Helpful Guidance About the Role of a UK Monitor in Terminating a Moratorium

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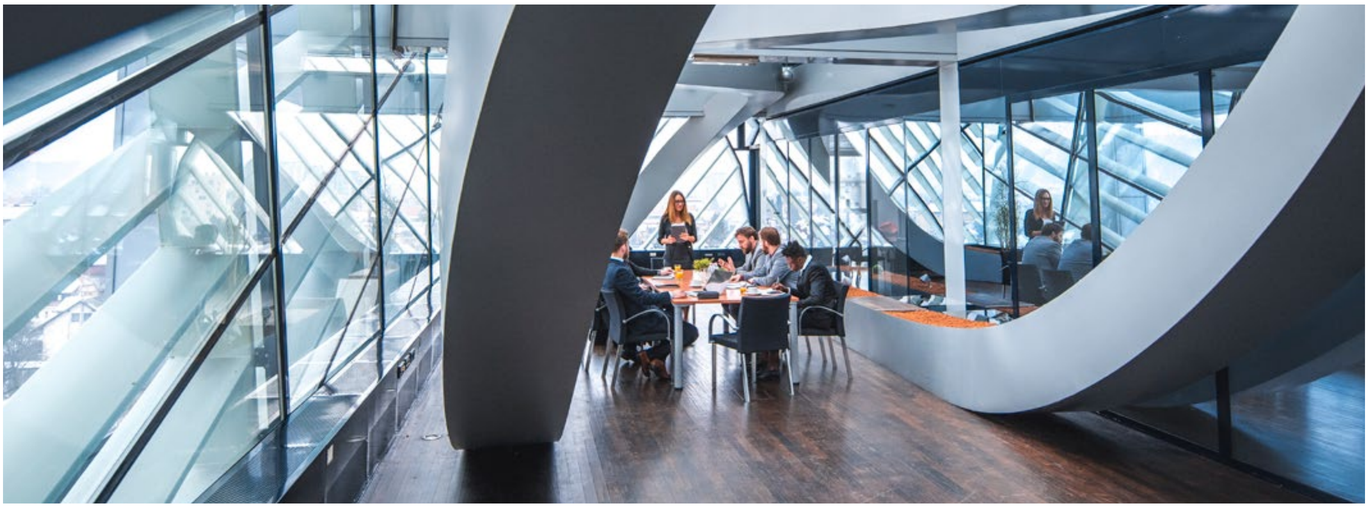

In *Minor Hotel Group MEA DMCC v Dymant & Anor [2022] EWHC 340 (Ch)*, is the first reported High Court decision considering a contested moratorium since the new Part A1 moratorium ("moratorium") was introduced in 2020, in which the monitors successfully opposed an application by the parent company's secured creditor to remove the monitors and end the moratorium.

The ruling gives useful guidance on how monitors should exercise their discretion when considering whether to terminate a moratorium if they think that the company is unable to pay pre-moratorium debts when the company does not have a payment holiday, and what "thinks" and "unable to pay" mean in this context. The ruling also considers whether a guarantee liability benefits from a payment holiday.

These points are considered below, but it is helpful to understand the background and facts of this case in considering these.

Background

The moratorium was part of a series of measures introduced in response to the COVID-19 pandemic to help facilitate the rescue of distressed companies. The moratorium was introduced as a stand-alone "debtor-in-possession" procedure designed to give struggling companies breathing space from enforcement action by certain types of creditors, allowing time for the directors to devise a restructuring or rescue plan.

The effect of the moratorium is that while certain debts benefit from a payment holiday, other debts (including those owed to financial creditors) that fall due during the moratorium must continue to be paid during the period of the moratorium.

A moratorium allows directors to continue to run the company as usual, while the appointed insolvency practitioner (the "monitor") oversees the process to ensure that the company continues to meet the moratorium eligibility requirements. If, at any point, the company does not, the monitor must terminate the moratorium.

One of the grounds on which the monitor must terminate the moratorium is if the monitor thinks that the company is unable to pay pre-moratorium debts.

Facts

The group at the centre of this case was Corbin & King group ("Group"), the owner of several high-end restaurants, including The Wolseley, The Delauney and Brasserie Zédel.

The ultimate parent company in the Group, Corbin & King Ltd ("TopCo"), was funded by a secured lender through two loan facilities totalling £34 million (together, "the Loan"). The Loan was secured by a debenture over the parent company's assets and guaranteed by each of the 10 operating companies ("OpCos").

The TopCo failed to repay the Loan when it fell due and the lender served a notice of demand, at which point an offer was received from an investor to acquire the interests in the TopCo and the OpCos for a sum equal to the total amount of the Loan.

Meanwhile, the OpCos each entered into a moratorium in view of their potential guarantee liabilities, satisfying the proposed monitors that the OpCos could be rescued as going concerns by providing details of the offer and evidence that showed they could pay their ordinary trading debts when due.

The day following the monitors' appointment, on 20 January 2022, the lender made demand of each of the OpCos under their guarantees, thereby making them immediately liable to pay £34 million to the lender.

The offer was subsequently rejected, and on 25 January 2022, the lender appointed administrators over the TopCo. A further offer was made to the joint administrators on 26 January 2022.

On 28 January 2022, the lender applied to the court for orders terminating the moratoria of the OpCos on the grounds that the monitor had failed to do so in circumstances where the OpCos could not pay the sums demanded and this had unfairly harmed the lender's interests.

A few days later, on 3 February 2022, the investor made a third offer of £45 million for the TopCo's interests. This was the first direct offer to repay the Loan due from the TopCo (as opposed to an offer to purchase assets, the proceeds of which could be used to repay the Loan).

The Law

Under Part A1 of the Insolvency Act 1986, a monitor must terminate a moratorium if they "think" that the company is unable to pay a pre-moratorium debt for which there is no payment holiday.

Is a Guarantee Obligation a Pre-moratorium Debt Subject to a Payment Holiday?

The answer to this is straightforward, and was agreed by all parties.

A "pre-moratorium debt" is one that the company has become, or may become, subject to during the moratorium by reasons of any obligation incurred before the moratorium comes into force.

The lender's demand under the guarantees following the OpCos entering into a moratorium, therefore, created a pre-moratorium debt. Generally speaking, although a company is entitled to a payment holiday for any "pre-moratorium debts" (meaning it does not have to pay those debts during the moratorium), there are a number of exclusions. One of those exclusions is a debt or liability arising under a contract involving "financial services".

It was agreed by the parties that the OpCos' guarantees were contracts involving financial services.

As there was no payment holiday in respect of the lender's debt, the court had to consider whether the monitors ought to have terminated the moratoria given that they would be obliged to end any of the moratorium if they thought that the relevant OpCos were unable to pay.

Although the OpCos were trading successfully, there was, it appears, no prospect of the OpCos being able to pay the guarantee debt, but there was a chance that the guarantee liabilities would be extinguished if an offer made for TopCo's interests was accepted.

What Is the Meaning of "Thinks"?

Monitors have a duty to terminate a moratorium if they "think" that the company is unable to pay a debt for which the company does not have a payment holiday.

The judge considered the meaning of the word "thinks" and referred to Judge Snowden's analysis of this in *Davey v Money* in the context of paragraph 3(3) of Schedule B1 to the Insolvency Act 1986 regarding the purpose of the administration.

In that case, Snowden said that the "use of the expression that the administrator 'thinks' rather than, for example, 'reasonably believes', is a clear indication that Parliament intended a degree of latitude to be given to an administrator in deciding upon the objective to be pursued". He went on to agree that an administrator's decision is only open to challenge if it is made in bad faith or no reasonable administrator could have reached that same decision.

This approach, which allows office holders "latitude" in their decision-making, has been applied in subsequent cases, and sensibly was also applied in this case to the decisions of the monitors.

It will give comfort to insolvency practitioners that when deciding on the appropriate course of action in light of their statutory duties and obligations, the court is unlikely to interfere with their decisions unless they have acted in bad faith or acted irrationally.

Having set out what "thinks" means in this context, the court went on to consider what "unable to pay" meant.

What Does the Company "Is Unable to Pay" Mean?

a. Does this mean the company subject to the moratorium is able to pay?

The answer to this is no, at least in so far as guarantee liabilities are concerned.

The lender's view was that because the OpCos could not pay, the moratoria should be terminated. However, the court disagreed and said it would be "wrong to … focus solely upon the ability of the guarantor to pay" and to ignore the prospect that a guarantee liability might be extinguished if the primary obligor pays.

In this case, it was appropriate for the monitors to consider the ability of the TopCo to discharge the Loan.

b. When does the company have to pay?

When considering this, the monitor has to disregard debts that are likely to be paid within five business days. If the debt is one that is likely to be paid, the company "is" able to pay it. However, anything over five business days requires specific assessment as to whether the company "is" able to pay.

Does this mean at this instant or in the reasonably near future?

The judge concluded that a company "is able" to pay a pre-moratorium finance obligation if it has the "immediate prospect of receiving third party funds or owns assets capable of immediate realisation".

The prospect of immediate payment is, therefore, key. However, what is "immediate" is a matter of commercial judgment for the monitor, as to which the monitor is allowed considerable latitude.

Although in this case the OpCos had no immediate prospect of receiving funds or realising assets, the monitors had to consider the position of TopCo and whether it would receive immediate funds or whether there would be immediate realisations that would discharge the primary debt obligation.

In the case of guarantee liabilities at least, monitors should consider whether there is an immediate prospect of the primary obligor paying, which would discharge the guarantee liability.

Another point to note is that the court disregarded the cash flow test under section 123 of the Insolvency Act 1986 when assessing whether a company "is" able to pay. This was because the question under Part A1 requires the monitor to consider whether the company is able to pay a pre-moratorium debt that is already due for payment, not whether the company is able to pay debts "as they fall due".

What Might Amount to a Perverse Decision?

Interestingly, at the time that the monitors resisted the lender's application to terminate the moratorium, the judge said that the monitors' decision "fell on the wrong side" as one that "no reasonable monitor" would have reached. Why? Because at this time, the offer to the administrators of the TopCo was not capable of immediate acceptance (the administrators had to conduct a sales process) and, therefore, immediate realisation was impossible.

However, by the time of the hearing, the offer of 3 February did provide the prospect of immediate payment and during the course of the hearing, funds had been tendered to repay the Loan.

Although the monitors appeared to have made the wrong decision and should have terminated the moratoria, the court did not exercise its discretion to do so.

In reaching that decision, the court assessed the harm suffered by the lender as creditor to be less significant than the harm suffered by the OpCos if the lender were able to commence insolvency proceedings given:

- That each OpCo was trading successfully
- There was an immediate prospect of the Loan being repaid and their guarantee liabilities being released

The court dismissed the lender's application and allowed the moratoria to continue until they lapse.

Conclusion

This case offers useful guidance on how monitors should exercise their judgment when considering terminating a moratorium, especially where the monitor thinks there is a reasonable prospect of payment of a debt, as well as how the concept of payment should be considered – at least in so far as guarantee obligations are concerned. However, the judgment could also be applied in other situations, where there is a prospect of the debt being immediately repaid by a third party.

Practitioners will welcome the decision and, in particular, it confirming that their decisions will be afforded the same degree of latitude when making decisions of a commercial nature, which we have seen the court apply in previous cases.

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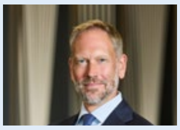

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