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Finance & Transactions Insights

English Court Refuses to Cram Down the Taxman

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Summary

Since their introduction to the English insolvency regime in 2020, court sanctioned restructuring plans under Part 26A of the UK Companies Act 2006 – a new, more-flexible alternative to traditional UK restructuring tools – which take some of their DNA from U.S. Chapter 11 bankruptcy proceedings (in particular, the 'cross class cram down' mechanism), have been a hot topic for insolvency lawyers.

After an initially slow uptake, the use of restructuring plans by companies which are in financial difficulties is increasing, and 2023 has already seen several English court judgments handed down in relation to requests to sanction plans, the most recent of which is *In the matter of the Great Annual Savings Company Ltd and In the matter of the Companies Act 2006* [2023] EWHC 1141 (Ch).

In this case, a struggling English energy supply contract broker applied to the English court to ask it to sanction a restructuring plan prepared by the company's insolvency advisors of which 12 of its fifteen classes of creditor had voted to approve.

To the disappointment of the applicant company and certain of its 'in the money' creditors, the English High Court rejected the company's application to sanction the plan which would have seen, amongst others, HMRC crammed down as a dissenting creditor.

Restructuring plans and cross class cram downs – a reminder

Part 26A of the UK Companies Act 2006, which was brought in by the UK Corporate Insolvency and Governance Act 2020, enables a company that is in, or is likely to end up in, financial difficulties to enter into a restructuring plan (a compromise or arrangement) with its creditors and/or shareholders to try to mitigate those financial difficulties.

The creditors (and, where applicable, shareholders) are divided into separate classes on the basis of what the company owes them, and those classes are then asked to vote on the proposed plan. Given the context, it is unlikely that all classes of creditor will be 'in the money' under a plan.

Provided that 75% (in value) of each class votes in favour, the company can apply to the court to sanction the plan (i.e. to confirm that the company can proceed with it). If sanctioned, all classes of creditor are bound by the plan.

If the 75% threshold is not met within a particular class, the court can still sanction the plan and bind the dissenting creditor(s) (a 'cross class cram down'). This can only happen, where both of the following two conditions are met when comparing the plan with the 'relevant alternative' (the outcome the court thinks most likely in the absence of the plan,:

- **Condition A** – the court is satisfied that none of the members of the dissenting class would be any worse-off under the plan than in the event of the ‘relevant alternative’; and
- **Condition B** – at least 75% (in value) of a class of creditors (or shareholders) who would receive a payment or have a genuine economic interest in the company if the ‘relevant alternative’ were pursued had still voted in favour of the plan.

Even if the conditions are met, the court retains, as with schemes of arrangement under Part 26 of the UK Companies Act 2006, a discretion as to whether to sanction the plan on the basis of its fairness – here it will look at the fairness of the intended distributions to creditors, as compared with the ‘relevant alternative’.

Facts

The company was an English business energy supply contract broker which generated its revenue from commissions paid for brokering those contracts. Its creditors included a third-party lender, its directors, certain energy suppliers entitled to claw back commission payments, trade creditors and HMRC.

The company entered into financial difficulty during the course of 2021 and instructed insolvency prac-titioners in September 2022. The insolvency practitioners formulated a restructuring plan which was put to a vote by company’s creditors in mid-March 2023.

Twelve of the company’s 15 classes of creditor voted in favor of the plan, with HMRC being the most notable objector, arguing that (i) the company had not shown that HMRC would not be any worse off under the plan than under the ‘relevant alternative’ and (ii) in any event, the plan operated unfairly and the court should therefore use its discretion to decline to sanction the plan which was put forward.

HMRC’s main contention was that, on the company’s projections, the return to HMRC under the plan was only marginally better than the return expected in the ‘relevant alternative’, and, on the facts, there were many viable challenges to the assumptions underlying those projections meaning that a different outcome was likely, i.e. one in which HMRC was better off in the ‘relevant alternative’ than under the plan.

In concluding that the company had not discharged the evidential burden of showing that HMRC would not be any worse off under the plan, Adam Johnson J said that he had serious reservations about the figures and analysis set out in the plan which had been provided by the company.

Even taking into account the hypothetical nature of the analysis and the insolvency practitioners’ expe-rience and expertise, he did not find their work persuasive, as it relied heavily on the company’s valua-tion of its debtor book (which was near zero in the ‘relevant alternative’), without any real independent scrutiny. Overall the court was not satisfied on the evidence provided that HMRC would be no worse off under the plan.

The judge further concluded that had he needed to, he would have declined to exercise his discretion to sanction the plan, as the distribution of benefits under the plan unfairly favoured certain of the unsecured creditors, who were ‘out of the money’ in the ‘relevant alternative’, at the expense of HMRC.

The court noted that there was nothing inherently objectionable in a plan proposing a different order of priorities to the one that would apply in the ‘relevant alternative’ (as Part 26A does not seek to preserve the order of priorities that would otherwise apply in an insolvency), and this could be justified if there is good reason for it. In this case, however, the overall structure which was proposed under the plan lacked any real discernment and the re-ordering of priorities was muddled in an attempt to promote future growth which would benefit the secured creditor and the existing shareholders/connected party creditors, but not HMRC.

The fact that no new money was to be contributed and that the plan centered on achieving growth on the basis of eradication of HMRC's debt whilst prioritising payments to various unsecured creditors at the expense of HMRC was also viewed as unfair.

Insights

- The court was unwilling to simply accept the company's insolvency practitioners' analysis of the likely benefits of scheme for creditors, as compared with the 'relevant alternative', at face value, particularly where it does not appear to check or scrutinise the company's figures.
- The burden of proof for the 'no worse off' test is for the company to discharge, on balance of probabilities. There was no requirement on HMRC, as a dissenting creditor, to provide its own expert evidence to contradict the analysis of the company's appointed insolvency practitioners.
- When assessing whether a plan is fair, the court will consider the following:
  - (i) the existing rights of creditors and the impact on them in the 'relevant alternative';
  - (ii) whether the plan's proponents will make additional contributions (particularly new money); and
  - (iii) whether disadvantaging certain creditors under the plan can be justified.
- When exercising its discretion to sanction (or not sanction) a plan, the court will give considerable weight to the views of major 'in the money' creditors notwithstanding the views put forward by the majority of other creditor classes.

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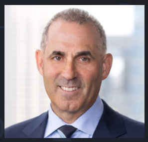

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