The voice of long-term investment

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Re: Consultation on Proposals for a Restructuring Moratorium

Dear Mr Vaithianathar

A About the BVCA

The British Venture Capital Association (the BVCA) is the industry body of the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms and their advisors.

The BVCA has 25 years of experience representing the UK private equity industry to government, the European Commission and Parliament, the media, regulatory and other statutory bodies at home, across Europe and around the world. It promotes the industry to entrepreneurs and investors, as well as providing services and best practice to its members.

This response has been prepared by the BVCA's Legal & Technical Committee which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry. The views set out in this response do not necessarily reflect the views of all members of the BVCA.

B Consultation Response

The BVCA broadly welcomes the proposals to introduce a restructuring moratorium as a tool to assist companies facing financial difficulty achieve a negotiated restructuring. The ability to apply for a restructuring proposal may have the effect in some cases of discouraging stakeholders from adopting a ransom position in the context of restructuring negotiations, albeit that in the case of secured creditors, the terms of the intercreditor agreement will likely include some constraints on junior creditor taking enforcement action. The availability of the procedure is likely in our view at least in some cases to save costs and promote the conclusion of a restructuring.

Before dealing with the specific questions posed in the July Consultation, we have the following more general comments and observations:

The scope of the moratorium:

In order to be sufficiently useful to companies who are not in extremis to use the proposed moratorium, it will be necessary to ensure that they can do so without substantial disruption to their business. We consider that the moratorium provisions need to be sufficiently wide in scope to prevent the initiation of the moratorium provisions operating as a triggering event enabling contracts to be terminated. Depending on the documentation, suppliers, for example, might otherwise be able to walk away from any existing contractual commitment to supply, alternatively adopt a ransom position and use this as an opportunity to renegotiate terms of supply. Similarly, licensors may elect to terminate intellectual property licences, without which the value of some businesses might be severely undermined.

As currently proposed, the moratorium would prevent meetings of the company taking place. We are uncertain why this is being proposed given that presumably in many cases it may be necessary for such meetings to take place, in order to implement and vote through the relevant restructuring plan. Presumably also company meetings will continue to be required in the ordinary course of business?

Interaction with overseas insolvency and restructuring proceedings:

It is not clear to us how it is envisaged that the restructuring moratorium would interact with other overseas insolvency processes, and whether, in particular, it is intended that the restructuring moratorium would (or could) be included as an applicable procedure under the EC Regulation on Insolvency Proceedings. If it were so included then presumably it would be included in Annex A to that Regulation. In relation to any proposed scheme of arrangement, the inclusion of the restructuring moratorium in Annex A would appear to limit the availability of the moratorium to companies with a COMI in England (where the entity has a centre of main interests in an EC Member State).

It may in the circumstances be prudent to limit the availability of the restructuring moratorium to companies having their COMI in the UK. This would mean that a restructuring moratorium would not be available in respect of all schemes where the English Court has jurisdiction and could not be sought, for example, where part of the restructuring proposals included a migration of COMI to England from another EC Member State which had not yet taken place. In our view, however, the fact that the restructuring moratorium might in practice not be available in all cases where schemes were proposed, should not be an obstacle in introducing the restructuring moratorium.

We do not agree with the restriction of eligibility criteria at Paragraph B.2 of Annex B which proposes that a company should not be eligible for a restructuring moratorium if it is a subsidiary of a company whose COMI is in another EU member state and which is in the process of being wound-up under a procedure recognised in the EC Regulation on Insolvency Proceedings 2006.

Q1: Do you agree with the expected costs and benefits of the proposals, as set out in the Impact Assessment? Are there other benefits or costs that you believe should also be considered?

A1: Whilst we consider that making a restructuring moratorium available is likely to be beneficial, we are unable to quantify what savings of costs will or may follow. Indeed in practice we consider that a pre-proposal moratorium may only be sought in a small number of cases, and where such a moratorium is sought there may be a degree of (relatively minor) interference costs whilst stakeholders consider the impact of such a moratorium. However, it is also possible that the ability of directors to retain management control might make the moratorium procedure attractive to medium sized companies, particularly those that are owner-managed. The fact that the restructuring moratorium is available is in our view in any event likely to help a greater number of companies achieve a negotiated restructuring without the need to implement the procedure.

Given that the process of applying for a restructuring moratorium itself will add to the costs of a restructuring and increase the burden on the courts, consideration might be given to whether the initiation of the process should be a court process, if the qualifying criteria can be sufficiently clearly identified. We make this suggestion as we are not clear that providing for a court application is necessarily a good use of the court's time as at the pre-proposal stage there may be difficulties in any creditor pursuing an unfair prejudice application (as contemplated at paragraph 4.4 of the consultation) when self-evidently, the terms of the restructuring have not been finalised. Provision could be included for creditors to object to a moratorium, however, on the basis that the qualifying criteria were not met and in such a case a court hearing could be convened. An alternative route would be not to require a court application unless the moratorium met with the objection of a certain value of creditors/a winding up petition had been presented so that appropriate provision could be made under S127 IA 86. If the existence of a winding-up petition was not a bar to a moratorium, the directors would have to make use of the validation procedure to continue trading unless the operation of S127 IA 86 was suspended by the process.

Q2: Do you agree that in order to help safeguard creditors' rights, a company should not be eligible for a moratorium if there is an outstanding petition for winding-up unless it has a statutory compromise proposal (a scheme of arrangement or CVA) that it is ready to put to creditors?

A2: As it is proposed that the moratorium will be obtainable on application to and subject to the discretion of the court, in our view the fact that a winding-up petition has been issued should not in itself be a reason to render a company ineligible for a moratorium. Just as is the case in an administration, the judge hearing the moratorium application should decide whether to grant the moratorium, whether or not to dismiss the petition (and any consequent S127 validation order as might be necessary) or to make a winding up order.

If the legislative provisions were to exclude companies in which winding up petitions were pending, a hold-out creditor aware of the possibility of a moratorium application could manipulate the position by tactically issuing a winding up petition to circumvent or delay the grant of a moratorium.

Q3: At the pre-proposal stage, do you agree that the two proposed qualifying conditions provide the right balance in ensuring that a moratorium is only available to companies where the core business is viable but there is nevertheless a need to restructure their debts.

A3: In principle, the proposed test that there should be a *'reasonable prospect that a compromise or arrangement can be agreed with its creditors'* and that the *'company must show that it is likely to have sufficient funds to carry on its business during the moratorium*' appear to strike the right balance to ensure the moratorium is only available to companies where the core business is viable. However, it is of key importance that the requirements of the qualifying criteria are clear, as the directors will only wish to make the application if they are confident that the application will succeed. The corollary is that if the application fails, the directors may need to consider initiating some form of insolvency procedure, so as to protect them from any claim for wrongful trading. In this regard it is noted that the *'reasonable prospect'* test echoes the provisions of S214 IA 86.

One can envisage intercreditor agreements in future seeking to prescribe an amount of support required in order for a pre-restructuring proposal to be sought, and potentially that could go so far as requiring 100 % support. This could clearly cut across the purpose of the proposed legislation. Consideration might be given to a legislative provision which rendered unenforceable a contractual provision requiring support above a prescribed level. There is an analogous provision preventing the enforcement of crystallisation provisions in floating charges in Schedule A1 IA 86. There is also a danger that if the reasonable prospect test were set at a particular or too high a threshold this would undermine the whole purpose and benefit of the moratorium as significant time and resources (hence cost) would have to be diverted to obtain support for the pre-proposal moratorium.

In the case of a pre-proposal moratorium in support of a contemplated CVA, it might be more difficult to gauge the level of creditor support – and the very act of seeking support might result in a fall away of confidence of key creditors. In practice, however, we would expect the pre-proposal moratorium to be sought more often in cases where a scheme of arrangement rather than a CVA was envisaged.

Q4: **Where a company has a proposal for a CVA or a Scheme of Arrangement and wishes to apply for a moratorium (or extend the existing moratorium), do you agree that provided the existing statutory conditions are met the only additional qualifying condition that should apply is that the company is likely to have sufficient funds to carry on its business?**

A4: Yes. In the case of a CVA the first part of the requirement is already provided for in existing legislation (S2 IA 86) save that the requirement is one which the nominee, rather than the directors, must satisfy.

In the case of a scheme of arrangement, the position is slightly different as this threshold eligibility criteria does not apply. In our view it would be extraordinary for a company to proceed with an application for a moratorium or for an extension of any existing moratorium unless its directors believed that there were reasonable prospects of success, as this would result in a huge waste of costs and could result in claims for wrongful trading or breach of duty.

Q5: **Do you agree that any extension of the moratorium during the period when a compromise proposal is still being negotiated should require a further court hearing?**

A5: On balance we consider that the monitor should have power to grant an extension providing that the qualifying criteria are still met.

Q6: **We would welcome views on whether an additional court hearing should be required for the extension of a moratorium to cover the formal approval of a CVA proposal**.

A6: We are not quite clear why this question refers only to CVAs as it is conceivable (although in our view less likely) that an extension of a moratorium might be sought pending the formal sanctioning of a scheme and the compliance with the relevant Companies Act 2006 requirements. We do not consider that an additional court hearing should be required for the extension of a moratorium to cover the formal approval of a CVA as, in the case of CVAs, IA 86 already requires strict time limits to be adhered to. In the case of schemes, we consider that the monitor should have power to agree an extension of an existing moratorium/ grant a moratorium provided that the qualifying criteria are still met, bearing in mind that the court has control of the timetable and could throw out the scheme at the first court hearing and is so able in that way to intervene in appropriate cases.

Q7: Do you agree that the proposed role of the monitor, together with the rights of creditors and the obligations on the directors, strikes the right balance in safeguarding the interests of creditors and deterring abuse, without imposing disproportionate costs or impeding the objectives of the moratorium?

A7: The role of the monitor and in particular the monitor's powers and directors' duties are not fully developed in the consultation document and further clarity on this area is essential, or the risk is that insolvency practitioners will not be willing to take such appointments. The lack of clarity in the role of the supervisor in the Schedule A1 IA 86 CVA optional moratorium provisions is widely considered to be one of the reasons (together with the expense of the procedure, relative to the company size) that those provisions have been so under-utilised.

Provision will also need to be included for the payment of the monitor's fees preparatory to and during the course of the moratorium, presumably as an expense of the restructuring/procedure and to include provisions as to how such fees are to be approved and capable of being challenged.

Q8: Do you agree with the proposals for treatment of moratorium debts in a subsequent CVA, and in any distribution undertaken in an administration or liquidation that immediately follows a moratorium?

A8: In principle we agree that in order for the procedure to be workable moratorium debts will need to be given super-priority status. Appropriate checks and balances should presumably be included within the definitions of allowable moratorium debts so that exceptional or unusual expenses cannot be cast within the provision. The debts which are allowable might be ones arising 'in the ordinary course of business', unless sanctioned by the monitor or by court (although we would caution against the use of this phrase within any statutory framework as it is a phrase borrowed from US jurisprudence.)

We would be very happy to discuss the issues by telephone or in a meeting if that would be useful.

Yours sincerely,

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cc:
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