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ARTICLE

Minority Junior Lender Rights: Getting a Seat at the Negotiating Table

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1. Introduction

In Europe restructurings are mostly achieved on a consensual basis outside of any formal proceedings, unlike in the US where the Chapter 11 proceedings are typically used to restructure and rescue distressed corporate debtors. One of the features of the distressed corporate debtors in Europe currently being restructured or those that are anticipated to be restructured in the future is their complex capital structure.[1] Distressed corporate debtors in Europe of a certain size are now not only burdened with (syndicated, as opposed to bilateral) senior secured bank debt, but also have layers of second lien bank debt, mezzanine bank debt, notes, PIK (Payment In Kind) instruments and/or hybrid instruments in their capital structure. Therefore, any consensual restructuring process is likely to involve different groups of creditors.

In this article the focus will be on junior lenders, such as for example second lien lenders or mezzanine lenders, and in particular the rights of junior lenders who have a minority position (the 'Junior Lenders'). An important driver in any consensual restructuring is a determination of 'where the value breaks'. This is based on a valuation of the distressed corporate debtor that must be restructured. The valuation will highlight which classes of creditors are 'in the money' and which classes of creditors are 'out of the money'.[2] How the valuation should be conducted and to what extent a certain valuation could (or should) be forced upon creditors of a distressed corporate debtor is an important topic, but will not be further addressed in this article.[3]

Where the value breaks in the mezzanine bank debt, the mezzanine lenders should have a say in the restructuring of the distressed corporate debtor as their consent is likely to be required for certain actions. In many cases, majority mezzanine lender consent would be required. If it is assumed that majority mezzanine lender consent represents those mezzanine lenders with more than 66⅔% of the outstanding principal amount of the mezzanine bank debt, then a minority of mezzanine lenders with at least 33⅓% of the outstanding principal amount of the mezzanine bank debt would constitute a 'blocking position'. If the minority mezzanine lenders do not have a blocking position, they would still be able to block decisions or actions that require the consent of all mezzanine lenders. In addition, there may be other non-contractual remedies available to the minority mezzanine lenders to challenge certain actions or decisions of the majority senior or mezzanine lenders in a restructuring of a distressed corporate debtor.

One aspect that further complicates matters is the existence of so-called cross-holdings[4] in the capital structure. With cross-holdings we mean that certain mezzanine lenders may also have (substantial) positions in other parts of the capital structure of the distressed corporate debtor such as the senior secured debt, the second lien debt or even the equity of the distressed corporate debtor. In a restructuring of the distressed corporate debtor, such cross-holdings may

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1 Compare European High Yield Association letter dated 23 April 2007.

2 For example in the matter of MyTravel Group Plc, the bondholders were excluded from consultations on a contemplated scheme of arrangement by the company because, on the basis of a valuation of the company, it was concluded that the bondholders had no economic interest. See *Re MyTravel Group Plc* [2004] EWHC 2741.

3 See Michael Crystal QC and Rizwaan Jameel Mokal, 'The Valuation of Distressed Companies – a Conceptual Framework', 3:2&3 *International Corporate Rescue* (2006).

4 Cross-holdings by lenders have increased over the recent years partly because of the growth in the secondary debt market and the emergence of specialist distressed debt investors who extract value in the restructurings of the distressed corporate debtors. See C. Howard and B. Hedger, *Restructuring Law and Practice* (Butterworths LexisNexis, London, 2008), at p. 159.

– in certain circumstances – create conflicts of interest and have a decisive influence on the voting behaviour within a certain class of creditors.[5] Cross-holdings are particularly prevalent in distressed corporate debtors that were refinanced multiple times in the recent past, which are highly leveraged with complicated capital structures and whose debt is actively traded in the secondary debt market. Minority Junior Lenders in such situations without cross-holdings should be aware of the risk of being disadvantaged in any decision making process or being squeezed out.

Another dynamic for a minority Junior Lender to be aware of is the risk that certain other lenders in either the same class or a different class may have bought credit protection (such as for example credit default swaps). Those lenders with credit protection may have a real incentive to block a (consensual) restructuring to trigger a Credit Event under their credit default swap instruments.[6] The issue of credit protection in restructurings is a separate topic, which will not be further addressed by us in this article.

The challenge faced by a minority Junior Lender is that information regarding both cross-holdings and credit protection may in most circumstances not be readily available.

In the second part of this article we will provide a high level overview of remedies and causes of action minority Junior Lenders may want to consider when trying to get a seat at the negotiating table in restructurings of a distressed corporate debtor in Europe. In the third and last part of this article we will draw some conclusions from the overview provided.

2. Available remedies and causes of action

Most remedies available to minority Junior Lenders are reactive in nature, not proactive. However, depending on the level of the minority position of the (ad hoc group of) Junior Lenders and the specific facts and circumstances of the case, minority Junior Lenders may be able to act proactively as well.

In the following subparagraphs we will briefly explore:

– Contractual consent and other rights of Junior Lenders in respect of Enforcement of Security (§2.1)

– Contractual consent and other rights of Junior Lenders *other than* in respect of Enforcement of Security (§2.2)

– Other non-contractual rights and remedies (§2.3)

2.1. Contractual consent and other rights of minority Junior Lenders in respect of Enforcement of Security

The analysis of the consent and other rights of Junior Lenders in respect of enforcement of security requires a detailed review of in the first place the Intercreditor Agreement. The Intercreditor Agreement should explain the ranking of the different types of debt in respect of payment and the ranking of the different types of secured debt in respect of the security. It should also contain prohibitions in respect of the payment of debt which is junior ('Junior Debt') to the senior secured debt together with carve-outs for permitted payments. The Intercreditor Agreement may also contain a mechanism for suspending permitted payments and for the turn-over by holders of Junior Debt of any proceeds received in violation of the Intercreditor Agreement.

An important definition in the Intercreditor Agreement for the Junior Lenders is the definition of Enforcement Action. Typically, the definition of Enforcement Action will include, in respect of any Obligor, (i) the acceleration of debt; (ii) the recovery (by legal proceedings or otherwise) of debt; (iii) the making of a demand against any member of the debtor's group in relation to the debt; (iv) the exercise of any right to enforce any security under any security documents; or (v) petitioning or initiating any insolvency, liquidation, reorganisation, administration or dissolution or any voluntary composition. Either as part of this definition or elsewhere in the Intercreditor Agreement,

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5 For example such a conflict of interest existed in the case of *Redwood Master Fund Ltd and Others v TD Bank Europe Limited and Others* [2002] EWCH 2703, where a syndicate of lenders had lent to a distressed borrower an A facility (revolving loan) and B facility (term loan). Most of the lenders had positions in both facilities. As part of a restructuring of the distressed borrower, the majority lenders voted to use the A facility to repay the B facility, which was opposed by those lenders who had positions only in the A facility. Those lenders with cross holdings were conflicted in there voting in that they stood to benefit from the use of the A facility to pay off the B facility and were therefore not opposed to the use of the A facility.

6 For example in the on-going case of Lyondell Chemical Company in the US Bankruptcy Court, Southern District of New York (Case No.09-10023(REG)), the court issued a temporary restraining order (TRO) based on section 105 of the US Bankruptcy Code, in order to prevent, among others, certain holders of credit default swaps (CDS), who also held certain bonds from accelerating the bonds so as to trigger a Credit Event under their CDS. Such acceleration would jeopardise the on-going restructuring of the Lyondell Basell Group. See Interim Order dated 8 January 2009 by Robert E. Gerber, United States Bankruptcy Judge.

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carve-outs to the definition of Enforcement Action could exist. If any such carve-outs do exist,[7] it will then have to be determined whether or not these carve-outs allow action by individual holders of Junior Debt.

Another aspect in respect of Enforcement Action which the Junior Lenders may want to focus on is whether or not the Intercreditor Agreement contains any obligations for the Security Agent or the Senior Lenders to maximise value and/or consider the interests of the Junior Lenders when taking any Enforcement Action.

The Intercreditor Agreement is likely to contain a Permitted Enforcement provision for the secured Junior Lenders. In certain circumstances, a majority (of typically more than 50%, 66⅔% or 75%) of the secured Junior Lenders will be authorised to instruct the Facility Agent to instruct the Security Agent to take Enforcement Action. At best, a minority secured Junior Lender will be able to block or consent to Permitted Enforcement instructions by the majority secured Junior Lenders to the Security Agent. Typically, Permitted Enforcement of secured Junior Lenders will require a relevant default under the secured debt of the Junior Lenders and notice of the default to the Senior Lenders. Such notice will then commence a standstill period of 90, 120, 150 or 180 days. An insolvency of one of the Obligors of the secured debt of the Junior Lenders may constitute a subordination event which could shorten the applicable standstill period, but at the same time limit the Permitted Enforcement available to the majority secured Junior Lenders. The Intercreditor Agreement should also be checked for provisions dealing with conflicting instructions to the Security Agent. The absence of such provisions may make it possible for the Security Agent to take the instructions of the Junior Lenders even where these contradict any instructions given by the Senior Lenders.

More generally, the agency provisions in the Intercreditor Agreement and the relevant facility agreement for the debt of the Junior Lenders should be reviewed to check whether, and to what extent, there are so-called ‘channelling provisions’. These channelling provisions would limit the right of Junior Lenders to take any individual action themselves, but instead channel such action through the Facility Agent and the Security Agent. In addition, there are likely to be provisions that allow the Facility Agent and the Security Agent to refrain from any action until – in their opinion – they are adequately indemnified. In practice, Senior and/or Junior Lenders may have to agree to indemnify the Facility Agent and the Security Agent first before any action is undertaken by them. It should further be noted that facility and security agents are usually very cautious and reluctant to use their discretionary powers without either clear lenders’ instructions or directions of the court. This rather conservative and prudent attitude of agents could provide leverage to vocal minority Junior Lenders who believe that certain action would prejudice their interests.

In European credits it is not unusual for the collateral package that secures the debt of the Senior Lenders and the secured Junior Lenders to be spread over various jurisdictions. Such multi-jurisdictional collateral packages are not an invitation for the secured lenders to ‘take control and start enforcement’. As each jurisdiction may have its own specific rules in respect of enforcement of security rights, a multi-jurisdictional enforcement of security rights is likely to be costly, time-consuming and difficult to coordinate in such a way as to keep the loss of value of the distressed corporate debtor to a minimum. This, combined with the absence in Europe of a harmonised insolvency proceeding that facilitates corporate rescue similar to a Chapter 11 in the US, explains why in Europe multi-jurisdictional restructurings oftentimes take place out of court and outside a formal insolvency proceeding. Depending on the facts and circumstances of the case, such consensual restructurings could provide leverage to vocal Junior Lenders and may result in a seat at the negotiating table for them.

Finally, in certain circumstances it may be worthwhile for minority Junior Lenders to consider challenging contractual subordination provisions contained in an Intercreditor Agreement governed by English law, in particular if the challenge takes place in a jurisdiction outside of the UK. In situations where there are relatively few ordinary unsecured creditors of the debtor and contractual subordination provisions can be challenged, it may also be worthwhile for minority Junior Lenders to consider challenging under local law certain security documents. A successful challenge would exclude the assets, that were secured by the security documents that were successfully challenged, from the enforcement provisions under the Intercreditor Agreement. If the contractual subordination provisions could be successfully challenged as well, the Senior Lenders may end up *pari passu* with the Junior Lenders. In practice, the success of such challenges

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7 Carve-outs of Enforcement Action may include: (i) any action taken solely to preserve the validity and existence of claims, (ii) the taking of action against any creditor (or any agent, trustee or receiver acting on behalf of such creditor) to challenge the basis on which any sale or disposal is to take place pursuant to powers granted to such persons under any security (iii) the bringing of proceedings solely for injunctive relief to restrain any actual or putative breach of the finance documents or specific performance not claiming damages, or (iv) legal proceedings or allegations against any person in connection with violations of securities laws or securities or listing regulations or fraud.

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is difficult to achieve. However, the existence of some merit in a threat by the Junior Lenders to institute such a challenge might be sufficient to get them a seat at the negotiating table.

2.2. Contractual consent and other rights of minority Junior Lenders other than in respect of Enforcement of Security

If the Senior Lenders decide not the take any Enforcement Action, but instead prefer to attempt a consensual out of court restructuring of the debtor outside a formal insolvency proceeding, the contractual consent rights in the relevant facility agreement of the Junior Lenders will be important.

One of the important provisions to review is the 'amendment and waiver' clause of the relevant facility agreement. Typically, all substantial amendments and waivers under the facility agreement will require the consent of a majority (of typically either more than 50%, 66⅔% or 75%) of the Junior Lenders, except for certain specifically listed amendments and waivers which may require the consent of a supermajority (of typically either more that 80%, 85% or 90%) or the consent of each lender. There may also be a separate specific provision dealing with the waiver of defaults and sometimes there is a waiver of acceleration (or de-acceleration) provision as well. In addition, the minority Junior Lenders should check whether or not there are 'replacement of lender' or so-called 'yank the bank' provisions which allow certain lenders to be 'replaced' if they oppose certain decisions for which a certain majority of consent by the other lenders has already been obtained. It should be noted, however, that if such replacement provisions require the non-consenting lenders to be taken out by the debtor at par, they may not be of much use in a restructuring context, in particular if the relevant lenders are underwater.

The above mentioned provisions will be important for the agreement of a standstill agreement allowing for the necessary time to negotiate, agree and implement a consensual restructuring.

Other provisions for a minority Junior Lender to consider are the negative covenants of the facility agreement to get a better understanding of both what the obligors are prohibited from doing without consent of the Junior Lenders and – more importantly – what the obligors are permitted to do without consent of the Junior Lenders. Certain negative covenants may only kick in if a threshold leverage ratio requirement is not met. Typically, in a distressed situation such requirement will not be met by the debtor and therefore the negative covenants will all apply. These provisions containing the negative covenants should give answers to questions like, what debt can be incurred by the obligors that either ranks senior or *pari passu* with the minority Junior Lenders? Is the debtor allowed to buy-back debt at a discount? Can the debtor offer to Junior Lenders and/or creditors subordinated to the Junior Lenders, a debt for debt exchange? What are the permitted disposals and how can/should the sale proceeds of a permitted disposal be used by the obligors (mandatory prepayment, reinvestment in the business, a combination of the two, something else)? What permitted corporate restructurings and permitted refinancings (if any) are the obligors allowed to undertake?

Usually, the so-called 'permitted baskets' under the negative covenants are subject to the condition that no event of default or potential event of default has occurred. In particular the definition of potential event of default could contain – in certain circumstances – some leverage for minority Junior Lenders. An amendment or modification of the negative covenants will typically require at least majority Junior Lenders consent.

Particular attention should be given to the release provisions in case of an asset disposal both pre-enforcement and post enforcement. Such disposal is either permitted or will need the required consent of the Junior Lenders. Mechanically, these release provisions, in respect of security interests that encumber the asset that is being disposed of or in respect of liabilities, such as guarantees, of subsidiaries which shares are being disposed of, must work correctly to allow for a 'clean sale'. Loopholes or ambiguities in the drafting of these release provisions could provide leverage to minority Junior Lenders.

To the extent the amendment and waiver provisions, negative covenants, use of proceeds provisions, and release provisions contain any rights for minority Junior Lenders, such rights will most likely be reactive rights and dependent on what actions the Obligors, the Senior Lenders and the majority Junior Lenders are considering to take. Having said that, instead of taking a 'wait & see approach', the minority Junior Lenders could also decide to proactively approach the company. In a letter, the minority Junior Lenders could – by alluding to their rights – put the company on notice that the minority Junior Lenders should be included in any restructuring negotiations.

2.3. Other non-contractual rights and remedies

Depending on what type of restructuring is contemplated or what the exact facts and circumstances of the case are, there may also be rights and remedies for the minority Junior Lenders in addition to the contractual ones highlighted in §2.1 and §2.2 above. In this part of the article we will start with briefly addressing the fashionable phenomenon of the pre-packaged sale or 'pre-pack' for short (§2.3.1). We will then look at the Scheme of Arrangement (§2.3.2) and conclude with some other non-contractual causes of action the minority Junior Lenders may want to consider (§2.3.3).

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2.3.1. A pre-pack sale

In the UK, the term 'pre-pack' is used to describe an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after his or her appointment. By adopting a pre-pack, a debtor company may be able to avoid liquidation and allow valuable assets to be bought out immediately while debts and loss making assets are left behind.

The negotiation of a pre-pack creates an inherent risk for the administrator of personal liability (under misfeasance) or a challenge to his or her conduct.[8] Recently, the Insolvency Practitioners Association issued a Statement of Insolvency Practice ('SIP 16')[9] for administrators involved in pre-pack sales in order to provide greater transparency for creditors in pre-packaged administrations and minimise the risk of liability for administrators.[10] SIP 16 details a process which practitioners implementing pre-pack sales are advised to follow.[11]

If a pre-pack sale is contemplated by the Senior Lenders and the debtor, it is important for the minority Junior Lenders to get an understanding of what exactly is needed to effect the sale. Are there any other creditor groups with which a deal needs to be struck before a pre-pack can take place? If so, depending on what deal is agreed, the minority Junior Lenders may be able to challenge this deal if it prejudices them. If the debtor has a multi employer defined benefit pension scheme (the 'Pension Scheme') and a pension deficit may exist, that will have an impact on a contemplated pre-pack and may provide leverage for the minority Junior Lenders. Any event which has a negative impact on the debtor's net asset value or enterprise value or balance sheet should be reported to and 'cleared' by the Pension Regulator ('TPR') to avoid the risk of attack by the TPR at a later stage.[12] If the effect of any sale or merger is to reduce the net asset value or enterprise value of the debtor, the TPR may require the company to provide further funding, security and/or even equity holdings to secure the Pension Scheme.[13] In short, any compromise in respect of the Pension Scheme that effectively elevates the Pension Scheme to the prejudice of the Junior Lenders may possibly be challenged on the basis that the Junior Lenders entitlement pre-reorganisation is stripped away.

It may further be necessary to move the COMI (Centre of Main Interest) of a group company in order to facilitate a pre-pack. Even if the facility agreement of the Junior Lenders allows the company to move its COMI or that of its group companies, it may still be possible for the minority Junior Lenders to challenge this in the local jurisdiction.

Lastly, it should be noted that to prevent creditors from being treated unfairly through the abuse of pre-packs, the Insolvency Service is due to publish a report in the summer of 2009 on a regime for monitoring pre-packs.[14]

2.3.2. Scheme of Arrangement

In the UK, where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the court may, on the application of the company or of any creditor or member of the company, or where the company is being wound up, of the liquidator, or where the company is in administration, of the administrator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such a manner as the Court directs.[15] This procedure is called a Scheme of Arrangement and

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8 In a series of cases, where the circumstances of the case warrant this, courts have held that an administrator has the power to sell assets without the prior approval of the creditors or permission of court. However, reliance on such authority does not protect administrators from potential challenges to their conduct under paragraph 74, or claims of misfeasance under paragraph 75, of Schedule B1 of the Insolvency Act 1986. The cases referred to include *T&D Industries Plc* [2001] 1 WLR 646 and *Transbus International Ltd* [2004] EWHC 932 (Ch).

9 SIP 16 came into effect on 9 January 2009.

10 See also the ILA Themed bullet *Pre-packs: the new 'Dos' and 'Don'ts'* of March 2009.

11 Under the guidance in SIP 16 practitioners should keep in mind that they owe a duty to the creditors as a whole; and be clear and transparent about their role and their relationship with the directors in the pre-appointment period. They should also ensure that their advice is to the company and not the directors and ensure that the pre-pack sale is in the best interest of the creditors as a whole. Lastly, they should disclose certain prescribed information to all creditors to ensure transparency.

12 A formal clearance procedure is provided for in sections 42 and 46 of the Pension Act, 2004. In general, the relevant parties negotiate with the pension trustees and reach an agreement, which is submitted to the TPR for clearance. For a more detailed discussion, see David Pollard, *Corporate Insolvency: Employment and Pension Rights* (3rd edn, Tottel Publishing, 2007), chapter 27.

13 See C. Howard and B. Hedger; *supra* note 4, at paras 8.145 – 8.182.

14 See budget report titled '*Budget 2009: Building Britain's Future*', April 2009, para. 4.18, at <www.hm-treasury.gov.uk>. It was indicated in the budget report that the Insolvency Service' report on pre-packs would be available in June 2009. However, the report is now likely to be available towards the end of the summer 2009.

15 See section 896 of Part B of the Companies Act 2006, which is, in all substantive respects, identical to what was section 425 of the Companies Act 1985.

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contains three distinct stages. First, there must be an application to the court for an order that a meeting or meetings be summoned. Second, the scheme proposals are put to the meeting or meetings held in accordance with the order that has been made and are approved, or not, by the requisite majority in number and value of those present and voting in person or by proxy. Third, if approved at the meeting or meetings, there must be a further application to the court to obtain the court's sanction to the compromise or arrangement.[16]

In the first stage the classes of creditors or members are constituted. The principle upon which those classes are to be constituted is that they should depend on the similarity or dissimilarity of their rights against the company and the way in which those rights are affected by the scheme and not upon the similarity or dissimilarity of their private interests arising from matter extraneous to such rights.[17] The entry by a scheme creditor into a lock-up agreement (i.e. an agreement to vote in favour of the proposed scheme) will not cause those creditors to form part of a separate class unless the scheme creditor has received a collateral benefit or inducement in exchange.[18] In practice, this may raise a number of questions such as could the opportunity to provide new money granted to only some and not all creditors of a certain class create a class composition issue?

The second stage ensures that the proposals are acceptable to at least a majority in number, representing three-fourths in value, of those who take the opportunity of being present (in person or by proxy) at the meeting or meetings of each respective class.[19] The creditors attending the meeting(s) are intended to have an opportunity to 'consult together' acting in their common interests and based upon adequate information.[20]

The third stage is the stage at which the court considers the wider questions of fairness. At this stage the court is not bound by the decision of the meetings. It is assumed that the classes were correctly determined, and the requisite majorities voted in favour of the scheme of arrangement at properly convened meetings. However, the court has discretion to refuse to sanction a scheme of arrangement if it falls short of the requisite standard of fairness.[21] At this third stage any special interests of creditors – such as cross-holdings in other debt or in the equity and/or board representation in the company or any other special interest that may have influenced their voting behaviour – become important. If the court is satisfied that the meeting is unrepresentative, or that those voting in favour at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent creditor, then the vote in favour may not be given effect by the sanction of the court.[22] Although creditors with different and potentially conflicting interests arising from circumstances unconnected with their interests as members of the class are not precluded from attending and voting at the meeting of the class, it may lead the court to decline to sanction the scheme.[23] The result of each meeting should fairly reflect the views of the creditors concerned. To this end, a court may discount or disregard altogether the votes of those who have such personal or special interests in supporting the proposals that their votes cannot be regarded as fairly representative of the class in question.[24]

From the above it follows that in each of the three stages for a scheme of arrangement there may be room for the minority Junior Lenders to object to and challenge the scheme proposals. In particular the third stage of a scheme of arrangement may provide an opportunity to challenge the scheme for minority Junior Lenders which believe that they are 'crammed down' by a majority of connected lenders with special interests due to cross-holdings or otherwise.[25] In that respect it is further important to note that to onus and burden of proof to establish that the scheme is fair rests on the proponent (i.e. the company, if they are the one proposing the scheme), not on the minority Junior Lenders if they would decide to challenge the scheme. This is different from a Company Voluntary Arrangement (or CVA) which can be challenged on the grounds of it being unfairly prejudicial because there the onus and burden of proof to establish that the CVA is unfairly prejudicial rests on the party that challenges the CVA.[26]

Notes

16 *Re Hawk Insurance Company Limited* [2001] 2 BCLC 480, para. 11 at pp. 510h to 511b.
17 See e.g. *UDL Holdings Ltd* [2002] 1 HKC 172 at p. 7 and *RE: Euro Bank Corporation (In Liquidation)* [2003] CILR 205, para. 9 at p. 209.
18 See *Re Telewest Communications plc*, [2004] BCC 342.
19 *Re Hawk Insurance Company Limited* , *supra* footnote 8, para. 12 at p. 511c-d. See also section 899(1) of Part B of the Companies Act 2006.
20 *Re British Aviation Insurance Company Ltd* [2005] EWHC 1621, paras 99-112.
21 *Re Hawk Insurance Company Limited, supra* footnote 8, para. 12 at p. 511d-e. See also *Re: English Scottish and Australian Chartered Bank* [1893] 3 Ch 385, at p. 409.
22 *Re: BTR Plc* [2000] 1 BCLC 740, at 747g-i.
23 *UDL Holdings Ltd, supra* footnote 9, at p. 8.
24 *UDL Holdings Ltd, supra* footnote 9, at p. 11.
25 For relevant factors when asking the question whether the votes cast adequately represent the views of creditors, see *Re: British Aviation Insurance Company Ltd, supra* footnote 11, paras 113-125.
26 *Re: T&N Ltd* [2005] 2 BCLC 488, para. 81 at p. 514a-g.

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2.3.3. Other non-contractual causes of action

In a two-parts article that was published in this Journal in December 2007 and January 2008[27] a number of litigation angles were explored that may become relevant in the present downturn in Europe. Some of those litigation angles are worthwhile highlighting here.

Provided that there or no insurmountable contractual restrictions to do so, minority Junior Lenders may be able to challenge a valuation of the debtor[28] or a proposed CVA on the basis that it is unfairly prejudicial.[29] Furthermore, in the context of a Scheme of Arrangement, the issue of whether or not a category of creditors (e.g. the Junior Lenders) have a sufficient economic interest to merit consultation, may arise if minority Junior Lenders decide to challenge a proposed scheme and are perceived to be completely 'out of the money'.[30]

Section 214 of the Insolvency Act 1986 states that, if the directors of a company allow it to continue trading when they knew or ought to have known that there was 'no reasonable prospect' of the company avoiding insolvent liquidation, the directors can be made personally liable to make a contribution to the company's assets. The law on wrongful trading is, to a certain extent at least, the English equivalent to the US concept of 'deepening insolvency' which has existed in the US jurisprudence for a number of years without its status ever being wholly clear. Depending on the circumstances, the law on wrongful trading, possibly in combination with the threat of a disqualification order being made against a director under the Company Director Disqualification Act, may be used by minority Junior Lenders to acquire a seat at the negotiating table.

The law on wrongful trading also applies to shadow directors. In reality, the likelihood of a lender qualifying as a shadow director is low. The court's attitude is that a creditor of a company is entitled to protect his own interests as a creditor without necessarily becoming a shadow director. However, undoubtedly there is a line which must not be crossed beyond which there is a risk that the lender will become a shadow director.

Another angle that may, in certain circumstances be worthwhile exploring by minority Junior Lenders is a claim for misrepresentation. Such a claim could arise where a corporate restructuring is proposed and a circular is published setting out the terms on which the restructuring is going to proceed. Certain lenders may rely on the restructuring proposal to make certain decisions. If the restructuring does not proceed, or if it proceeds in a different form to that foreseen by the circular (and the related representations made) the lenders may suffer a loss as a result of their reliance on the contents of the circular (and the related representations made).

3. Conclusions

Against a background of complex capital structures of distressed corporate debtors in Europe and with the knowledge that in Europe restructurings are mostly achieved on a consensual basis outside any formal proceedings, we have looked at the minority Junior Lender rights to assess if and how they could get a seat at the negotiating table. A key question for Junior Lenders to consider in this context is where does the value break and if the Senior Lenders or the debtors have any views on this, do they agree with those views? If they do not agree with those views, what can they do?

A thorough legal review of the relevant loan documentation is essential. Although a minority Junior Lender with a blocking position (i.e. whose consent is needed for any action that requires majority Junior Lenders consent under the relevant loan documentation) will generally have more options, a minority Junior Lender without a blocking position is not necessarily without any rights. A lot will depend on the specific language in the loan documentation and the circumstances of the matter at hand. Are there substantial cross-holdings? What credit protection has been bought by whom?

Generally, the Intercreditor Agreement should provide answers to questions on enforcement of security. The focus of minority Junior Lenders should be on (i) carve-outs of Enforcement Action, (ii) Permitted Enforcement, (iii) obligations for the Security Agent or Senior Lenders to maximise value, (iv) scope of agency or other channelling provisions, (v) cross-border nature of collateral package (which may create difficulties with local enforcement rules and possibly perfection issues), and (vi) validity (and possible ambiguity) of subordination provisions.

If, instead of enforcement of security, a consensual out of court restructuring is pursued by the Senior Lenders and the debtors, the contractual rights in the relevant facility agreement of the Junior Lenders will be important. If a standstill is required, the 'amendment and waiver' provisions of the relevant facility agreement must be reviewed to assess whether a majority

Notes

27 See Peter J.M. Declercq and Neill Shrimpton, 'More Litigation in the Next Downturn in Europe?', 4:6 *International Corporate Rescue* (2007) 296-304 (Part One) and 5:1 *International Corporate Rescue* (2008) 12-16 (Part Two).

28 As was unsuccessfully attempted in *In Re Colt Telecom Group Plc*, [2020] EWHC 2815 (Ch).

29 As was unsuccessfully attempted in *Sisu Capital Fund Limited v. Tucker and others*, [2005] EWHC 231 (Ch).

30 See *Re MyTravel Group Plc, supra* note 2.

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(of more than 50%, 66⅔% or 75%), a supermajority (of more than 80%, 85% or 90%) or consent of each Junior Lender is required. How does acceleration work? Is it possible to de-accelerate? Are there yank-the-bank provisions?

Other provisions for the minority Junior Lender to consider are negative covenants and permitted baskets to the same. These provisions should provide answers to questions like: What happens with proceeds of a disposal? To what extent can the debtor buy back debt at a discount? To what extent can the debtor propose a debt for debt exchange? Particular attention should be given to release provisions, loopholes and ambiguities in release mechanisms.

In the article we have further touched upon a pre-pack sale, a Scheme of Arrangement, and certain other non-contractual causes of action for minority Junior Lenders to consider. In respect of a pre-pack sale it is important for the minority Junior Lender to understand the transparency required by SIP 16 and the inherent risk for an administrator of personal liability. It is further important to understand what exactly is needed to effect a sale. Is there an Employer Pension Scheme and does the sale require clearance of the TPR? In respect of a Scheme of Arrangement, do the Junior Lenders as a class have a sufficient economic interest to merit consultation? Can class composition be challenged? Are there fairness issues due to cross holdings or other aspects of the contemplated composition? Can wrongful trading be used as a means of pressure by minority Junior Lenders? Are there claims of misrepresentation?

If there is no or very little value left in the debtor, it is going to be extremely difficult for minority Junior Lenders to substantially influence the outcome of a restructuring. Any 'hold-up' value will most likely be an uphill battle requiring a substantial upfront investment in advisory fees and expenses with the risk of 'throwing good money after bad'. However, if there arguably is value worthwhile saving and there is therefore something to gain by a consensual restructuring and something meaningful to lose by liquidation, there may definitely be a number of actions worthwhile exploring for minority Junior Lenders, as hopefully this article has demonstrated.

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International Corporate Rescue

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