company, this will generally be a beneficial outcome for creditors, compared to liquidation. If, however, directors use the moratorium to prop up an economically distressed company and the "breathing space" simply means that the company goes into liquidation later, and with less money available for distribution, then this will be problematic. The court has a relatively limited role in this context at present, in large part because a statutory moratorium only arises in two circumstances, namely administration and very CVAs of very small companies; no general restructuring moratorium exists in English law at present, although the Insolvency Service's 2016 proposals recommend its introduction.[69] If these proposals are adopted, the court's role will need to expand significantly.

### 5.1 The role of the court at present

At present, a statutory stay attaches to administration, and to CVAs when these are used to restructure the debts of very small companies. Of the two scenarios in which a statutory stay can arise, the most significant in practice is that attaching to administration. The small company moratorium in CVAs is naturally limited by the very small size of companies that can make use of it, namely a company which satisfies two or more of the requirements for being a small company specified in section 382(3) of the Companies Act 2006, and is not a company excluded from eligibility for a moratorium.[70] Furthermore, no such moratorium will arise unless the terms of the CVA so provide, and in a recent study Professors Frisby and Walters found that only 1% of those small companies that could have made use of such a moratorium actually chose to do so.[71] By contrast, the statutory stay that arises in administration is very significant in practice. The statutory stay that attaches to administration arises automatically. It is a moratorium on insolvency proceedings and on other legal process. A creditor can however apply to

[69] For discussion see 5.2 below.
[70] Insolvency Act 1986, Sch 1A paras 2-4.
[71] A Walters and S Frisby, "preliminary Report to the Insolvency Service into outcomes in company voluntary arrangements" (2011) available at ssrn.com/abstract=1792402. Professor Goode's interpretation of this study is that the small company moratorium is a "dead letter": R Goode, Principles of Corporate Insolvency Law, 4th edn, 410.

court for leave to assert his legal claims against the company, for example to assert his security or to repossess his goods.[72] The court therefore has a key role is ensuring that the statutory stay is not operated abusively, to the detriment of creditors.[73]

The onus is on the person seeking leave, and the court will balance the legitimate interests of that individual against the interests of all of the other creditors of the company, in determining whether to grant leave and, if so, whether to impose terms on the leave. [74] The court will take account, inter alia, of the purpose for which the administration order was made, and will seek to facilitate that end but the court will relax the prohibition where it would be inequitable for the prohibition to apply. It is not a strict mechanical exercise. The person seeking leave will generally need to demonstrate loss of some kind, direct or indirect, if leave is not granted, but this may not be sufficient for the claim to succeed if a substantially greater loss would be caused to others (the remainder of the creditors, for example) which would be out of all proportion to the benefit that would be gained by the claimant. While the court will rarely grant leave where the claim is purely monetary,[75] the court is prepared to grant leave in other circumstances, for example to allow landlords to regain their property free from the shackles of an administration order. The court is therefore engaged in a difficult balancing exercise, with the protection of the legitimate interests of the individual creditor, to be weighed against the interests of the many in terms of the overall goal of the administration. This is inevitably a difficult matter, calling for a careful assessment of the interests and position of the claimant, of the company, of the purpose of the administration, of the relatively likelihood of loss to both sides should leave be granted or refused, and a number of other pertinent factors.[76]

5.2 The development of a restructuring moratorium

In June 2009 the Insolvency Service put forward reform proposals, including the introduction of a wider statutory moratorium (for debt restructurings carried out via CVAs for large companies as well as small

[72] Insolvency Act 1986, Sch B1 para 43.
[73] For the list of factors that the court will take into account in this exercise see *Re Atlantic Computer Systems plc* [1992] Ch 505, 542-544 per Nicholls LJ.
[74] *Royal Trust Bank v Buchler* [1989] BCLC 130, 135 per Peter Gibson J.
[75] *AES Barry Ltd v TXU Europe Energy* [2005] 2 BCLC 22.
[76] See eg *Magical Marking Ltd v Phillips* [2008] FSR 36 and *Funding Corp Block Discounting Ltd v Lexi Holdings plc* [2008] 2 BCLC 596 for examples of successful applications.

companies).[77] The proposals regarding an enhanced moratorium received substantial support from respondents to the consultation paper, although many respondents suggested that the moratorium should be extended to include schemes in the next iteration of the consultation process in July 2010.[78] This document developed the proposals regarding an enhanced moratorium, extending its proposals to encompass schemes and workouts as well as CVAs. However, the Insolvency Service subsequently reported that the responses to this latter consultation did not support the need for urgent change, and reform plans were shelved: "[it] is generally felt that the existing UK insolvency framework is coping and adapting well to the challenges that the current round of restructurings are posing, and the urgency of the case for introducing a new moratorium is not fully made out."[79]

One explanation for this is the development of the distressed debt market which provides creditors with an option to exit the company without the need to enforce their debt if they no longer wish to remain invested in the company. Another explanation is that creditors can agree a standstill arrangement amongst themselves. Indeed, this is common in restructuring schemes. The possibility of such an arrangement is facilitated by the fact that many schemes involve only the financial creditors (trade creditors being paid in full and therefore they don't need to be brought into the scheme). The number of creditors that need to agree to the standstill is therefore reduced and this is a sophisticated group that may be expected to appreciate that a rescue via a scheme is likely to be better for everyone than liquidation should the scheme fail.[80] However, changes in the credit market mean that it is not always straightforward to identify all of the financial creditors or for their views to be sufficiently aligned to guarantee a consensual arrangement. The fact that a moratorium is in fact needed in a scheme is evidenced by recent case law in which a judge used his case management jurisdiction under the UK's Civil Procedure Rules to stay claims brought by certain creditors while the company's creditors

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[77] Insolvency Service, *Encouraging Company Rescue- A consultation*, June 2009. Both of these issues had been discussed on previous occasions. The issue of the introduction of DIP financing was discussed when the changes to the insolvency regime were introduced by the Enterprise Act 2002 and the lack of a moratorium was raised by the Cork Report in 1982 (Report of the Insolvency Law Review Committee, *Insolvency Law and Practice* (Cmnd 8558, 1982)) and by the Company Law Review in 2001 (Company Law Review, *Modern Company Law for a Competitive Economy- Final Report*, URN 01/943, 2001).

[78] Insolvency Service, *Encouraging Company Rescue- Summary of Responses*, November 2009, paras 24-26. See also Insolvency Service, *Proposals for a Restructuring Moratorium*- A *Consultation*, July 2010.

[79] Insolvency Service, *Proposals for a Restructuring Moratorium- Summary of Responses*, May 2011, 5.

[80] An alternative explanation is that the development of the distressed debt market in the UK in the last decade or so means that financial creditors who no longer wish to remain invested in a company can exit without needing to go through the process of enforcement of their claim against the company.

considered a scheme.[81] Tellingly, the May 2016 Insolvency Service proposals do include a restructuring moratorium as part of the core package of measures,[82] and a majority of respondents to the consultation paper thought that a moratorium would promote business rescue.[83] The Insolvency Service therefore proposes a moratorium that will act as a single gateway to different forms of restructuring including a compromise with creditors, a contractual/consensual workout, a CVA, administration or a scheme of arrangement, and will covers both initial negotiations, aimed at developing a proposal, and, if needed, the time required for creditor approval of a statutory proposal.[84]

The effect of the proposed moratorium would be broadly the same as that which exists in administration, namely a moratorium on insolvency proceedings and on other legal process[85] but with one important extension. In contrast to the US Chapter 11 regime,[86] the moratorium in the UK has not, to date, extended to a general prevention of customers and suppliers terminating their contracts with the company on the grounds of insolvency alone, although some limited inroads have been made into creditors' rights in this regard.[87] The Insolvency Service's 2016 proposals recognise the value of the US approach, and expand the scope of the proposed moratorium beyond the parameters of the stay that attaches to administration at present, although the ambit of the proposals is more limited than Chapter 11.[88] In particular, the proposals suggest that companies should have the right to designate some contracts as essential contracts and it would then not be possible for these contracts to be terminated or varied during the moratorium.[89] This proposal is potentially valuable, and recognises the fact that the

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[81] *Bluecrest Mercantile NV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm). The judge held that such a stay was possible on a case by case basis, provided, among other things, that the scheme is reasonably likely to succeed.

[82] It is notable that the EU Restructuring Recommendation also includes a court-ordered stay of enforcement action as one of its "minimum standards": recommendations 6(c), 10-14.

[83] Insolvency Service, Summary of Responses, September 2016, para 2.1.

[84] Insolvency Service, May 2016, part 7.

[85] Insolvency Service, May 2016, para 7.10.

[86] See Chapter 11, s 365(e). For discussion see *Lehman Brothers Financing Inc v BNY Corporate Trustee Services Ltd* 422 BR 407 (Bankr SDNY 2011).

[87] For example, the Insolvency Act 1986 was amended on 1 October 2015 to ensure the continuity of supply of utilities and IT goods and services to insolvent businesses: The Insolvency (Protection of Essential Supplies) Order 2015 SI 2015 No. 989. See also s 233 of the Insolvency Act 1986, which provides that where a request is made by an administrator for supplies of gas, water, electricity and communications services, the utility supplier may not, as a condition of supply, require the payment of charges incurred by the company in respect of supplies provided prior to the administration.

[88] This was not a feature of the moratorium proposed by the Insolvency Service in its June 2009 Consultation paper. It is notable that the EU Commission's proposal for a Directive also contains proposals in this regard: COM(2016) 723 final, Art 7.

[89] See part 8 of the Insolvency Service's Consultation Paper.

withdrawal of vital services can reduce the chance of a successful business rescue and that this knowledge may lead some suppliers to demand "ransom" payments at the expense of other creditors. It does, however, raise the possibility of abuse by the company, designating a wide variety of contracts as "essential" in order to prevent their termination in this period.

The proposals envisage a number of protections for creditors. The court's involvement will be a crucial element of this protection, but there are others too. There are important constraints suggested on the way in which the stay would operate. For instance, a maximum of three months is suggested.[90] The intention is to provide directors with a brief respite in which to negotiate the restructuring, but for these issues not to drag on indefinitely.

In order for the moratorium to commence, directors need to propose a supervisor, and will need to ensure that the company meets eligibility and qualifying conditions. The directors can then file the relevant documents with the court and with the registrar of companies.[91] These conditions are intended to ensure that it is not misused by directors. One concern raised about potential misuse of this procedure is that it may be used by directors of healthy companies to 'shake off' liabilities inappropriately. This is addressed via an eligibility condition that the company is already in financial difficulty of "imminently" will be,[92] in order to prevent such restructurings being used at too early a stage. The other major concern is that directors of unviable businesses may use the breathing space to prop up a company that can never be rescued. The Insolvency Service's attempts to address this via qualifying conditions which include the company being able to show that it is likely to have sufficient funds to carry on its business during the moratorium, meeting current obligations as and when they fall due as well as any new obligations that are incurred. This is to ensure that existing creditors are no worse off as a result of the moratorium.[93] A further protection is the appointment of a supervisor (such as an insolvency practitioner). On commencement of the moratorium, the supervisor will need to be satisfied that the company is eligible. The supervisor will be expected to base their assessment on evidence requested from and prepared by the directors. For the duration of the moratorium the

[90] Para 7.35. An extension of this period is possible but would require the consent of the creditors (all secured creditors and 50% of the unsecured creditors): para 7.36.
[91] Ibid, para 7.14.
[92] Para 7.18. The precise meaning of this term is unclear in the Consultation Paper.
[93] Para 7.22.

supervisor's role will be to ensure that the qualifying conditions continue to be met. If they are not met the supervisor will make the creditors aware and report it to court.[94]

The court has an important role in this proposed process. The moratorium would only commence when the relevant documents are filed with the court,[95] and creditors would have the right to apply to court to challenge the moratorium.[96] The Insolvency Service proposals suggest this would only be possible in the first 28 days of the moratorium, but it isn't clear why creditors should not be able to apply at any point to challenge it. The infringement of creditor rights is significant, and providing them with the opportunity to challenge the moratorium in court throughout its existence would be a potentially valuable protection. Presumably the factors that the court would take into account at this point would be whether the company had satisfied the qualifying and eligibility requirements, as well as the kind of balancing process between individual creditors and the creditors as a whole that is currently undertaken when a creditor seeks leave to bring proceedings despite the existence of a moratorium following an administration order.

Where, however, the company proposes to designate a contract as essential (such that the creditor cannot then terminate it or vary it during the moratorium), this additional imposition on creditor rights requires a greater level of court oversight to ensure that creditors are appropriately protected. This will involve a significant constraint on creditors' freedom of contract. Provisions which entitle a counterparty to terminate a contract with the company in such circumstances (so-called ipso facto clauses) are common. These clauses form part of the commercial bargain which company's suppliers and customers negotiate with the company and are valid and enforceable in English law at present. They are potentially problematic for companies seeking to reorganise themselves, as they allow customers and suppliers to walk away at a time when the company is most dependent on their continued custom, or to use this powerful lever as a mechanism for extracting significant benefits from the company to the potential detriment of other stakeholders, particularly junior lenders who can see their holdings squeezed out.[97] Consequently, constraints on the creditors' ability to walk away can be valuable if a regime is seeking to maximise the potential for a rehabilitative rescue of the company. In the US, for example, the Chapter

[94] Para 7.43.
[95] This does not envisage a requirement for a court hearing: para 7.15.
[96] Para 7.25.
[97] This is not generally regarded as problematic in English law, see eg *Leyland Daf Ltd v Automotive Products plc* [1993] BCC 389 in which the Court of Appeal held that there was nothing objectionable about a creditor using its bargaining power to hold an administrator "to ransom".

11 moratorium renders unenforceable contractual provisions that give a counterparty the right to terminate an executory contract, or modify rights or obligations thereunder.[98] Constraining creditors' ability to utilise such clauses is controversial in the UK, however, because it is antithetical to the notion of freedom of contract, and it is notable that the Insolvency Service's 2009 restructuring moratorium proposals did not include provisions to this effect.

The Insolvency Service's proposals are a little different from the US version, as not all creditors and suppliers are prevented from terminating, only those whose services are deemed essential, which after all are the primary focus for concern regarding ipso facto clauses. Further, the invalidation of such clauses is not automatic, on the entry on the moratorium, but will require the debtor to designate the relevant contract as essential and to justify that designation in the documents filed with court to commence the moratorium.[99] The proposals build in a safeguard for the supplier, as the supplier would have the right to challenge the designation in which case the court would be required to approve the application.[100] However, this safeguard is reduced somewhat since the burden seems to be cast on the supplier to provide an "objective justification" as to why the supply should not be designated as essential. This is an issue which requires clarification.[101] Constraining the use of ipso facto clauses, and preventing vital creditors from terminating their contracts with the company in the period of restructuring can have clear benefits as a means of promoting rehabilitative rescue, but it comes at a cost to individual creditors freedom of contract. Some infringement of those rights can be justified, but only if suitable protections are put in place. These might include assurances from the company that its future obligations in relation to any contracts that cannot be terminated will be performed in full. Any payments for damages that result from the debtor's default and for future performance under such a contract should be treated in the same way as costs in administration, namely they should be repaid first by the company as an expense of the process.[102] It is also notable that there will need to be carve-outs from this provision for certain financial contracts. Most developed legal systems grant certain financial contracts special protection from insolvency laws in order to provide certainty and liquidity in

[98] 11 USC § 365(e)(1), 365(e)(2).
[99] This can alleviate the uncertainty that is sometimes seen in Chapter 11 reorganisations as the parties wait to see which unexpired executory contracts will be adopted, and which rejected, by the trustee
[100] Para 8.13.
[101] It is notable that 69% of respondents to the Consultation Paper did not agree that the proposals as drafted offered sufficient safeguards for suppliers: Insolvency Service, Summary of responses, para 3.7.
[102] See Insolvency Service, May 2016, para 7.46 as regards the suggested treatment of costs incurred during a reorganisation. It is suggested here that damages etc arising from these contracts should be treated as such a cost.

the marketplace and to reduce or eliminate systemic risk,[103] and a similar carve-out here, in particular for funding or hedging arrangements.[104]

The court has an important potential role to play, and its existing role in the stay that attaches to administration at present, set out in 5.1, demonstrates that the court is able to conduct a careful balance of the interests and position of the debtor and creditors. The current proposals of the Insolvency Service do not currently get the debtor-creditor balance quite right in this regard. Greater protection is needed for creditors, via increased court oversight, both generally during the moratorium, such as the ability to apply to court to challenge a moratorium throughout the moratorium period, and more specifically where the contract is deemed to be an essential contract by the company.

## 6. The role of the court in DIP financing

Companies continue to require financing during the period that debt restructuring is taking place, and securing such financing can increase the company's chance of survival. It can be difficult to attract new financing in this period, and for this reason some jurisdictions have included advantageous treatment of lenders who provide finance in this period (sometimes called DIP lending). For example, in Chapter 11 if the debtor can demonstrate that financing could not be procured on any other basis, the court can, subject to certain limitations, authorise the debtor to grant the DIP lender a lien that has priority over pre-bankruptcy secured creditors and a claim with super-priority over administrative expenses incurred during Chapter 11 and over all other claims.[105] DIP loans may be provided by existing lenders or by new third party lenders.

In contrast to other regimes, such as the US, the UK lacks a broad and long-established market in specialist rescue finance. No statutory provisions presently exist in the UK which specifically relate to this issue,[106] but neither does UK law actively prevent such provisions. Indeed, options for super priority

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[103] The special protection currently granted to financial contracts under English law may be seen in Part VII of Companies Act 1989, the Financial Markets and Services (Settlement Finality) Regulations 2001, Financial Collateral Arrangements (No 2) Regulations.

[104] Chapter 11 provides safe harbour provisions for certain financial contracts, which protect a qualifying counterparty's contractual right to terminate those contracts from the automatic stay in § 365(e)(1).

[105] 11 USC § 507(b).

[106] It has been suggested that section 19(5) and schedule B1 paragraph 99 of the Insolvency Act 1986 provides a potential route to post-petition financing: G McCormack, 'Super-priority New Financing and Corporate Rescue'

do exist, for example, in administration, administrators have statutory powers allowing them to borrow funds and grant security[107] over the property of a company, and the costs of finance rank highly in the hierarchy of administration expenses.[108] However, such options are rarely used in practice.[109] The introduction of DIP financing is by no means a straightforward issue, however, given the need to balance the interests of the debtors and new lenders with those of existing creditors. In particular, the introduction of such provisions might dissuade some lenders from providing finance for companies in the first place. Reform in this area will unfortunately not be merely a case of copying the provisions that have been successful in other jurisdictions. What works in the US, for example, in unlikely to be successful in the UK given the different legal frameworks (the US is generally regarded as more debtor-friendly than the UK), the different nature of the court systems and distinctions in prevailing business cultures and practice.

The Insolvency Service's proposals in June 2009 included proposals for the introduction of a form of DIP financing.[110] These proposals proved problematic. Respondents raised particular concerns as to how the rights of existing secured lenders would be protected and what the effects of the proposals would be on broader lending to businesses in general. The lack of any guidance as to what might constitute "adequate protection" when putting super-priority funding in place was specifically highlighted. Accordingly, the DIP financing proposals did not appear in the next iteration of the consultation process in July 2010.[111] They were however brought back onto the agenda by the Insolvency Service in May 2016.

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[2007] JBL 701-732; V Finch, 'The Dynamics of Insolvency Law: Three Models of Reform' [2009] Law and financial Markets Review 438-448, although this option has not been fully explored.

[107] Insolvency Act 1986, Sch 1.

[108] Insolvency Rules 1986, rule 2.67.

[109] It has been suggested that this is because new funding in administrations is typically provided by the existing floating charge holder, who has no need to vary their existing security, and any assets not covered by the floating charge will already be subject to fixed charges.

[110] Insolvency Service, *Encouraging Company Rescue- A consultation*, June 2009. Both of these issues had been discussed on previous occasions. The issue of the introduction of DIP financing was discussed when the changes to the insolvency regime were introduced by the Enterprise Act 2002 and the lack of a moratorium was raised by the Cork Report in 1982 (Report of the Insolvency Law Review Committee, *Insolvency Law and Practice* (Cmnd 8558, 1982)) and by the Company Law Review in 2001 (Company Law Review, *Modern Company Law for a Competitive Economy- Final Report*, URN 01/943, 2001).

[111] Insolvency Service, *Proposals for a Restructuring Moratorium*- A *Consultation*, July 2010.

The Insolvency Service put forward a number of options, many of which have been advanced previously.[112] These include super-priority for rescue finance in administration expenses, something that was proposed in the 2009 Consultation Paper and which was generally felt to be likely to have a modest impact given that administration expenses are generally discharged in full. Another suggestion is the ability to override negative pledge clauses in certain circumstances in order to enable a distressed company to grant security for new finance. The 2016 Consultation Paper offers as an alternative option the ability of the company to grant security to new lenders over company property already subject to charges, where that new security might rank as an additional but subordinate charge on the property, or possibly as a first charge on the property (where the existing holder does not object), and, further, where the assets against which the new charge is secured prove insufficient to discharge the amount owed, any shortfall would rank above preferential and floating charge holders. The devil with all such proposals is generally in the detail, something which is largely absent in the Consultation paper, and the need to demonstrate that existing creditors are protected. The major concern here is the situation is which existing security is overridden. If the introduction of DIP financing is to be meaningful, it is likely that this will be needed, in order to persuade new creditors to invest in the company whose assets are already encumbered. Yet, this raises real concerns about the protection is existing security holders, and the possibility that eroding their protection will act as a disincentive for them to invest in the first place or, more likely, it will have the effect of raising the cost of borrowing for companies.

The US Chapter 11 provisions include a significant role for the court in ensuring that existing creditors are appropriately protected if the DIP financing provisions are utilised.[113] If the company already has secured debt, to borrow funds secured by a lien equal or senior to the existing lender (often called "priming" the existing lender), the company will either need the existing lender to consent or will have to convince the Bankruptcy Court that the existing lender’s lien position will be "adequately protected".[114] It would be important to build in a similar role for the court in English law were these provisions to be introduced. In practice this seems to be unlikely to occur. Indeed, the responses to the Consultation Paper suggest that it is unlikely that these proposals will be advanced. Of the respondents

[112] Insolvency Service, May 2016, part 10.

[113] For example, the company must seek the approval of the Bankruptcy Court for the DIP financing: 11 USC §364. If the company already has secured debt, to borrow funds secured by a lien equal or senior to the existing lender (often called "priming" the existing lender), the company either will need the existing lender to consent or will have to convince the Bankruptcy Court that the existing lender’s lien position will be "adequately protected": 11 USC §364(d).

[114] 11 USC §364(d).

to the Consultation Paper who commented on rescue finance, 73% disagreed with the proposals.[115] Many respondents highlighted the fact that a lack of rescue finance rarely prevents business rescue, and that as long as a business is truly viable, there is no shortage of funding available.

## 7. Conclusion

The law can have an important role in facilitating successful corporate rescues by constraining creditors' rights in various ways. The law also needs to act to ameliorate the consequential creditor abuse and oppression that can arise, however. The court has a central role in this regard. The main danger facing creditors at present arises from the fact that restructurings can be imposed on dissenting creditors. The courts have developed successful mechanisms for tackling the potential oppression of minority creditors that can arise as a result, but more attention needs to be given to the issue of valuation, and the courts need to be vigilant so as to ensure that restructurings are not used inappropriately as a means of transferring wealth from the junior creditors, and shareholders, to the senior lenders. The other concerns raised by this paper, namely issues arising from a moratorium imposed during restructuring and from DIP financing options, raise fewer concerns for creditors at present given the under developed nature of English law on these topics. This will change if the Insolvency Service's proposals are implemented, at which point the court's role in protecting creditors from possible abuse will need to be expanded in order to ensure that creditors, particularly minority creditors, are protected appropriately during the restructuring process.

[115] Insolvency Service, Summary of Responses, para 5.2.