ATTRACTION

Richard Buttigieg, **Gemma Arias** and **Michael Castiel** of **Hassans** explain how a new statutory regime under Gibraltar law will affect companies and their creditors

The Insolvency Act was passed by the Gibraltar Parliament on September 8 2011, and comes into operation on the day appointed by the relevant Minister by notice in the Gibraltar Gazette. This is likely to happen soon.

There is little doubt that the Act sees a confirmation of a change of attitude in Gibraltar towards insolvency procedures. The Act makes directors directly responsible (and even liable) for some of the consequences of decisions taken by the directors of a company. It aims to improve the plight of creditors in insolvency scenarios by handing over control of insolvent companies to individuals appointed by the creditors in defined circumstances. It also brings in novel workout procedures which attempt to save companies (which are either insolvent, or likely to become insolvent) as going concerns.

The Act is likely to have a significant effect on the attitude of bank lenders and creditors in Gibraltar.

The advent of workouts

When companies find themselves in financial distress, the solution need not always be the liquidation of the company. Options other than liquidation (be it a members' voluntary liquidation, or a winding up by the court) are novel under Gibraltar statutory law.

The Insolvency Act offers different alternatives through which a company can seek to stabilise itself and explore options which could, if implemented correctly, successfully rescue the company. The input of creditors, who will no doubt often be financial institutions, in these processes will be fundamental. They will also be beneficial for banks in the long term since the rescue of the firm could mean the bank's debts are paid in full, and potential further business could result from the company which was once in distress.

Under the Act, a company will have the option, with the support of all fixed charge holders, to enter into company voluntary arrangement (CVA): an easy and comparatively low-cost rescue procedure which is an alternative to administration or liquidation for companies in financial difficulty. CVAs can also be used for solvent companies on the cusp of insolvency and by liquidators/administrators in a liquidation/administration scenario.

If the company is in financial difficulty and the directors of the company believe (on reasonable grounds) that the company is either insolvent or likely to become insolvent, the directors may propose to the creditors of the company the possibility of entering into an arrangement. Notice of a meeting must be given to creditors and shareholders, to discuss the CVA. Proposals can include rescheduling the debt, a debt-for-equity swap, or the directors being prepared to sell assets to repay the creditors within a set period of time. A majority of the creditors of the company (or those affected) must approve the proposal.

Although not specifically stated in the Act, this majority is determined by the amount of debt outstanding per creditor, rather than by the number of creditors present. Furthermore, the proposal will not be passed without the approval of any secured creditors of the company. Once passed, the CVA is binding on all creditors.

Under a CVA, banks and other creditors have the opportunity to work with financially distressed companies to formulate an arrangement that will bring the company back to having a positive balance sheet and result in liquidation being avoided. The bank, as a creditor, will have to approve of the proposal in order for the arrangement to go ahead. Further, if the bank is a secured creditor and does not approve of the proposal, it may veto it altogether.

Additionally, if any creditor believes that an arrangement has unfairly prejudiced their interests, they may apply to the court on the grounds of unfair prejudice, to ask the Court to revoke or suspend the arrangement.

Under the new Act a creditor will also have the option of forcing the company into administration. Administration is an insolvency process that is designed to encourage the restructuring and refinancing of a company in order to avoid liquidation. The administration procedure involves the appointment of an administrator who displaces the directors of the company.

There are two routes under which a creditor may push a company into administration; the out-of-court route or the court route. If the creditor is a qualifying floating-charge holder, it may appoint an administrator through an out-of-court route under the Act. A floating charge is known as a qualifying floating charge if it is created by an instrument which states that section 48 of the Act applies to the floating charge. Alternatively, an administration order may be sought by the bank (regardless of what type of charge it holds) through the court.

The circumstances under which a holder of a qualifying floating charge and the court may appoint an administrator differ. In order for the court to appoint an administrator, it must be satisfied that the company is insolvent or is likely to become insolvent. The Act specifically states that when the holder of a qualifying floating charge makes an application for the appointment of an administrator, the court may make an administration order whether or not it is satisfied that the company is insolvent or

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An LLB honours graduate in Law and Spanish Studies from Kingston University in the UK, Buttigieg completed the Bar Vocational Course at the Inns of Court School of Law in London and, as a member of the Middle Temple, was called to the Bar of England & Wales and Gibraltar in 2003. He is also called to the Bar of the Eastern Caribbean Supreme Court and therefore advises corporate services providers in all matters concerning the laws of the British Virgin Islands, including those arising under the BVI Insolvency Act.

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> **"The threshold for placing a company into administration is a lot lower for a person holding a floating charge"**

Gemma Arias

Gemma Arias specialises in corporate advisory work, advising clients on a range of transactions, such as the corporate restructure of several private equity funds through the use of different mechanisms available under Gibraltar company law. She regularly advises clients on methods of returning value to the shareholders without requiring court approval. Having come from a financing and insolvency background, with the passing of the Insolvency Act in Gibraltar she is now looking to extend her practice to include advising corporate clients on matters arising from the Act.

Arias graduated from Oriel College, Oxford University, with a BA in jurisprudence and continued at the Oxford Institute of Legal Studies to complete her LPC. She then carried out her training at Slaughter and May (spending six months at Uria Menendez's offices in Madrid) before qualifying as a solicitor in the banking department, where she worked on several acquisition finance transactions and the high profile re-financing of several public companies. She returned to Gibraltar and was called to the Gibraltar Bar in 2007, and can practice as both a barrister and solicitor in Gibraltar.

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is likely to become insolvent.

This means that the threshold for placing a company into administration is a lot lower for a person holding a floating charge than any other creditor. It would therefore be useful for creditors to consider entering into floating charges, as well as fixed charges, in order to make such options available to them.

The Insolvency Act provides creditors with rights during administration. This allows them to have a form of control over the administrator during the process. The Act requires a meeting of the creditors to be held in order to consider the administrator's proposals. The only instance where a creditors meeting would not be held would be if the administrator is of the opinion that the company has sufficient assets to enable each creditor to be paid in full. A meeting may nevertheless be held if requested by creditors whose debts amount to at least 10% of the total liabilities of the company.

These provisions clearly aim to keep companies afloat during harder times. Whether the difficulties arise due to cash flow problems (in which case a CVA may be more appropriate) or due to a bad management team (in which case administration may be more appropriate), the Act clearly signals a desire to keep companies afloat. This should be welcomed by both companies and creditors since, long term, it may be in both their interest to maintain the company as a going concern.

Balancing interests

The aim of administration is to rescue companies in distress and, as a last resort, to turn to efficient asset realisation. An administrator must perform his functions with the aim of achieving one of the statutory objectives of administration, which are:

(i) to rescue the company as a going concern;

(ii) (if the first objective is not achievable) to achieve a better result for the company's creditors as a whole than would have been likely on a liquidation; or

(iii) (if the first or second objective is not achievable) to realise property in order to make a distribution to one or more secured or preferential creditors.

The administrator must first act in the interests of the insolvents by attempting to rescue the company as a going concern. If the second objective would achieve a better outcome for the creditors of the company, the administrator must perform his functions in accordance with the second objective. This means that although the company's interests seem to be at the top of the list, if the creditors' interests are in conflict with the insolvent's interests, the creditors' interests are paramount. The third option is only to be resorted to when neither of the other options is feasible.

An administrator is an officer of the court and acts as an agent of the company. He has a duty to act in the best interests of the company's creditors as a whole. This duty applies even in circumstances where the administrator has been appointed by a particular creditor of the company.

To assist administrators in achieving the relevant statutory objective, the company has the benefit of a moratorium for the duration of the administration. This means that, without the administrator's consent or leave of the court, creditors are prohibited, for example, from taking steps to enforce security over the company's property or to repossess goods in the company's possession under an agreement. Furthermore, no legal process may be commenced or continued against the company or its property.

Although on the face of it these restrictions would seem to be a detriment to the creditors of the company, they are intended to benefit the creditors in the long run. If the administration process succeeds in saving the company, the creditors are more likely to be paid back in full. Further, by enforcing a moratorium, the interests of the creditors as a whole are likely to be better served than the interests of an individual creditor chasing the debt in a predatory manner.

The power of the veto

Whether a company enters into a CVA or administration, creditors should be aware of the time-frames within which they may exercise certain rights afforded to them under the Act and certain powers of veto which they have.

Where a CVA has been approved, a person (administrator, liquidator, creditor, director, member or a person affected by the arrangement) may apply to the court for an eligible insolvency practitioner to be appointed as supervisor or interim supervisor. The court will not make such an order for a period of 28 days after the chairman's report is filed at court. During this period creditors can challenge a CVA on grounds of unfair prejudice or material irregularity.

In the run up to the appointment of an administrator, only those creditors holding a qualifying floating charge are given the opportunity to exercise certain rights. Under the new Act, a qualifying floating-charge holder may not ap-

point an administrator of a company unless he has given at least two business days' written notice to the holder of any prior floating charge and the holder of any prior floating charge has consented in writing to the making of the appointment.

This means that floating-charge holders may veto the appointment of an administrator under the Act, if it fails to consent to the appointment within two days from being served with the written notice; however, a floating-charge holder may apply to the court for an administration order should they not receive the consent from the prior floating-charge holders.

Under the Act, a creditor who holds a debenture or other instrument of the company, secured by a floating charge may veto the appointment of an administrator by appointing an administrative receiver instead. If a bank holds such a charge, it must be served notice of the appointment of an administrator not less than seven business days before the date fixed for the hearing. If during that time the holder appoints an administrative receiver, the court must dismiss the application for the appointment of an administrator. The court will not dismiss the application if the holder who has appointed the administrative receiver consents to the making of an administration order.

Creditor-driven procedures

Another new feature under the Act is that it allows a secured creditor to appoint a receiver. Receivership is a procedure whereby a receiver is appointed to take control of specific assets under a debenture or other debt instrument, sell the assets and then pay the secured creditor what he is owed.

Administrative receivership is the same as receivership but the administrative receiver is appointed by a creditor with a floating charge; however, unlike CVAs and administration, the objective is not to save the company. Banks will often take such a charge to give themselves this power, even though the floating charge may be of little additional financial value (because they have fixed charges as well). The administrative receiver will take control over most of the assets held as security under a floating charge.

Unlike administration, where the administrator is appointed to represent the company and the creditors as a whole, in receivership the primary duty of a receiver is to exercise his powers "in a manner he believes, on reasonable grounds, to be in the best interests of the person in whose interests he was appointed" (s.111(1)(b)). The receiver must also exercise his powers with reasonable regard to the interests of the creditors of the company and the company itself, but only to the extent that it is consistent with the interests of the person by who he was appointed (s.111(1)(2)).

Therefore, if the interests of the creditor in whose interests the receiver was appointed are not consistent with the interests of the company, the receiver must act in favour of the creditor. The effect of section 111 is that it relieves a receiver to some extent from the burden of balancing the interests of the creditor and the insolvent company, unlike an administrator who must work for the benefit of both the company and the creditors.

If a company has no prospect of being rescued it will be put into liquidation. When a company enters liquidation, a liquidator has custody and control of the company's assets. The purpose of liquidation differs depending on whether the liquidator has been appointed by the members or by the court. A member-appointed liquidator's purpose is solely to concern himself with the distribution of available

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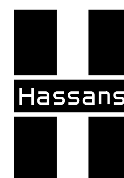

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Michael Castiel is a senior partner of Hassans, specialising in international tax, corporate and business law. He is internationally recognised as a leading corporate and tax lawyer, regularly advising large multinationals, investment banks and ultra-high net worth individuals and families on a wide range of complex corporate matters and cross-border tax arrangements. He is renowned for his vision and ability to develop creative solutions to deal with complex client issues. Over the years he has advised in relation to numerous high profile corporate re-organisations, mergers and acquisitions as well as joint venture structures and transactions involving Fortune 500 companies.

He is widely recognised as a leading lawyer is his field of work as is demonstrated by his inclusion in prestigious legal publications, where he has been described as an "outstanding" lawyer.

A member of STEP and the International Fiscal Association, Castiel studied law at East London University and at the Inns of Court School of Law. He was called to the English and Gibraltar Bar in 1993 and became a partner at Hassans in 1999. In addition to his legal qualifications and training, he has management and business administration qualifications and worked in UK industry for eight years before completing his legal training.

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assets between the shareholders. Conversely, a court-appointed liquidator's purpose is to recover and realise a company's assets and, where possible, distribute them or their proceeds amongst the creditors.

The current law on insolvency, which can be found in the Companies Act, is very limited and somewhat outdated. The new Insolvency Act will fill in many gaps and introduce new options for financially distressed companies.

Under the Act, it would appear that voluntary liquidation procedures will be simple and clear, and the cost, therefore, will be quite modest. Court procedures will be dealt with quickly, especially in the light of the six-month time limit on applications, default of which is an automatic dismissal.

The provisions of the Companies Act relating to members' voluntary liquidations would, however, seem to conflict with the provisions relating to liquidations commenced by members' resolutions in the Act. It is not entirely clear whether a Declaration of Solvency or an equivalent will be required from the directors under the Act, as was required under the Companies Act. What is meant by a "Statement of Affairs" under the Act is to be defined under rules which have yet to be published. Unfortunately, given the conflicting provisions of the Act and the Companies Act, it is this area of the new Act which we are able to comment on least.

Effect on business

The Act is most definitely likely to have a significant effect on business in Gibraltar. A very simple example of this effect will, no doubt, be that banks will always, as a matter of course, ask for a floating charge in a financing transaction. Companies will thus be forced to consider the effect of the Act from the outset of a transaction. This may, however, mean that, given that the creditor is more likely to be able to secure the return of his monies, finance may be more readily available in Gibraltar. Given the effects of the credit crisis, this will be a very welcome outcome.

A second noticeable effect will be the certainty that the Act provides other creditors and companies, as all the remedies available are now codified. This is a welcome change.

Most of the Act is modelled on the BVI Insolvency Act 2003. Since its enactment, that Act has made significant and positive changes to insolvency law in the British Virgin Islands. For example, the regime for receivership has been used a number of times and has often resulted in significant recoveries by lenders. The out-of-court nature of receivership has both protected value and limited publicity. It is very likely the Act will have the same effect in Gibraltar.

The Act gives primacy to the interest of creditors (particularly secured creditors) in dealing with the consequences of insolvency, and enforcement of security rights. The provisions relating to voidable transactions, as well as the new concept of liability of directors for insolvent trading, will provide a higher level of protection to creditors.

Until recently CVAs have seldom been used in the UK and when used have generally been unsuccessful. Many directors are unaware that they exist and so do not explore the possibility. Also, a CVA does not have the same advantage of an automatic moratorium as administration. Recently, however, CVAs have become increasingly more popular in the UK. The number of UK retailers using CVAs to renegotiate their debts with landlords has jumped by almost a quarter in a year. The fact that more CVAs are being agreed suggests that recent experiences and very uncertain economic circumstances mean that landlords see the risk of the company being pushed into administration by their actions as a likely outcome of enforcing their security and therefore CVAs are the lesser of two evils.

A catalyst for development

As Gibraltar develops as an international finance centre, an Insolvency Act that provides a clear and all-encompassing insolvency regime is a welcome addition to the territory's legislation.

The implementation of the Act introduces a list of options for companies and creditors to consider in order to avoid liquidation and achieve a better outcome for both. Although the Act is moving the legislation toward a more creditor-friendly regime, with directors being held responsible for their actions while in office, the Act ensures that insolvency practitioners balance the interests of the creditors and insolvents when carrying out their duties.

The added protection afforded to creditors by the Act will attract potential investors and the rescue culture that the Act introduces will reassure existing companies. This will encourage lending, making Gibraltar an increasingly attractive and secure finance centre in which to do business.