International Corporate Rescue

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Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2009 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

Re Whistlejacket Capital Limited [2008] EWCA Civ 575 and the Race to Priority

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The vulnerability of structured investment vehicles ('SIVs') to the difficulties experienced in financial markets has attracted much attention. Issues arising out of their insolvencies required the consideration of the courts prior to the recent events which now dominate the UK press. Those issues, which stem largely from the security documentation governing the operation of SIVs, last year manifested themselves in the decision of the English High Court in *Re Cheyne Finance Plc (No. 1)* [2008] 1 BCLC 732. Cheyne was the first SIV to enter receivership. Following that decision, on 12 February 2008 receivers were appointed in relation to a second SIV: Whistlejacket Capital Limited, a Jersey-incorporated company. Thereafter the receivers of Whistlejacket sought judicial guidance in relation to the distribution of the company's assets, in circumstances where the assets of Whistlejacket were inadequate to meet its extensive liabilities.

Both *Cheyne Finance plc* and *Whistlejacket Capital Ltd* involved points of construction on documentation governing the operation of the SIV. They did not involve matters of general legal principle. However, the latest development in *Whistlejacket Captial Ltd* calls for comment as it is instructive for creditors of SIVs and other corporate entities with similar governing documentation seeking to identify their position in the priority of repayment. The issues arising for determination by the Court of Appeal in *Whistlejacket* related to the effects of a 'waterfall' priorities provision and of an acceleration provision relating to the stated maturity dates of senior notes on insolvency.

Factual background

The receivers brought an application for directions as to the manner in which they should manage and apply Whistlejacket's assets having regard to the interests of various noteholders. Several series of senior notes with a variety of maturity dates had been issued by Whistlejacket. The Security Trust Deed contained a priority provision, setting out the order of priority in which Whistlejacket's creditors were to be paid. The third level of priority provided that any monies received were to be applied to pay, 'pari passu and pro rata in accordance with the respective amounts then owing thereto, any amounts due to Senior Creditors'.

The provisions governing the notes, contained in an Indenture, accelerated the stated maturity dates of the relevant notes on insolvency. If the Security Trustee delivered to Whistlejacket notice of an Insolvency Acceleration Event (an 'Insolvency Redemption Event'), Whistlejacket was obliged to pay the noteholders what was termed the Enforcement Redemption Amount on a date known as the Insolvency Redemption Date. That due date for payment was thirty days after the insolvency. On 15 February 2008 notice of an insolvency was delivered to Whistlejacket, the redemption date therefore being 16 March 2008. The redemption amount was however calculated by reference to the Redemption Price Calculation Date, itself defined under the Indenture as the date on which the Insolvency Redemption Event occurred. Therefore although the redemption date here was 16 March 2008, the amount required to be paid on that date was calculated by reference to the earlier date of 15 February 2008.

The issues

The dispute was essentially one as to priority as between different senior creditors. The issues were whether: (i) the waterfall provision provided, after insolvency, for a 'Pay as You Go' regime of payments to creditors by reference to the stated maturity dates of their notes (i.e. disregarding future claims of creditors whose notes did not yet fall due, and thus creating an order of priority as between different senior creditors based purely on date of maturity); and (ii) the 'acceleration' provision had the effect of postponing the stated maturity dates of certain notes.

As to the first issue, the receivers contended that they would be acting properly by making pari passu distributions to all senior creditors, taking into account amounts owing but not yet due among the whole class of senior creditors. As such, their contention was that the provision did not create any order of priority within the class of senior creditors. Holders of senior notes, appearing at the hearing as interested parties, argued that the receivers were bound to apply cash received by

them in full payment of creditors as their debts fell due (Pay As You Go), ignoring any amounts that had not yet fallen due for payment.

On the second issue, the receivers submitted that as a result of the insolvency all unpaid notes fell due for payment on the same date at the end of the thirty-day period, even though a particular note may have a stated maturity date on or between 15 February and 16 March 2008. The interested parties contended that the notice had no effect on the obligation to pay the principal amount of their notes on the relevant maturity dates. The notes remained due to be paid on the stated maturity dates falling before 16 March 2008, notwithstanding the provisions contained in the Indenture. Those provisions, they said, did not apply to them as their notes had already fallen due for payment.

The first instance decision

Mr Justice Etherton (as he then was) preferred the Pay As You Go construction. According to what he construed as the literal wording of the provision, the Deed envisaged that the receivers were obliged to distribute money received by them pari passu to senior creditors whose debts were then due for payment, without taking into account debts due to be paid in the future.

Etherton J also held that senior notes remaining unpaid yet which would have fallen due for payment within thirty days after the insolvency, but not those whose due date for payment coincided with the date of insolvency, were, in accordance with the provisions of the Indenture, postponed. The provisions were intended to set in place a regime in which there was an actual or notional acceleration of the due time for payment of the notes: in the case of notes with a stated maturity date on or before 15 February 2008, there could be no actual, or even notional, acceleration of the time for payment, and they should therefore be paid in full. In addressing the submissions of the interested parties that certain terms used in the Indenture indicated early payment and not postponed payment of noteholders, Etherton J relied on the provisions for calculation of the redemption amount and interest on that amount by reference to the date of the insolvency. As such, he held that the provisions substituted for the stated maturity dates of senior notes outstanding on the date of the insolvency, a deemed payment date of the insolvency event, with provision for interest from that deemed payment date to the date of actual payment (the Court of Appeal considered this 'somewhat artificial', it being clear from the Indenture provisions that a new redemption date for obligatory payment had been substituted).

The Court of Appeal decision

The receivers appealed and the appeal was allowed. In broad terms, the Court of Appeal held that: (i) the receivers had a discretion as to when to apply monies to the discharge of Whistlejacket's debts; and (ii) unpaid notes falling due for payment before the insolvency were postponed.

The first question was articulated by the Court of Appeal as being whether the Security Trust Deed, in setting out an order of priority for payments as between different creditors of Whistlejacket, went so far as to create an order of priority as between different senior creditors. Put differently, how after insolvency was the order of priority to operate, where different senior creditors had different amounts owing to them, with different maturity dates, some of which had not yet arisen?

Counsel for the receivers submitted that the receivers had a discretion as to when to pay senior debts. The clause was only concerned with priority; it did not impose any obligation to pay money out at a particular time, but rather an obligation prescribing how and to whom money should be paid out as and when it was available. As the clause did not impose an obligation as regards the timing of payment, it could not have the effect of prescribing priority within a class of creditors. It was further submitted that, although no money could be paid out in respect of amounts which had not yet fallen due for payment, nevertheless, when deciding how much was to be paid out, the receivers must take into account liabilities to senior creditors which had yet to fall due. The argument was that, whereas 'any amounts due' to senior creditors meant 'amounts due and payable', so as to exclude from payment any liabilities not yet due for payment, 'the respective amounts then owing thereto' meant something different, namely all sums due (whether or not yet payable) to the senior creditors as a class. It was agreed that 'amounts due' meant 'due and payable'. The meaning of 'owing' and 'thereto' remained a point of dispute.

The Court of Appeal accepted that the provision set out the order of priority as between successive classes of creditors, and did not impose any particular obligation as regards payment and as to time of payment. It could not therefore be construed as prescribing priority within the class of senior creditors on the basis of the chronological order of payment dates. If this was the intention, the clause would have been more specific about how it worked: for example, it did not say whether the governing date was that of receipt or application. In its reasoning the Court of Appeal was in large part persuaded by the anomalous differences of outcome which could occur if there were successive realizations and a sequence of partial payments, and also the fact that its preferred construction would work during the period of enforcement of security envisaged by the Indenture, when insolvency had not occurred.

The second question – although a matter of lesser import given the conclusion arrived at on the first question – was approached by the Court of Appeal from a different starting point than that taken by the court at first instance. Rather than articulating the issue as being whether the terms of the Indenture were intended to, actually or notionally, accelerate the due time for payment of the notes (undoubtedly the case in relation to notes with a stated maturity date later than 16 March 2008), the Court of Appeal made it plain that here it was a question whether the Indenture postponed the due payment date for notes whose stated maturity date was before 16 March. This tension was reflected in the submissions made by counsel for the Bank of New York, the Security Trustee. His contention was that there was nothing in the text which permitted a conclusion that notes otherwise payable at an earlier date would become payable on the (later) redemption date. That would be a postponement, not an acceleration.

The Court of Appeal nevertheless concluded that the provision applied a new obligatory payment date, the redemption date, to all notes which had not been paid in full – including those falling due for payment at the date of insolvency. It was considered that since notice to the company of an insolvency event was likely to be given either on, or immediately before, a day on which some obligation to a class of senior creditors arose for payment, it was not obviously sensible that that particular group of senior creditors should be regarded as having priority over others.

Future consequences

As stated at the outset, the case did not generate issues of general principle. This should not detract from its relevance to creditors of SIVs and corporate entities alike, the operation of which is governed by similar provisions. Security documentation applicable to other types of corporate entity inevitably contain similar 'waterfall' priorities provisions and acceleration provisions akin to those construed in *Whistlejacket* will also govern repayment of the debts of those entities. In a similar vein, the decision is instructive for officeholders seeking to advance the restructuring process and in so doing, to understand the obligations imposed on them.

Competing entitlement to large sums of money of different creditors, and different classes of creditors, may therefore turn on analogous issues of construction. The race to priority is intensified in the case of SIVs, which by virtue of their structure have extensive liabilities. The decision in *Whistlejacket* responds to this situation in two ways. First, it affords an insight as to how the courts will approach the construction of this type of documentation, notwithstanding that the terms of the documentation may not be identical. Secondly, it indicates the culture of the courts which is, insofar as possible, to prevent a race to priority.

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