

Pre-packs U.K. Style, French Debt Cancellation Law

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Editor's Note: *The French advance toward reforming its jurisdiction into one more suitable to restructuring continues. Following the introduction of the sauvegard procedure, (Eurotunnel, GAL-CAT) further recent changes in France now make it simpler for public creditors—such as financial authorities, social security bodies etc.—to agree to waive debts owed by a troubled entity. This is intended to assist in the promotion of France as a venue for financial restructurings. The second of our two articles below considers these changes in greater detail.*



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Although formal U.K. insolvency proceedings are still perceived by many to be value-destructive, they can, when used in a controlled manner, enable an insolvency office holder to maximise value by carrying out a “pre-

packaged sale” of the troubled business. Sales of entire estates by office holders is not itself controversial. However, it is when such sales are effected before creditors’ meetings have been convened, which has sometimes attracted complaint from those disenfranchised by the transaction; particularly as no court sanction is required.

This is where the U.K. perhaps has an advantage to the nearest U.S. equivalent (§363 asset sales), since pre-pack sales rarely require court involvement. Instead, U.K. insolvency practitioners are required to come up with the right deal with the right purchaser at the right price and at the right time. There is no “stalking horse” procedure or statutory entitlement to break fees. English courts instead require U.K. office holders to get on with making their own commercial judgment, and there is strong case law precedent to dissuade the officeholder from attempting to substitute the court for his or her own commercial judgement. Indeed, this simplicity often comes as a shock to non-U.K. lawyers and advisors who are surprised at the freedom given to the insolvency practitioner.

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In times of readily available debt financing, formal insolvency processes have been relatively few. However, out-of-court restructurings have often required a fully credible plan for a pre-packaged sale to be in place. As such, “Plan Bs” could typically be instigated solely by the senior secured creditor, and their existence has helped to “persuade” recalcitrant parties to do a “consensual” deal. In a less-liquid environment, there will be fewer hiding places for unattractive, failing businesses, and formal insolvencies (possibly with pre-packs) might be expected to rise. Even in

a consensual deal, a pre-pack may still be used as a controlled tool to achieve the desired outcome (for example, in the recent restructuring of Polestar, the international printing group).

In our first piece below we consider a recent English decision offering further (not so tacit) support for the use of the pre-pack tool. The decision is, perhaps, surprising given the strident opposition from the majority creditor.

No Veto by Majority Creditor on Implementation of Administration Proposals

Those who have spent any time in the company of English insolvency lawyers may be familiar with the term “pre-pack sale.” For those who have not, a pre-pack sale involves the appointment of an insolvency officeholder (usually an administrator) who, immediately upon appointment or very shortly thereafter, sells the company’s assets to a purchaser on pre-agreed terms.

The pre-pack sale has become part of the insolvency landscape. However, its use is not always universally welcomed as it involves a sale of the company’s assets

without court approval and without a meeting of creditors having first met to consider the proposed sale. Often, creditors will only be aware of what has happened after the event and may feel (rightly or wrongly) that the officeholder has not spent enough time marketing the assets to obtain the maximum potential price.

A recent case in the United Kingdom, *DKLL Solicitors v Her Majesty’s Revenue and Customs* [2007] EWHC 2067 (Ch), may serve as a boost for the use of pre-packs in insolvency. The High Court held that a majority creditor does not have a veto on the implementation of an administrator’s proposals, and the court granted an administration order despite the majority creditor’s opposition. The administrators were then able to carry out a pre-pack sale of the insolvent partnership’s business.

DKLL Solicitors (the partnership) became insolvent, and its equity partners applied for an administration order. The proposed administrators planned to effect a sale of the partnership’s business to another firm of solicitors immediately upon

their appointment (*i.e.*, they planned to effect a pre-pack sale). The proposed administrators considered that this would maximise the value of the partnership’s assets, preserve employee jobs and provide continuity to the partnership’s clients and existing client matters. However, the revenue and customs commissioner (the revenue), who was the majority creditor, objected to the administration application and issued its own winding-up petition against the partnership.

The revenue accepted that the administrators had power to complete the proposed pre-pack sale without the sanction of a creditors’ meeting or a direction of the court: *Re Transbus International Limited* [2004] 1 WLR 2654. However, the revenue submitted that if a meeting of creditors were held pursuant to paragraphs 50-55 of Schedule B1 to the Insolvency Act 1986 to consider the administrators’ sale proposals, it could, as majority creditor of the partnership by value, vote against and defeat those proposals. It submitted that the court should not make an administration order where it knows that the majority creditor opposes the proposed pre-pack sale and

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would be “disenfranchised” by a pre-pack sale without a creditors’ meeting taking place. The revenue therefore objected to the making of an the administration order.

Simmonds QC disagreed with the revenue. He held that even a majority creditor does not have a veto on the implementation of the administrators’ proposals. The judge pointed out that where a creditors’ meeting is held to consider an administrators’ proposals, the court is able, exercising its powers under paragraph 55(2) of Schedule B1, to authorise the implementation of the proposals, notwithstanding any opposition of the majority creditor: *Re Structures & Computers Limited* [1998] 1 BCLC 292. The fact that the present case concerned a pre-pack sale (where there would be no meeting) should not put the proposed administrators in a worse position or the revenue in a better position.

In the exercise of the court’s discretion to grant the administration application, the interests of the majority creditors were not the only interests to be considered. Simmonds QC confirmed that, while taking into account the majority creditors’ opposition, the court can also take into account the interests of other stakeholders, not merely those of the partnership’s creditors. In this case, the saving of the jobs of employees that would be brought about by the appointment of the administrators and the subsequent pre-pack sale was a particularly relevant factor. Furthermore, while making clear that it was ultimately for the court to decide, Andrew Simmonds QC placed great reliance on the fact that the pre-pack was formed by experienced and impartial insolvency practitioners. If the court were to make a winding-up order, it was likely that the Law Society (the body that regulates solicitors in England & Wales) would become involved in order to protect the interests of the partnership’s clients. This would inevitably lead to an erosion in the value of the partnership’s business. Accordingly, Simmonds QC granted the application for an administration order.

Pre-pack sales can limit the destruction in the value of assets that would otherwise be brought about by an insolvency filing. While the administration regime envisages a creditors’ meeting to approve the proposals of administrators, this can take several months during which time value leaks away. The ability of an administrator, therefore, to

use his powers to sell the assets immediately upon appointment is a vital business rescue tool. This decision will be welcomed by the restructuring community as providing support for the use of pre-packs.

The Cancellation of Public Debts under French Insolvency Law

On July 26, 2005, prompted by the need for an overhaul of the French judicial process in insolvency proceedings, the French legislator enacted a new law (*loi de sauvegarde des entreprises*) designed to increase the options available to companies in financial troubles and to increase their chances of recovery.

The aim of the reform was three-fold: a change to the out-of-court voluntary arrangement procedure to encourage lenders to refinance a company in difficulties by granting super-priority to such refinancing (*conciliation*); the implementation of safeguard proceedings (*procédure de sauvegarde*), a kind of chapter 11 *à la française* to allow a company that is in difficulty but is not yet formally insolvent to seek court protection before it actually becomes insolvent; and speedier liquidation proceedings for small companies.

One of the mechanisms designed by the new bankruptcy law is that provided for by Article L. 626-6 of the Commercial Code, which only entered into force on Feb. 8, 2007 (pursuant to two decrees of Feb. 5, 2007).

Article L. 626-6 states that: Financial authorities, social security bodies, institutions managing the unemployment insurance system... may consent, simultaneously with the efforts agreed to by other creditors, to cancel all or part of the debtor’s debts on similar terms to those that would have been granted to the debtor, under normal market conditions, by any private economic agent placed in the same situation.

The ability for public creditors to agree to waive public debts did exist before the new law was enacted. However, its scope was much narrower. Cancellation of public debts was only possible when the debtor proved that it suffered from *financial difficulties or destitution*. Moreover, the principal amount of the debt could not be cancelled. In relation to direct taxes, only penalties or surcharges were subject to cancellation. As for indirect

taxes, any cancellation was prohibited by article L. 247 of the *Tax Proceedings Book*.

Its scope is now much wider in that public creditors may agree to cancel the debtor’s debts, even if the company is not actually insolvent, such as in the context of conciliation proceedings and safeguard proceedings.

In addition, pursuant to Article L. 626-6 of the Commercial Code, public creditors may cancel the full amount of “any directly paid taxes raised for the benefit of the state and of local authorities as well as any other amounts in the state budget payable by the debtor.” This includes local tax, professional tax and property tax, as well as social charges.

However, as far as indirect taxes (raised on behalf of central and local government authorities) are concerned, Article L. 626-6 provides that “only late payment penalties, surcharges, penalties or fines may be cancelled.”

The debtor’s request must be filed within two months of the date the proceedings were commenced.

Public debts may be cancelled only if the debtor meets certain requirements. First, the debtor should not have been charged with an illegal work-related crime for the last 10 years. Second, the amount of public debt cancelled cannot exceed three times the amount of the private debts cancelled. Third, cancellation of public debts must occur at the same time as the cancellation of private debts (and in practice, public creditors may only agree to cancel certain public debts if private creditors do so). Fourth, the order of cancellation is (1) prosecution costs, then (2) surcharges, fines and late payment penalties, and finally (3) the principal amount of the debt owed. Debts owing to affiliates will not be considered “private debts,” and in a conciliation proceeding, private creditors are limited to the ones involved in the proceedings.

Article L. 626-6 of the Commercial Code leads to greater involvement of public creditors in the reorganization of ailing companies. Equally, time is of the essence, and the debtor must assess quickly whether it wants to obtain relief from public creditors, since requests are time-barred two months after the commencement of conciliation, safeguard or insolvency proceedings. ■