Issues for practitioners dealing with long-running insolvencies (Heis v Financial Services Compensation Scheme Ltd)

21/06/2018

Restructuring and Insolvency analysis: Can special administrators confirm the effectiveness of a company voluntary arrangement (CVA) notwithstanding substantial late filed claims which are prospective and contingent in nature? Marc Florent, partner, and Oliver Rule, counsel, of the banking, finance and regulatory litigation group at Allen & Overy LLP, look at the issues and the law in this area.

Heis and others v Financial Services Compensation Scheme Ltd and another [2018] EWCA Civ 1327

What are the practical implications of this case for insolvency lawyers advising their clients?

This was an innovative CVA designed to address a couple of classic problems facing insolvency practitioners in long-running insolvencies:

- how do you keep costs down, and
- how can you realise value for creditors when there are significant long-tail issues still to be resolved?

The solution—inviting some of the larger, more sophisticated, creditors to buy out the rest—makes practical and commercial sense. However, as shown by this case, there are a number of structural and other issues which can complicate matters and which need to be catered for.

Hard bar date

As the administrators made clear in the proceedings, the introduction of a hard bar date was important. It ensured that the 'participating creditors' (including our client, Attestor Capital) could have confidence that no new claim would emerge in the future which could undermine their position. It also forced the hand of a large potential creditor—the German Tax Authority (GTA)—to 'put up or shut up'. This potential claim had been reserved for in full and had been priced into the CVA.

However, the administrators, no doubt wishing to reduce the risk of creditors challenging the CVA on the grounds that they hadn't had long enough to prove, set the bar date more than a month after the creditors' meeting. This reduced the risk of challenges, but it also created a timing problem. The creditors approved the CVA based on one set of assumed liabilities, but (as it proved) the possibility that a new claim would emerge between the meeting and the bar date, which might fundamentally alter these assumptions, could not be ruled out.

The question at the heart of this case was whether and, if so how, the administrators had chosen to solve this timing problem. It was common ground that the participating creditors had not been expressly warned that they would be on the hook for new unanticipated claims, but nor had 'exiting creditors' (ie those who wanted to leave) been expressly warned that new unanticipated claims might preclude the CVA from becoming effective. In the event, Attestor's argument that this timing problem had been solved by the inclusion of the condition precedent prevailed.

Division of creditors

The CVA was structured in a way which, in light of the late new claim, pitted two camps of creditors, with diametrically opposing interests, against each other. Given their duties to act in the interests of all creditors, the administrators were understandably keen not to be thought of as taking one 'side' or the other. However, the CVA required them to decide whether or not to give the confirmation as to whether or not the CVA should proceed.

This resulted in a no-win situation in which the administrators found themselves assailed on all sides by creditors anxious that the CVA should fail or succeed, depending on their economic interest—not implement the CVA and the

RELX (UK) Limited, trading as LexisNexis®. Registered office 1-3 Strand London WC2N 5JR. Registered in England number 2746621. VAT Registered No. GB 730 8595 20. LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. © 2018 LexisNexis SA-SA-0918-035. The information in this email is current as of September 2018 and is subject to change without notice.

administrators would have 4,000 or so disappointed exiting creditors claiming they had failed in their duties; implement and face the threat of participating creditors accusing them of having failed to spot and raise the possibility of the late claim.

As officers of the court, administrators have the ability to ask the court for guidance on the meaning of the clause and what they should do. On this occasion, the court stepped in to resolve the matter at extremely short notice (and the speed at which it did so is a credit to the English court). However, with hindsight, clearer drafting might have avoided the uncertainty which led to this litigation.

More generally, the temptation for officeholders is to give themselves maximum flexibility in such agreements to try to cater for any eventuality. The downside of this flexibility is that it may require administrators to take decisions which in the heat of battle they may be reluctant to take.

What was the background to the case and what issues are pertinent to insolvency professionals?

MF Global UK Ltd, which was a major brokerage firm, has been in special administration for over six years and paid out over 90p in the £ to its creditors. The remaining material assets/liabilities relate to certain German tax issues. These are likely to take a long time to resolve, and potentially involve claims by the GTA against MF Global, and by MF Global against the GTA.

In November 2017, the administrators, who are KPMG partners, put forward a CVA in which a small number of participating creditors would buy out the other 4,000 or so creditors for an additional 9.75p in the £ (or £64m in cash terms). The idea was to reduce the running costs of the administration by reducing the number of creditors, while at the same time providing an exit at a fixed price for those exiting creditors who wanted to leave. The CVA included a hard bar date of 15 January 2018 to give creditors one final chance to submit their claims.

The CVA was duly approved at a meeting of creditors on 12 December 2017. However, before the CVA came to be implemented, a new claim for €126m was submitted by a previously unanticipated (purported) creditor. Although the new claim was rejected by the administrators, the rejection was appealed and will not be decided until 2019 at the earliest. If this unanticipated claim succeeds, it would be entitled to a catch-up dividend which could have wiped out the entire £64m investment of the participating creditors envisaged under the CVA.

On 23 March 2018 the administrators brought an application seeking directions from the court as to whether they should implement the CVA in the face of this new claim. The litigation took place at great speed, as it had to be resolved prior to a 'drop dead' date of 12 June 2018, at which point the CVA would terminate automatically if not implemented.

What were the main legal arguments raised?

The legal arguments centred on the meaning of a condition precedent to the CVA coming into effect. If there were 'disputed claims'—it was common ground that the new claim was a disputed claim—the CVA would not take effect, unless and until the administrators gave a confirmation that 'this would not preclude the CVA coming into effect'.

Attestor, which represented the participating creditors, argued that this clause constituted a safety value to ensure that the deal being implemented was the same as the one approved at the creditors' meeting back in December 2017—ie if an unexpected claim came out of the woodwork which altered the economics underlying the CVA, this should preclude the CVA from coming into effect.

The Financial Services Compensation Scheme (FSCS), which represented the exiting creditors, argued that the condition precedent was a technical and limited clause, focused on creditors, who had not had notice of the CVA as of the date of the creditors meeting, wanting to bring a late challenge under section 6 of the Insolvency Act 1986. They relied in particular on the fact that the other conditions precedent were mechanical in nature. They also argued that, if the clause required the administrators to exercise the sort of wide-ranging discretion contended for by Attestor, they would have expected clearer words to have been used.

RELX (UK) Limited, trading as LexisNexis®. Registered office 1-3 Strand London WC2N 5JR. Registered in England number 2746621. VAT Registered No. GB 730 8595 20. LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. © 2018 LexisNexis SA-SA-0918-035. The information in this email is current as of September 2018 and is subject to change without notice.

What did Court of Appeal decide, and why?

The Court of Appeal decided that Attestor was right. FSCS's construction (despite being the judge's preferred reading at first instance) wasn't borne out on the words of the clause—it made no reference to late challenges at all. While it could have been expressed more clearly, Attestor's construction did fit with the words used. It also fitted with the commercial purpose—to deal with the issue that the economics of the deal could be changed by a large unknown claim emerging after the creditors' meeting but before the hard bar date.

Having determined the meaning of the clause in favour of Attestor, the court decided that the fairest outcome was for the CVA not to proceed, thereby putting the parties back in the position they had been prior to the CVA and relieving the participating creditors of their obligation to pay the £64m.

To what extent is the judgment helpful in clarifying the law in this area, and what practical lessons are there to be learned?

This was a case about the meaning of a clause in a bespoke statutory contract, and as such does not represent any great legal advancement. However, it is a good case study as to the difficulties and uncertainties inherent in litigating the meaning of contracts.

Here, the Court of Appeal thought the High Court's preferred reading was 'absurd', while the reading rejected by the High Court was in fact 'obvious'. As noted above, it is also a reminder to insolvency practitioners to be careful what they wish for when reserving for themselves the power to arbitrate between groups of competing creditors.

Interviewed by Diana Bentley.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.

RELX (UK) Limited, trading as LexisNexis®. Registered office 1-3 Strand London WC2N 5JR. Registered in England number 2746621. VAT Registered No. GB 730 8595 20. LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. © 2017 LexisNexis SA-0617-25. The information in this document is current as of June 2017 and is subject to change without notice.

FREE TRIAL

The Future of Law. Since 1818.

RELX (UK) Limited, trading as LexisNexis®. Registered office 1-3 Strand London WC2N 5JR. Registered in England number 2746621. VAT Registered No. GB 730 8595 20. LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. © 2018 LexisNexis SA-SA-0918-035. The information in this email is current as of September 2018 and is subject to change without notice.