Briefing

BURGES SALMON

Corporate Turnaround and Insolvency

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Pre-pack the backdoor to UK insolvency regimes?

Preamble

The COMI rules prevent a foreign based company from accessing the UK insolvency regimes, unless it has a sufficient connection with the UK. However, in Christophorus 3 Limited the High Court approved the ‘flipping up’ of a specially created UK newco in a German group to enter administration.

The background

The High Court described this case as ‘an elaborate scheme for the restructuring and refinancing’ of a German group.

The group was headed by a Luxembourg and German holding structure beneath which two German intermediate holding companies were the main borrowers. Beneath the borrowers was the German trading group which provided security. An intercreditor agreement regulated the priority of indebtedness owed by the two intermediate holding companies under three facilities: a revolving credit facility and senior and junior loan notes. The loan notes were unlikely to be repaid.

The creditors wanted to avoid an insolvent liquidation. The intercreditor agreement included two standard but important terms: (1) any new subsidiaries were required to join the intercreditor agreement and to provide security; (2) the security agent could release an “obligor” upon a share sale provided it was implemented under a court process.

The issues

The group could not overcome the COMI rules given the location of the borrowers and security providers.

Christophorus 3 was created as a newco intermediate holding company <u>beneath</u> the German borrowers (alongside the rest of the group) which acceded to the intercreditor agreement. The newco provided a nominal form of security (a pledge over an intragroup debt) to become an obligor under the intercreditor agreement.

The newco’s immediate parent (one of the intermediate German borrowers) sold newco to the ultimate parent Lux holding company. The newco then owned the main operating part of the group as a new intermediate holding company.

The senior loan notes were accelerated and the holder called in the newco’s security. Newco applied for an administration order in the UK with a proposed pre-pack to sell the shares in the intermediate (borrower) holding companies to a new company owned mainly by the creditors in order to repay the revolving credit facility. The loan notes were to be surrendered for new debt.

What did the court decide?

As Christophorus 3 was incorporated in the UK COMI considerations did not apply.

The Court determined that Christophorus 3 was an ‘obligor’ under the intercreditor agreement even after it was moved around the group’s chain of ownership. This was based on the wording of the intercreditor agreement and the fact that it would not have made sense for an obligor to be released simply because of an intragroup transfer. It was important that Christophorus 3 was a subsidiary for six months before it was sold to the ultimate parent company so that it was not merely a ‘fleeting or evanescent’ group entity.

What does this mean for practitioners?

This decision does not change the COMI rules but suggests that an intercreditor agreement could be used to ‘flip up’ a UK newco to permit a UK pre-pack.

This is likely to be an attractive option if shifting COMI would have adverse tax or bureaucratic consequences. Alternatively, the creditors could agree to change the governing law of the facility to English law.

This new area retains many uncertainties such as the length of establishment of the newco before flipping up (which will require creditor forbearance) and the potential for challenging any new security given by an acceding newco as a preference or transaction at an undervalue. This decision should accordingly be treated with a degree of caution rather than being viewed as a panacea for changing COMI.

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