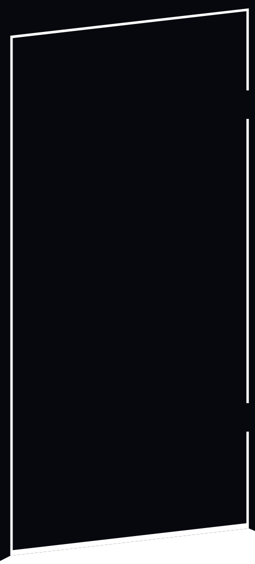

Close, but no CIGA

Howard Morris speaks to restructuring and insolvency stakeholders far and wide to gather their views on the new Act.

In welcoming the Corporate Insolvency and Governance Act 2020 (CIGA) reforms Mark Byers of Grant Thornton cautioned me not to expect altruism. But altruism is really what the corporate rescue culture is about: it calls for some stakeholders to act at their own expense in order to benefit another. Of course, Mark is right – it can't be altruism if it is compelled and enforced by rules such as CIGA.

Over the last couple of months, I've been speaking to people inside and outside of the restructuring and insolvency industry to see how CIGA is viewed.

CIGA, running unopposed?

No one I spoke to opposes the reforms. The well-known academics, Professor Christoph Paulus of The Humboldt University (now at White & Case) and Irit Mevorach, professor of international commercial law at Nottingham, echoed a lot of the respondents in expressing admiration for the speed with which the Act was drafted, debated and passed. Graham Bushby, head of restructuring advisory at RSM sees the reforms as a needed move towards debtor-in-possession (DIP) rescue procedures and thinks the industry broadly welcomes the changes, also cautioning that the challenge will be raising the additional funding needed for debtors to continue trading. The missed chance to introduce DIP funding was reiterated by Elizabeth Turner, European counsel with investment firm Castlelake. She contrasted the UK reform with what's expected from the new European directive. Elizabeth expects that the reforms will increase the cost of capital, and senior creditors will look for extra protections against the risk of cram down. Maurice Moses, the restructuring specialist, notes that we're entering a time of disruption and distress and the new measures are an important addition to what we have.

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The moratorium: old news?

I started by asking people about the *new* moratorium and was pulled up straightaway by Christoph Paulus on the point that there is, in fact, nothing new under the sun. Did I not know, he asked me, that the town charter of Freiburg legislated for a moratorium back in 1520? Geoff Carton-Kelly of FRP noted that the moratorium is an urgent solution for something that isn't, at the moment, an issue, stating that there are 'no burning platforms yet but in due course there will be'.

The big problem, Geoff said, and all of the IPs with whom I spoke agreed, is the responsibilities of the monitor. IPs can clearly see a variety of legal and practical risks. Creditors will expect them to be able to police the debtor without the power or real-time information to do so. At the same time, they will have to rely on an uncertain area of new law without the full-blooded protections many would like. Many IPs I spoke to prefer the informal forbearance approach that is common but the moratorium procedure, or the threat of one, will be useful to stop creditors breaking ranks. But, as CRO and restructuring professional David Hargrave observed, the informal forbearance approach will be tested by the ending of government support programmes, the end of the VAT holiday and the return of Crown preference. On the Crown preference point Lucy Armstrong, CEO of fast-growth business advisory firm The Alchemists and chair of UK Finance's Professional Standards Council, feels that Crown preference will have a chilling effect on funding for SMEs.

Senthil Alagar and Chris Laverty of Grant Thornton feel that the moratorium has been rushed into law, and ruefully noted that many in the profession have been struggling for years to get a debtorcontrolled rescue procedure. Others, such as Jo Hewitt and Ben Cairns of Alvarez & Marsal feel that the moratorium period is just too short. While it could be useful for an operational restructuring it has its limitations. Saro Bos of Imperial Capital noted the moratorium isn't available for a company that has issued bonds, disqualifying many companies that could make use of a stay on hostile creditor action in order to restructure. Maurice Moses observed that while a light-touch administration, of which we have seen recent instances following its first use by EY some years ago, lasts longer than the new moratorium, although it brings with it costly obligations including reporting and investigations.

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Graham Bushby, head of restructuring advisory at RSM, sees the moratorium as a useful alternative to administration but was one of the respondents puzzling about the super priority given to debts in the moratorium. This could have a serious effect on Accelerated M&As and pre-packs, which may become unaffordable. Others foresee ingenuity being brought to bear on gaming the rules about this super priority.

Before we get to the new restructuring plan, a word about the *ipso facto* rule. Again, it is welcomed but professionals are smart enough to figure out what will be the common work-around of suppliers and what has become commonplace in the US: inexplicable delivery vehicle break downs or unavailable stock. Like the moratorium it's seen as shifting the balance of power in negotiation but is not a game-changer.

Inter-creditor politics

The new restructuring plan that permits a whole class of creditor that votes against a deal to be compelled to accept it, cross-class cram down (CCCD), received the most and most varied comments.

Generally, there is disappointment that there is little sign that the procedure will cost less than a part 26 scheme of arrangement and so is out of reach for SMEs. Jo Hewitt, who worked on Virgin's restructuring, the very first use of a part 26A restructuring plan, comments that a lot of preparatory work has to be done and it will be crucial. Jim Peck, the former federal bankruptcy judge in the Lehman Brothers Chapter 11 filing and head of my firm's cross-border restructuring and insolvency practice, speaks for a number of experts with experience of Chapter 11 when he says that the Chapter's plan of reorganisation is part of a sophisticated matrix of provisions and rules to ensure protections in the use of its provisions. Rick Morris of HPS Investment Partners thinks that senior secured creditors who sit at the top of a borrower's capital structure will be alarmed at their apparent vulnerability to CCCD. In the US there is the absolute priority rule (APR) providing that a dissenting class must be paid in full before a more junior class receives any payment. Instead we are relying on a test of what is fair and equitable. Barrister Riz Mokal of South Square, an academic with a deep knowledge of the US Chapter 11 process, is sanguine about the lack of an APR. Riz observes that in Chapter 11 cases, rather like the *pari pasu* principle, APR informs the jurisprudence but issues are invariably solved through the exceptions to the rule. Secondly, notwithstanding that the UK has never had the APR rule, it has nonetheless become a prominent jurisdiction of choice for restructuring. Thirdly, the counterfactual, that no creditor class should be left worse off than it would be in the relevant alternative ensures that the only value at play is the value added or preserved by the restructuring. This doesn't soothe everyone's concerns that CCCD will be too easy to achieve and consequently investors will, as Elizabeth Turner observes, want more protections in the inter-creditor agreement and those in that top layer of a company's debt stack will be less willing to invest or want a better return for doing so.

Choosing to omit an APR won't avoid controversy, I've been told. The battlefield will be valuation. To determine which creditors can vote on the plan one must know where the value breaks and figure out if the plan meets the test of offering creditors an outcome not worse than the relevant alternative, which is what the court considers would be the most likely alternative if the plan isn't confirmed. Valuation is key. And, as Rick Morris posits, what if if the likely alternative is a restructuring in France, for senior secured creditors? Their outcome in that restructuring could be that their claim isn't then repayable for ten more years at a low-interest rate.

The English scheme of arrangement and, it is expected, the new restructuring plan are pre-negotiated before they reach the court for sanction. In contrast, the US Bankruptcy Court is traditionally closely involved in the making of a commercial deal, although pre-packed deals in Chapter 11 are more and more common. While the English courts and English judges are not at all inclined or supposed to be involved in hashing our commercial deals, they also aren't in the business of being a rubber stamp. With more plans, CCCD, and disputes about valuation, the counterfactual and fairness to be decided with little precedent to call upon, there is an expectation that there will be more litigation.

Towards a Chapter 11-ish future

The UK is a centre for international restructuring. This earns the country millions of pounds and adds lustre to the profession. The CIGA reforms bring us into line with the World Bank's endorsed global direction of travel, and towards a Chapter 11-ish future. Remaining a centre for this business post-Brexit is a goal for some and they believe that the reputation of our courts and the concentration of expertise and experience in the UK profession, along with the modernisation of our laws by CIGA, will help the UK retain its international position. While so many countries are adopting substantially similar reforms, such as the European Commission's insolvency directive requiring EU members reach the standard of a common framework and the new Dutch insolvency legislation due to become law in October, there will be competitors for restructuring assignments that might otherwise have come to the UK.

> Change is never easy, even change for the better poses challenges, but the great strength of the industry is its adaptability.

Reform isn't over. The government will be looking carefully at the effect of CIGA. But there are elements of our restructuring and insolvency regime that will attract greater interest as we wrestle with the recession and its aftermath. Dame Teresa Graham thinks that the pre-pack sale to a connected party will become a focus of attention.

Change is never easy, even change for the better poses challenges, but the great strength of the industry is its adaptability. While the tools may not be quite right to fix the problems with which we must deal, speaking with those around the industry has reinforced my view that we have the intellectual muscle and commercial chops to meet those challenges.

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