Wimbledon Football Club – A Successful Outcome for a Well-Structured Voluntary Arrangement

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Introduction

Football clubs and insolvency law appear to be in many instances inseparable companions, but the recent challenge to a company voluntary arrangement proposed to its creditors by Wimbledon Football Club raises issues which go beyond the domain of football. In fact, had the challenge brought by the Inland Revenue succeeded, then many cases of so-called trading voluntary arrangements may well have been placed in jeopardy by an adverse ruling. However the Court at first instance, as well as the Court of Appeal, have made it clear that voluntary arrangements will be carefully scrutinized to ensure that they are not in some way a device to get round the Insolvency Act and Rules. That scrutiny will be very much in evidence in cases where there is differential treatment between creditors. Therefore, even those who believe that the Wimbledon case is really restricted to football clubs and the 'football creditor' rules which exist would do well to consider the further ramifications of this case.

The Football League rules and policies

The Football League has an authorized share capital of 100 shares of 5 pence each and 72 of the shares have been issued to Member Clubs. Only Member Clubs may play in League matches. The articles of the League stipulate that the Board of the League may serve notice upon the member in question requiring it to transfer its share to such person who is nominated by the Board for a nominal consideration. The Board will serve such a notice in the event that a winding-up order is made against a member club and also when an administration order is made. However the provisions of the Articles do permit the Board to suspend such a notice in the event that a member club satisfactorily exits from the relevant insolvency proceedings.

In its policy document in this regard, the League sets out the matters which are considered in a case where a member seeks to have the notice suspended or withdrawn. One of the matters which the Football League requires is the payment in full of the so-called 'Football Creditors' prior to any withdrawal of notice and also prior to any proposed transfer of the member's share to a new or another company. Article 70 of the Articles sets out who those Football Creditors are: viz. employees, former employees, players, and former players as well as other member clubs who are owed money.

Wimbledon's administration

As supporters and non-supporters of Wimbledon Football Club may be aware, Wimbledon FC went into administration (old style administration) on 5th June 2003. Originally the administrators hoped to be able to secure sufficient funding to enable the football club to survive and indeed they did obtain funding which enabled them to start the new season in August 2003. The Club was hopelessly insolvent with debts in excess of GBP 20 million. The funding the administrators obtained enabled the Club to continue in existence and more importantly to be able to start the season and play its games in the Football League. The administrators sold off players and made cuts and the Club commenced the season in August 2003. The Football League had served the appropriate notice of withdrawal of membership and then suspended it to enable the Club to commence the 2003 season on the basis that it was satisfied that the Club had secured sufficient funding to enable it to play that season.

In fact the administrators had secured a series of loans from a third party, Inter MK Limited ('IMKL'), a company who was interested in bringing football to Milton Keynes. IMKL advanced in excess of GBP 1.5 million to enable to Club to play the 2003/2004 season, which came to an end on 9th May 2004. In the meantime, the administrators had succeeded in negotiating a sale agreement with IMKL which would enable the Club to be acquired by another company and ultimately be controlled by IMKL.

The sale agreement

The terms of the sale agreement entered into on 4th March 2004 by the administrators required the payment of the Football Creditors by the Buyer, without

which the Football League would not consent to the transfer of Wimbledon's share to the new entity. The agreement provided for the Buyer to acquire the undertaking and assets, excluding book debts, cash in hand and the lease of the training ground. The consideration for the sale was GBP 800,000 (although GBP 400,000 of that was conditional upon the particular planning condition being satisfied), the sum lent by IMKL (the GBP 1.5 million), the assumption by the Buyer to pay (to a maximum of GBP 642,096.32) all 'TUPE' debts and any other Football Creditors. There was an additional consideration payable in the event that the Club succeeded in being promoted to the Premier Division before or at the end of the 2006–7 season. The sale agreement was conditional upon various matters, including that Wimbledon exited the current administration by way of a company voluntary arrangement, that Wimbledon's share in the League be transferred to the new entity and that the League would not exercise its right to compel the transfer of the share to its nominee by reason of the Club being in administration. Significantly, at no stage did the Revenue seek to challenge the sale agreement itself and the decision of the administrators to enter into the same (section 27 of the 'old' Insolvency Act 1986).

The proposed voluntary arrangement

It is significant that the company voluntary arrangement proposal did not seek the creditors' approval to the terms of the sale agreement. The administrators, in the exercise of their powers and functions as administrators, had reached the conclusion that the proposed sale was effectively the best deal they could obtain. In order to comply with the conditions of the sale agreement, the administrators proposed the voluntary arrangement. The voluntary arrangement proposal had, it was recognized by the Court, certain advantages. In so far as it was approved, then the sums which had been loaned to the Club by IMKL during the administration would not be charged as administration expenses, but instead IMKL had agreed to treat those loans as discharged. Secondly, the administrators had also agreed to place a cap on the fees which they would claim in this administration in the event that the voluntary arrangement was approved. Consequently, after the payment of some of the costs and expenses of administration, the voluntary arrangement proposed that the sums then available would produce a dividend of approximately 30 pence in the pound for the benefit of the preferential creditors. There would be no distribution for the unsecured creditors at all.

Therefore the voluntary arrangement effectively produced for the benefit of the Revenue a dividend which clearly would not be available to it in a liquidation. Upon a liquidation, there would be no sums payable under the sale agreement, and the Club's only valuable asset, its share in the League, would be transferred for a nominal consideration to another party by the League. Additionally the assets (in so far as any existed) of the Club would be charged by the fees and expenses of the administration which would include the GBP 1.5 million loan which had been made to the Club during the administration.

The voluntary arrangement was approved by a meeting of creditors and members on 18th March 2004 and the Revenue thereafter launched its challenge to the approval given to the voluntary arrangement. The hearing of both the first instance hearing as well as the Court of Appeal hearing were both expedited. The application was issued by the Revenue on 14th April 2004, the order for expedition made on 28th April 2004 and the hearing before Mr Justice Lightman was heard on 6th May 2004 with judgment given on 11th May 2004. The Court of Appeal heard the appeal on 18th May 2004 and indicated at the end of that hearing what its decision was, although its written reasons were not handed down until 28th May 2004. A great example of the Courts, Judges and lawyers moving quickly when necessary!

The issues raised by the voluntary arrangement challenge

Section 6 of the Insolvency Act 1986 provides disgruntled creditors (as well as the company itself) with the mechanism for challenging decisions taken at meetings of the company and creditors which have either approved or rejected a proposal for a CVA. Such challenges have to be either on the basis that the voluntary arrangement which has been approved unfairly prejudices the interests of a creditor, member or contributory of the company or alternatively that there has been some material irregularity at or in relation to the meeting. Section 4(4) sets out limitations on the approval of a CVA by setting out restrictions upon such approval, for example section 4(4) prevents a CVA from proposing that certain preferential debts are to be paid in full whilst others are not.

Before Mr Justice Lightman, two grounds were relied upon by the Revenue. Firstly the Revenue asserted that the voluntary arrangement breached section 4(4)(a) of the Insolvency Act 1986 in that a meeting shall not approve a proposed voluntary arrangement under which any preferential debt of the company is to be paid otherwise than in priority to such of its debts as are not preferential debts. Essentially the Revenue's argument was that as the Football Creditors were being paid in full and that the payment of the Football Creditors was part of the proposed voluntary arrangement (some sort of term of the same) then their preferential claim was not being paid in accordance with section 4(4)(a). The

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second ground was that the proposal unfairly prejudiced the interests of the Revenue as a creditor. Mr Justice Lightman decided that the Revenue's challenge failed on both grounds. The Revenue appealed the section 4(4) point but did not appeal Mr Justice Lightman's determination of the section 6 point. Accordingly it is well worth considering his decision in relation to section 6, which may prove to be the more useful in this area in the future.

Unfair prejudice

Mr Justice Lightman summarized the authorities in this area by stating that: (1) to constitute a good ground of challenge the unfair prejudice complained of must be caused by the terms of the arrangement itself; (2) the existence of unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but may give rise to inquiry and require an explanation; (3) in determining whether or not there is unfairness, it is necessary to consider all the circumstances including, as alternatives to the arrangement proposed, not only liquidation but the possibility of a different fairer scheme; (4) depending on the circumstances, differential treatment may be necessary to ensure fairness. Mr Justice Lightman added by way of a fifth principle (5) differential treatment may be necessary to secure the continuation of the company's business which underlies the arrangement.

The Judge has given a useful and concise set of principles which should stand the test of time. (1) to (4) were already established in cases such as *Cazaly Irving Holdings Ltd v. Cancol Ltd*[1] and *Sea Voyager Maritime Inc v. Bielecki*.[2] The Judge's addition was that differential treatment may well be necessary to secure the continuation of the company's business. *Business City Express Ltd*[3] requires a Court to consider whether the differential treatment is a necessary feature of the arrangement itself. For example, if there is to be a trading CVA proposed and the instalment payments which are to be made to the Supervisor are to come from the profits to be generated by the company trading during the voluntary arrangement, it is of course key to the success of the voluntary arrangement that the company can trade and can do so profitably. If one of the key suppliers refuses to supply the company with its goods unless it is paid its outstanding invoices in full, then this is the price which needs to be paid in order for the company to have a viable voluntary arrangement. In *Leyland DAF v. Automotive Products*,[4] it was made quite clear by the Court of Appeal that a creditor can choose if he wishes to trade with the insolvent company and such a creditor may well be able to exert a considerable amount of commercial pressure to enable it to place itself in a better position than other creditors simply because the company's future trading depends upon the supply of its products.

It is this part of Mr Justice Lightman's judgment which is of great interest outside the world of football. In many cases administrators or the companies themselves have to pay certain key suppliers or pay arrears of rent on premises which the company needs to retain to continue its trade. There is clearly a differential treatment which is made and Mr Justice Lightman has clearly set down that the test in those circumstances does require a careful consideration of the reason for the differential treatment. This judgment is not an invitation for companies proposing voluntary arrangements or administrators making such proposals to create such a position, but this is a recognition that such a differential treatment may well be necessary as part of the arrangement and may not be deemed unfair.

It is clear from both the judgment of Mr Justice Lightman and the structure of the Court of Appeal judgment (even though that judgment dealt with the section 4(4) point only) that the courts will scrutinize very carefully the terms of the arrangement and test quite carefully the differential treatment proposed to see whether it is indeed necessary. In my example of the trading voluntary arrangement, it may well be that the court will be less than enthusiastic in holding that someone is indeed a key supplier if there is any evidence that someone else could supply the company. In *Leyland DAF*, the evidence was that only Automotive Products could carry out the work needed. Therefore Automotive could dictate their terms. Administrators proposing voluntary arrangements and companies need to ensure that effectively 'there is no other option' than to create the differential treatment. Moreover there may well still be a problem in sale agreement scenarios and the consideration which it is proposed will be paid. This aspect is dealt with below.

This was the conclusion reached by Mr Justice Lightman in relation to Wimbledon. The Judge held that in reality the requirement to pay the Football Creditors was in reality a condition precedent to any

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1 [1996] BPIR 252.

2 [1999] 1 All ER 628.

3 [1997] BCC826.

4 [1994] 1 BCLC 245.

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sale of the real asset of value held by the Club, namely its share in the Football League. It was clear that the Club did not have the means to pay those Football Creditors from its own assets and therefore if someone was interested in buying the assets and undertaking of the Club, those Football Creditors had to be discharged. The Judge concluded that essentially the Buyer was commercially obliged to pay the Football Creditors if he was going to acquire the Club's share in the League. Therefore the requirement which was set out in the sale agreement requiring the payment of the Football Creditors could not create unfairness in the arrangement. Significantly there was no evidence before the Judge or any suggestion or submission that the imposition of the obligation upon the Buyer to discharge these Football Creditors reduced in some way the consideration payable by the Buyer and accordingly available for dividend to the Revenue. This point about there being no evidence in relation to any reduction in consideration is another key feature which comes out from not only the judgment of Mr Justice Lightman but also the Court of Appeal. It is quite clear that arrangements whereby there is a substantial reduction in the consideration payable due to the payment of certain creditors in priority to others may well succumb to a successful challenge, and those preparing and negotiating sale agreements in these circumstances need to be well aware that the differential treatment may be found either not to have been necessary or that in the circumstances it has the effect of decreasing the consideration payable so as to make it unfair.

In order to realize its asset, the Club needed to remove the power of the Football League to block the proposed transfer and under the League Rules to require the payment of the Football Creditors. No matter how unattractive the Football Creditors rule may appear and how many adverse comments may be made about its existence, it remains legal and the Football League are perfectly entitled to rely upon it in these circumstances. The Rule does actually have good reasons for its existence, but that would need to be addressed in another article.

Before turning to the issue which formed the subject of the unsuccessful appeal, there are a few more matters which arise from Mr Justice Lightman's judgment which are of a more general nature. The exploration of alternatives, for example of the position in liquidation, is useful to bear in mind. In many cases, the voluntary arrangement which is being proposed is likely to provide a better return than a liquidation. In particular, in any case where third party funds are being used, such as in this case to discharge some of the company's debts, there is always a strong argument that a liquidation will produce much less because the third party monies will not be available in a liquidation. Mr Justice Lightman also held that the real challenge of the Revenue was not to the terms of the voluntary arrangement but to the sale agreement. The Judge considered that it was under the terms of the sale agreement that there was the responsibility imposed upon the Buyer to pay the Football Creditors. The Judge concluded that there was no alternative to passing the obligation of paying these creditors onto the Buyer if there was to be any beneficial realization of the assets of the Club. This point about whether the challenge was to the terms of the arrangement or actually to the terms of the sale agreement itself was taken up in the Court of Appeal in relation to the appeal on the section 4(4) point.

In the Court of Appeal, Lord Justice Neuberger agreed with the Club's submissions that the proposal in this case was limited to what is in the proposal. The proposal dealt with how the cash to be realized by the disposal of the business and assets of the Club under the sale agreement was to be disposed of and therefore the proposal for the voluntary arrangement did not extend to the terms of the voluntary arrangement. However a quick word for the future: the Court of Appeal did indicate that this case was unusual on its facts and therefore practitioners do need to be careful in the future, not only in relation to the drafting of the sale agreement in any case, but also in the terms of the proposed voluntary arrangement. Moreover the Football Creditors could not enforce the terms of the sale agreement. The obligations therein were imposed upon the buyer.

Mr Justice Lightman's approach and decision in relation to unfair prejudice is therefore of a much wider interest and significance. The inequality of treatment test used in cases like *Re A debtor 259 of 1990*[5] has progressed the recognition of the commercial reality which exists in many cases where creditors – for example, vital suppliers or employees – are going to be treated or will have to be treated in a more favourable way than others simply because of the commercial pressure they can bear on the business and future viability of the company. However the judgments of both Mr Justice Lightman and the Court of Appeal indicate that any differential treatment will be subject to careful scrutiny and practitioners should bear this is mind when negotiating and structuring the rescue deals.

The section 4(4)(a) issue

Although Mr Justice Lightman's decision in relation to section 4(4)(a) was the basis for the Revenue's appeal,

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5 [1992] 1 WLR 226.

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this point is much more peculiar to the facts of the particular case. The Revenue argued that there was a breach of section 4(4)(a) because the Football Creditors were being paid in priority to the Revenue who had a preferential claim. Mr Justice Lightman rejected this argument and in doing so examined the provisions of section 175 of the Insolvency Act 1986. Under that provision, in a liquidation, the assets of a company shall be applied in payment in full of the preferential creditors ahead of any payment to the non-preferential creditors. The Judge held that neither section 4(4) or section 175 precludes the payment by a third party of non-preferential creditors out of their own free money. They are not therefore paid at the cost of the company.

The Revenue appealed this part of the judgment and the Court of Appeal dismissed the appeal. The Court of Appeal, in agreeing with Mr Justice Lightman's conclusions, indicated that section 4(4)(a) needed to be looked at in the light of the facts of the case, namely this was a case where the administrators had entered into a contract for the sale of the undertaking of a company (the Club) to a prospective purchaser, who had agreed to pay certain creditors of the company, but who was not accorded a corresponding reduction in the sum of money the buyer was to pay for the undertaking. The Court of Appeal then analysed the words of section 4(4)(a) and held that this did not include the terms of the sale agreement.

Lord Justice Neuberger also made some more general comments and observations about the statutory CVA regime and in particular the need for a system which provides more flexibility than other insolvency process such as liquidation. The Judge considered that in voluntary arrangement proposals third party funds could be introduced, such as in the Club's case by the Buyer to pay the Football Creditors, which if the Revenue's argument was correct would be caught by section 4(4)(a). This, the Judge observed, would hamper the flexibility of the regime and make it less likely that third parties would be prepared to provide assets to assist in the achievement of the voluntary arrangement.

There was no reason why a third party cannot choose to pay out of his own free money a creditor. The sums which were to be paid over by the Buyer to the Football Creditors were not the company's funds, but a third party's free money which is not advanced at the cost of the company. It is in relation to this last point that the Court of Appeal judgment becomes one of more wider interest and significance.

Lord Justice Neuberger effectively endorsed the view expressed by Mr Justice Lightman that, in so far as a particular agreement was a device designed to get round section 4(4), or had that effect, then such an agreement would be susceptible to challenge. Lord Justice Neuberger also concurred with the observations of Mr Justice Lightman that a voluntary arrangement which is said with apparent justification, to cause unfair prejudice, can expect to receive 'careful scrutiny as to its propriety and conformity with section 4(4)(a) (and indeed with fairness) and if it is improper or unfair, the court no doubt will deal with it accordingly'.

Lord Justice Neuberger was very careful to indicate the unusual facts of this case in that the payment of the Football Creditors' obligation in the sale agreement did not lead to a reduction in the consideration payable by the Buyer. This is one of the key points which arises from the Court of Appeal judgment. Lord Justice Neuberger did refer to the more common type of arrangement where the company (albeit indirectly through a discount in the purchase price) funds the payment of the non-preferential creditors with the result that there would be less available to pay the preferential creditors. That type of a case would potentially be unfair. The court would then apply the careful scrutiny referred to by Mr Justice Lightman.

So where does this leave the law on voluntary arrangements? Leaving aside the issue of the Football Creditors rule and whether it should exist or not and issues relating to its justification, the general importance of the Wimbledon case comes from the approach presented at first instance and also in the Court of Appeal. The requirement of good faith and transparency (from *Somji v. Cadbury Schweppes PLC*[6]) remains vital but also practitioners need to consider what is and what is not really necessary as part of the proposed sale agreement or the proposed voluntary arrangement. In many ways, Wimbledon was an easy case because the Football League rules meant that the only way for the Club to realize its asset, the share in the League, was to get the Football Creditors paid off.

There will be many cases and there are many cases where there is some differential treatment whose reasons are much less clear-cut than in Wimbledon. The decisions do leave open a case of a reduction in consideration paid and whether, in that scenario, an unfair prejudice challenge would succeed. There may be a reduction in price, but the particular sale agreement may still be the only deal on the table and the only deal available to the insolvency practitioner and it may also be the only deal capable of producing some dividend despite the reduction in consideration. What then? That careful scrutiny referred to by Mr Justice Lightman is, I suspect, going to be very much in action in future challenges.

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6 [2001] 1 BCLC 498.

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