(Re)considering the Position of Corporate Rescue Finance for Distressed Companies under English Insolvency Law

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Abstract

This article advocates statutory super-priority for rescue finance in English Insolvency Law to tackle challenges faced by distressed companies. It critiques current market and legal framework, proposing clear guidelines to grant super-priority while protecting creditor rights. Strategic recommendations for an effective rescue finance mechanism are also offered.

1. Introduction

This article proposes the inclusion of corporate rescue finance provisions into insolvency law. In this context, "rescue" refers not only to the salvation of the entire company but also to preserving critical aspects of its business. While England is prioritising market-based solutions and certain legal approaches to rescue finance, it has yet to directly address the issue. The purpose of promoting rescue finance through legislation is to provide incentives for financing distressed companies. This issue has preoccupied the UK Parliament and Government,[1] several times, although without any legislative outcome at the time of writing. Navigating the issue of rescue finance is both difficult and challenging, given the importance of meeting the necessary conditions to mitigate potential adverse outcomes. Addressing this matter is crucial, as the lack of rescue finance can hinder the company's/business's rescue prospects.[2] The absence of rescue finance may also inadvertently discourage the risk-taking and entrepreneurship essential for successful corporate rescues.[3] It is worth acknowledging, however, that the presence of finance might not in itself be a panacea for rescue, as the parlous state of the company, macro-economic and internal factors, would all play a part in the viability of any rescue consideration/package.

Rescue finance provisions are also contained in the European Union (EU) through Articles 17 and 18 of the Preventive Restructuring Directive 2019/1023 (Restructuring Directive). This article borrows some of the definitions provided by the Restructuring Directive, which refers to 'interim' and 'new' financing.[4] Rescue finance for the purposes of this article would be both

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[1] Some examples: Department of Trade and Industry/Insolvency Service, 'Company Voluntary Arrangements and Administration Orders',1993; Department of Trade and Industry/Insolvency Service, 'Consultative Documents: Revised Proposals for a New Company Voluntary Arrangement Procedure',1995; Insolvency Service, 'A Review of Company Rescue and Business Reconstruction Mechanisms', 1999; Insolvency Service/ Department of Trade and Industry, 'A Review of Company Rescue and Business Reconstruction Mechanisms', 2000; Insolvency Service, 'Encouraging company rescue – a consultation', June 2009; Insolvency Service, 'A Review of the Corporate Insolvency Framework: A consultation on options for reform the Corporate Insolvency Framework response form', 25 May 2016; Insolvency Service, Summary of Responses: A Review of the Corporate Insolvency Framework, September 2016.

[2] Kayode Akintola, Creditor Treatment in Corporate Insolvency Law (EE Publishing 2020) 13.

[3] Department of Trade and Industry, 'White Article: Our Competitive Future: Building the Knowledge Driven Economy', Cm 4176, December 1998, para 2.12; Vanessa Finch, 'Security, Insolvency and Risk: Who Pays the Price' (1999) 62 M.L.R. 633-670.

[4] Article 2 of the restructuring directive adopts the following definitions: "'new financing' means any new financial assistance provided by an existing or a new creditor in order to implement a restructuring plan and that is included in that restructuring plan; 'interim financing' means any new financial assistance, provided by an existing or a new creditor, that includes, as a minimum, financial assistance during the stay of individual

for financing distressed companies who are pursuing rescue and of finance granted during an insolvency procedure. This is similar to the approach taken by the Restructuring Directive since interim financing sustains the company's operations while preparing for a restructuring process, while new financing fuels the implementation of strategic measures outlined in the restructuring plan.[5] Both interim and new financing are integral to the broader mission of rescuing the company from distress and orchestrating its turnaround through effective restructuring efforts. It should also be clarified that rescue finance is not solely necessary for the actual rescue of the business/company but for concurrently bringing creditors to a better position, through the realisation of the company assets. For further clarity financial assistance within the meaning of rescue finance should be interpreted widely beyond only money, which would include inter alia, new loans, the supply of stock, trade credit, inventory, raw materials and utilities.

A key element that this article addresses is whether "super-priority" for rescue finance providers should be a sought-after aspect of insolvency law. The article argues that while such priority does have a role to play, it is crucial to establish specific conditions for rescue finance to prevent undesirable outcomes. This includes examining whether rescue finance providers should receive greater priority in administration proceedings and potentially other procedures as well, a critical aspect of rescue finance that warrants exploration. It is now important to clarify what super-priority means for this article. Although super-priority could be designed to prime the entitlement of fixed charge holders, this article adopts an alternative definition. From the reading of Article 17(4) of the Restructuring Directive, priority of rescue finance could even mean beyond fixed charge holders. However, the definition used in this article for super-priority entails prioritising the rescue financier above *all* debts, *except* those of fixed charge holders. The reasons for choosing this approach are explored in section 7 where the circumstances in which statutory super-priority should be introduced is analysed.

The article begins by exploring the regulatory challenges of rescue finance in section 2, explaining the reasons that this status quo is unsatisfactory, underscoring the necessity of legislative implementation. Despite some existing solutions for the lack of explicit rescue finance provisions in legislation, notable issues persist. Section 3 discusses both the market-based solutions and the legal solutions. It highlights that the market-based solutions are flawed, as well as analysing the treatment of rescue financiers in administration and the moratorium. Section 4 examines the market problems for financially distressed companies to obtain finance and supports the implementation of super-priority to improve rescue finance incentives. Section 5 explores the complexities and limitations of current legal solutions for rescue finance and also proposes the initiation of super-priority to address these issues. Section 6 examines past consultations and recommendations concerning rescue finance, highlighting some of the debates on super-priority. Section 7 deals with the requirements under which statutory super-priority should be initiated. These conditions will also address some of the problems discussed in previous sections. Section 8 concludes.

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enforcement actions, and that is reasonable and immediately necessary for the debtor's business to continue operating, or to preserve or enhance the value of that business."

[5] For clarity, rescue and restructuring are often seen as intertwined components of a comprehensive strategy aimed at saving a company from financial ruin. While rescue focuses on immediate measures to stabilise the company's finances and operations, restructuring involves broader, longer-term initiatives to reorganise the company's structure, operations, and finances for sustained viability.

2. Regulatory problem

This section explores the difficulties encountered by distressed companies in securing value-creating financing, identifying the shortcomings of the market and legal framework in addressing these challenges. Through an analysis of the regulatory issues, the aim is to provide insights that contribute to a broader understanding of rescue finance and support the overarching argument of this article: the necessity of legislative intervention specifically targeted at enhancing and facilitating rescue finance within the English insolvency law.

In England, the common approach is to assess the viability of a company through a market evaluation, where creditors analyse the risks to decide on financing a distressed company without legal interference.[6] This market-based test indicates that companies with genuine survival prospects should be able to secure funding. Campbell believes that regulation is indispensable for welfare-enhancing economic action to take place – ie a market rests on regulation – and that 'regulation' in this sense must be distinguished from 'intervention'.[7] He adds that regulation seeks to facilitate the working of the market that will produce results which cannot and should not be known in advance.[8] Intervention seeks to produce a collectively chosen result, changing the result produced by the market.[9] This article is in support of statutory intervention and thus, rests on a claim that the result currently yielded by the market is not always ideal.

The incidence of rescuing distressed but potentially viable companies is low, indicating many such businesses are not successfully saved.[10] A key factor is the perception that these companies are not viable "going concerns," impacting creditors' willingness to provide rescue funding. Creditors often underestimate a business's rescue prospects as a result of market failures like information asymmetry, where they lack accurate information about the company's potential.[11] This misperception can lead to undervaluation and withholding of funding, causing viable companies to be denied the financial support needed to restructure and continue operating.

Debt overhang can deter new investments, making it difficult for companies with existing debt to secure rescue finance, even if they have viable recovery plans. This deters potential creditors and exacerbates underinvestment issues, as companies lack the financial capacity to pursue value-generating finance.[12] The distressed company might be worth more if it continues operating (capturing the 'going concern' value), but without new funding, this potential cannot be achieved.[13] Consequently, market failures often prevent corporate rescues, highlighting the need for interventions to correct misperceptions and support companies with genuine survival

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[6] Jennifer Payne, Janis Sarra, 'Tripping the Light Fantastic: A comparative analysis of the European Commission's proposals for new and interim financing of insolvent businesses' (2018) International Insolvency Review 178, 200.

[7] See David Campbell, 'The 'Market' in the Theory of Regulation' (2018) 27(5) Social and Legal Studies 545-571.

[8] Ibid.

[9] Ibid.

[10] Frisby in her empirical research indicates that even though it is easier to achieve a business rescue than a company rescue, asset sale is the most prevalent outcome of administration. See Sandra Frisby, 'Interim Report to the Insolvency Service on Returns to Creditors from Pre- and Post-Enterprise Act Insolvency Procedures' (July 2007).

[11] BIS Economics paper No 16 'SME access to external finance', January 2012, 9 https://assets.publishing.service.gov.uk/media/5a789648e5274a3b4807f07a/12-539-sme-access-external-finance.pdf accessed 28 June 2024.

[12] Barry Adler, George Triantis, 'Debt Priority and Options in Bankruptcy: A Policy Intervention' (2017) 91 American Bankruptcy Law Journal 563, 567-568.

[13] Kenneth Ayotte, David A. Skeel, 'Bankruptcy Law as a Liquidity Provider' (2013) 80(4) The University of Chicago Law Review 1557-1624, 1570-1572.

prospects. Statutory intervention that includes super-priority rescue finance, can mitigate these issues by offering clearer, more secure investment conditions for rescue financiers. However, assessing the company's viability remains crucial, as creditors are unlikely to lend to companies in severe financial distress.[14]

The current legal framework is flawed. Rescue finance features can be found in the administrator's and monitor's powers to use company assets and borrow during administration and a Part A1 moratorium, respectively.[15] Arguments (explored in section 3) suggest that rescue financiers can gain priority over floating charge holders through administration expenses but not over fixed charge holders. Since administration expenses are carved out of floating charge assets, current legal solutions depend on the availability of these assets. Therefore, the presence of those assets is vital However, the increasing use of fixed charges and factoring and invoice agreements means many assets may not be available for this purpose. Consequently, rescue financiers may face challenges in securing repayment, as fixed charges take priority, and assets tied up in factoring and invoice agreements are outside the traditional hierarchy of priorities in insolvency proceedings.

Secured creditors typically exert significant influence in insolvency proceedings owing to their proprietary interests in the company's assets. Banks strategically include both fixed and floating charges in their debenture agreements[16] to leverage the distinct advantages each type offers. While both fixed and floating charges exercise control over administrations, the nature of their control varies. This influence can complicate the process of securing rescue finance, which creates a regulatory problem.

The preference for fixed charges primarily stems from their position of priority and encumbrance. Fixed charge holders have priority over rescue financiers, raising scepticism among the latter if there are no available assets to secure their investment. However, recommendations regarding super-priority should not extend beyond fixed charges. Encumbrance means that assets cannot be freely sold or disposed of without the consent of the charge holder[17] and this also arises from the 'total' control that fixed charge holders have over the assets.[18] Without the fixed charge holder's support, especially when floating charge assets are scarce, rescuing the company becomes less feasible. Although priority and encumbrance pose challenges to rescue finance, fixed charge holders sometimes voluntarily cover the administration expenses.[19]

The priority of floating charges should not be overlooked, as they can provide some recoveries in insolvencies and are better positioned than unsecured creditors.[20] However, Mokal argues that the main benefit of floating charges is not their rare recoveries[21] but their ability to allow creditors to appoint an administrator and influence their choice, even if indirectly.[22] In this way, when it suits floating charge holders, they can displace the management of the company. This justifies the fact that floating charge assets can be used by

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[14] Payne and Sarra (n 6) 201.

[15] For administration: Insolvency Act 1986 (IA 1986), Sch 1, para 3 and Sch B1 para 70-71; For Part A1 moratorium: IA 1986, s A26(1).

[16] Akintola (n 2) 150.

[17] Riz Mokal, 'The Floating Charge – An Elegy' in Sarah Worthington (ed), *Commercial Law and Commercial Practice* (Oxford: Hart, 2003) 8; This is also supported by IA 1986, Sch B1 para 71.

[18] *Re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 Lloyd's Rep. 275; *Re Avanti Communications Ltd* [2023] EWHC 940 (Ch).

[19] Akintola (n 2) 72.

[20] According to *Re Lehman Brothers International (Europe) (In Administration)* [2017] UKSC 38 the waterfall of priorities runs as follows: fixed charge creditors; insolvency procedures expenses; preferential creditors; prescribed part for unsecured creditors; qualified floating charge holders; unsecured provable debts; statutory interest; and non-provable liabilities; shareholders.

[21] Mokal, 'The Floating Charge – An Elegy' (n 17) 6.

[22] IA 1986, Sch B1, para 26 and 36.

the administrator without the creditors' consent in a way that will help orchestrate a successful administration.[23] However, these features can create challenges in obtaining rescue finance, as potential new lenders may be wary of the control exerted by existing secured creditors.

Current legal solutions mainly address ex-post rescue finance, focusing on administration and, to some extent, moratoriums, potentially missing opportunities to save viable businesses. This approach delays action until insolvency is imminent. Introducing formal rescue finance with clear guidelines could address these issues effectively. Although the market aims for ex-ante rescue finance, financiers are hesitant to invest without collateral. With many companies' assets already heavily secured, providing additional collateral is challenging.[24] Therefore, guaranteeing super-priority for rescue financiers would be a practical solution.

3. Existing market and legal solutions for rescue financiers

Market judgements are shaped by current legal provisions, indicating that market behaviour and decisions are heavily influenced by the legal environment. This underscores the interconnected nature of market operations and legal regulations, where changes in the law can impact market outcomes. Currently, the legal framework lacks statutory priority for rescue financing, meaning any priority must be individually negotiated with the rescue financier. Subordination and intercreditor agreements sometimes address this gap.

A market-based solution involves negotiating between existing creditors, the company, and new creditors through subordination agreements.[25] While these agreements may require compromises, they can benefit all parties. Challenges regarding the interpretation of subordination agreements, particularly their potential impact on the *pari passu* rule, have been addressed and clarified that they do not disrupt this principle.[26] However, further negotiations can be time-consuming, which is critical for a company near insolvency. Therefore, granting statutory super-priority to rescue financiers – allowing them to precede *all* insolvency expenses, including those of floating charge holders *but not* fixed charge holders – would be a practical solution.

Intercreditor agreements, based on contract law and often found in Schemes of Arrangement[27] and Restructuring Plans,[28] can be divided into three types. The first type involves a pre-agreed seniority of rescue finance, ensuring a clear priority for repayment.[29] The second type allows senior creditors to increase their debt within a set limit while maintaining their repayment priority, indirectly supporting the availability of additional funds without the need for new negotiations.[30] The third type involves no pre-agreed terms regarding rescue finance,[31] which can lead to extensive costs and time for creditors to reach an agreement.

The first two scenarios provide structured funding frameworks for distressed companies, but the third, lacking pre-agreed rescue finance terms, leads to delays and higher costs from prolonged negotiations. Although statistics on intercreditor agreements are not available because they are private, they are more common in larger companies with complex business

[23] IA 1986, Sch B1 para 70.
[24] Gerard McCormack, 'Super-priority New Financing and Corporate Rescue' [2007] JBL 701, 705.
[25] Lydia Tsioli, 'Rescue financing under a 'viability spotlight'' (2023) 23(1) Journal of Corporate Law Studies 843-885, 870.
[26] *Re Maxwell Communications Corp (No 2)* [1993] 1 WLR 1492; *Re SSSL Realisations (2002) Ltd* [2004] EWHC 1760 (Ch); *Re Kaupthing Singer & Friedlander Ltd* [2010] EWCH 316 (Ch); *Re Lehman Bros* [2017] UKSC 38.
[27] Companies Act 2006 (CA 2006), Part 26.
[28] CA 2006, Part 26A.
[29] Tsioli (n 25) 878-883.
[30] Ibid
[31] Ibid.

structures.[32] Smaller companies may use them less frequently, which can diminish their effectiveness. While 'super-priority' could be established through subordination or intercreditor agreements, the low rate of company/business rescues highlights the need for statutory intervention. Caution is needed to avoid artificially prolonging economically unviable entities. The natural cessation of businesses can align with creative destruction, which drives economic innovation.[33] Rescue finance should support only viable enterprises capable of thriving in a dynamic market.

Examining existing legal solutions is essential to understand how super-priority affects insolvency laws. These solutions mainly concern administration, which can result in various outcomes: full or partial company rescue, business rescue, or asset sales.[34] Relevant features are also found in the Part A1 moratorium. Administration's impact on creditors is crucial, potentially offering better returns than liquidation, though this depends on costs.[35] A business/asset sale, whether as a going concern or piecemeal, can still be part of a rescue agenda and benefit all stakeholders. Therefore, access to rescue finance is vital for saving companies and achieving effective business rescue and asset realisation.[36]

The administrator can raise funds secured against the company's assets,[37] even though rescue finance is not explicitly provided for in legislation. This includes managing assets under a floating charge[38] as if they were unencumbered.[39] For example, available cash can be used for financing without creditor consent or court involvement,[40] unless the account is under a fixed charge, which requires consent.[41] The primary aim of IA 1986, Sch B1, para 70 is to enable the collection of funds necessary for effective administration management.[42]

The administrator plays a crucial role in assessing the feasibility of administration objectives, particularly ensuring sufficient funds or assets for ongoing operations.[43] By granting this power, Parliament recognised the challenges when no unencumbered assets are available, essential for effective administration.[44] The growing use of fixed charges and

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[32] One of the most recent examples of a complex large business structure and an intercreditor agreement involving a restructuring plan that went to the Court of Appeal is *Re AGPS BondCo Plc* [2024] EWCA Civ 24 (CA).

[33] This is in line with Schumpeter's argument that it is better to let failed businesses go to the wall and let the entrepreneurs start again. See Joseph Schumpeter, *Capitalism, Socialism and Democracy* (Harper & Brothers 1942) Chapter VII. As regards to the connection between creative destruction and rescue see John Wood, 'Creative destruction and the post COVID-19 economy: a critique of the (un)creative rescue value contained within the permanent CIGA 2020 reforms' (2023) 3 JBL 197-221.

[34] The hierarchical objectives of administration are that the company should be saved as going concern; produce a better result for creditors rather than in liquidation; and realise the assets of the company for the benefit of secured and preferential creditors; See IA 1986, Sch B1, paras 3(1)(a)-(c).

[35] In *Re Logitext UK Ltd* [2005] 1 BCLC 326 it was highlighted that the outcome for creditors can be better in an administration than in a liquidation; Kayode Akintola, Sofia Ellina and David Milman, 'Should we rescue in Insolvency?' UK Insolvency Service Publications (2022) <https://sites.google.com/view/forwardthinkingconference2021/home> accessed 17 July 2024.

[36] This should only be pursued if does not sustain unviable companies.

[37] IA 1986, Sch 1, para 3.

[38] IA 1986, Sch B1, para 70(1).

[39] *Davey v Money* [2018] EWHC 766 (Ch), [2018] Bus LR 1903 [593] (Snowden J).

[40] Sarah Paterson, 'Finding our way: secured transactions and corporate bankruptcy law and policy in America and England' (2018) 18 Journal of Corporate Law Studies 247, 254.

[41] IA 1986, Sch B1, para 71(3).

[42] Gavin Lightman, Gabriel Moss et al., *Lightman & Moss on the Law of Administrators and Receivers of Companies* (5th edn, Sweet & Maxwell, 2011) 177; Akintola, *Creditor Treatment* (n 2) 101.

[43] Akintola, *Creditor Treatment* (n 2) 83.

[44] Sarah Paterson, 'Finding our way' (n 40) 254; A further rationale behind the IA 1986, Sch B1, para 70 is that an administrator, in an attempt to rescue the company, should be able to use the company's assets in the same way as the company did prior to administration: Law Commission, Report No 296, Company Security Interests: Final Report (Cm 6654) 71, 7 July 2005

receivables financing complicates the purpose of IA 1986, Sch B1, para 70, reducing the pool of assets available for rescue finance and underscoring the need for dedicated legislative provisions, including super-priority.

The priority status of rescue financiers is crucial but not fully addressed by current legal solutions. McCormack argues that a broader interpretation of IA 1986, Sch B1, para 99(4) could prioritise debt or liability contracts entered into by an administrator over administration costs and floating charge assets,[45] potentially allowing super-priority for rescue finance agreements. However, a narrower interpretation of this paragraph suggests that such contracts are only prioritised over floating charges and are considered part of administration expenses rather than being placed above them. This interpretation is linked to IA 1986, Sch B1, para 70 and para 99(3), which state that if rescue finance agreements are deemed administration expenses, they would supersede floating charge assets but not fixed charge assets.[46] This creates challenges when assets are encumbered by fixed charges or when creditors use asset-based lending, reducing the pool of assets available to cover administration expenses.

The connection of IA 1986, Sch B1, para 99 with rescue finance has on a certain extent now been clarified by the High Court decision in *Bibby Trade Finance Ltd v McKay*[47] through also interpreting Insolvency Rules 2016 (IR 2006), r 3.51 (which previously was Insolvency Rule 1986, r 2.67). This case indicated that a creditor providing fresh capital to the company would be considered as part of the administration expenses, thus receiving priority over both floating charge holders and of other creditors *ex-ante* administration (excluding fixed charge holders).[48] While legislation largely overlooks the topic of rescue finance, judicial developments underscore the significance of administration funding, and on a certain extent incentivising creditors to provide it.

Upon closer examination of the Insolvency Rules, the rescue financier may be encompassed by IR 2006, r 3.51(2)(a), which states that administration expenses payable from the floating charge assets include "expenses properly incurred by the administrator in performing the administrator's function". This means that rescue financiers are placed in the first category of expenses, but their distribution will be equal among those included in that category.[49] Yeowart notes that "no provider of funds is likely to be willing to advance new money, unless it is satisfied that the new money will be fully recoverable."[50] The interpretation of administration expenses, including the classification of rescue finance, is still evolving, albeit partially addressed by various cases[51] and IR 2016, r 3.50-3.51. Consequently, the recovery of rescue finance becomes uncertain, particularly in cases where assets are scarce.

<https://www.lawcom.gov.uk/app/uploads/2015/03/lc296_Company_Security_Interests.pdf> accessed 21 June 2024.

[45] McCormack, 'Super-priority' (n 24) 728.

[46] Vanessa Finch, David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, CUP 2017) 336-338; McCormack, 'Super-priority' (n 24) 728.

[47] [2006] EWHC 2836 (Ch).

[48] Ibid para [22].

[49] Kristin van Zwieten (ed), *Goode on Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell 2018) 546; Even in a situation where this is uncertain if a case reaches the court, the salvage principle can be used in a way of interpreting the rules like in was the case in *Pillar Denton Ltd & Ors v Jervis & Ors (Game)* [2014] EWCA Civ 180, which interpreted that rents fall within the meaning of administration expenses in a trading administration.

[50] Geoffrey Yeowart, 'Encouraging company rescue: what changes are required to UK insolvency law?' (2015) 3(6) Law and Financial Markets Review 517-531, 523.

[51] See the following cases on the challenging issues of administration expenses: *Re Lundy Granite Co; ex p Heavan* (1871) LR 6 Ch App 462; *Re Atlantic Computer Systems Plc* [1992] 2 WLR 367; *Powdrill v Watson* [1995] 2 W.L.R. 312; *Re Toshoku Finance UK Plc* [2002] 1 WLR 671; *Re Trident Fashions Plc* [2006] EWCA Civ 203; *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2010] 3 WLR 171; *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd* [2013] 3 W.L.R. 1132; *Pillar Denton Ltd & Ors v Jervis & Ors (Game)* [2014] 3 WLR 901.

Granting further priority to rescue financiers would alleviate concerns regarding the repayment of their debt. It would also be crucial to specify in legislation the types of credit covered by the definition of rescue finance. Further implications as regards to limited availability of assets, are discussed in section 5, aiming to provide additional justification for introducing the super-priority of rescue finance.

Pre-administration rescue finance would not receive priority under the administration expenses as it is not "a debt or liability arising out of a contract entered into by the former administrator."[52] Under these circumstances, contracts entered into prior to administration would rank as provable debts, with only post-administration finance deemed part of the administration expenses.[53] It is worth noting, however, that through the equitable principle of *Lundy Granite* some pre-administration expenses can be classified as administration expenses. This is where market failure is accentuated since here the rescue financier will have two options: to obtain a floating charge as security or provide funding on an unsecured basis. Both occasions can be disincentivising, as in the event of default the waterfall of priorities[54] would apply. Unsecured creditors would typically rank at the bottom of the waterfall of priorities so the only reason to provide rescue finance is if they are guaranteed a priority.

To make finance more accessible and minimise the expenses, companies often use pre-packaged administrations (pre-packs).[55] Securing rescue finance for pre-packs is comparatively simpler, as it involves gaining support from floating charge holders who would provide funding under such circumstances. A key criticism of pre-packs is that they deviate from the principle of collectivity among the general body of creditors, while also lacking transparency.[56] Although the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 has been introduced to deal with some of these issues, pre-packs might not be the most appropriate way to pursue rescue finance. Therefore, while pre-packs come with their own rescue financing arrangements, they are also coupled with other challenges, which is another reason prompting to a legislative adoption.

The Part A1 moratorium introduces relevant legal developments for rescue finance.[57] If the monitor consents, security can be granted over company property, enabling access to rescue finance.[58] This shift of responsibility to the monitor, instead of involving directors or courts, can speed up funding but raises concerns about accountability and stakeholder interests. It would be more appropriate for the court or the directors, who have heightened duties during a moratorium, to be more involved in obtaining rescue finance, rather than placing that responsibility solely on the monitor. Creditors can also play a key role, as they will provide finance only if they believe the company can be rescued; otherwise, they may enforce their debts and end their relationship with the company.

Another potential drawback of not legislating super-priority is evident when a company secures such financing during the moratorium. In this scenario, the financing would be

[52] IA 1986, Sch B1, para 99(4).

[53] van Zwieten (ed) (n 49) 546

[54] See footnote 20 for the waterfall of priorities.

[55] Andrew Keay, Peter Walton, *Insolvency Law: Corporate and Personal* (5th edn, Jordan Publishing, 2020) 137; A pre-pack is a pre-arranged strategy where the company secures a buyer for its operations swiftly before formally undergoing administration.

[56] Bolanle Adebola, 'Transforming Perceptions: The Development of Pre-pack Regulations in England and Wales' (2023) 43(1) Oxford Journal of Legal Studies 150.

[57] For more on the Part A1 moratorium see Jennifer Payne, 'An assessment of the UK restructuring moratorium' (2021) Lloyd's Maritime and Commercial Law Quarterly 454-475; Angharad James, 'Curtailment of individual rights by statutory moratoria' (2022) 22(2) Journal of Corporate Law Studies 1017-1044; Sarah Paterson, 'Restructuring moratoriums through an information-processing lens' (2023) 23(1) Journal of Corporate Law Studies 37-67.

[58] IA 1986, s A26(1).

categorised as a moratorium debt which is not a holidayed debt,[59] allowing creditors to accelerate the repayment of the debt. Debts that are *not* holidayed receive a priority status if the company uses either administration or liquidation within 12 weeks of terminating the moratorium.[60] These debts are prioritised over any debts payable under IA 1986, Sch B1, para 99.[61] This technically means that under these circumstances rescue financiers would receive super-priority, as they are prioritised over all insolvency expenses but not of fixed charge holders. As a result of not having super-priority available in other circumstances, the moratorium could be used functionally to grant priority to some rescue financiers. This underscores another reason for supporting the legislation of super-priority, as it would regulate potential opportunism.

4. Problems with existing market solutions

Securing rescue finance for distressed companies presents numerous challenges, exacerbated by inherent market imperfections. These issues can restrict the potential of a viable company to be saved, arising from information asymmetry and debt overhang. This can be even more devastating for smaller companies. Addressing these challenges necessitates measures such as legislative reforms incorporating super-priority to incentivise creditors and enhance market dynamics.

Involving existing creditors helps address information asymmetry, as they often have long-standing relationships with the debtor,[62] leading to less rigorous screening compared to new creditors.[63] This imbalance exacerbates information gaps and deters new financiers, complicating rescue efforts. Accessible finance during financial distress can signal the company's potential for recovery, attracting more creditors.[64] To incentivise both existing and new creditors, especially those hesitant to provide finance without security, introducing super-priority could offer greater assurance of repayment and mitigate information asymmetry.

When there is an overhang problem within the company if existing creditors are unwilling to provide rescue finance, a distressed company may run out of options. Also, even if new creditors are willing to provide the funds, without unencumbered assets, they will do that at a high cost, that the company may not be able to afford.[65] The debt overhang problem and the limitations to obtain rescue finance significantly impact the ability of companies/businesses, particularly smaller ones, to survive financial distress.

Larger and medium-sized companies, with valuable assets and market presence, are more likely to secure rescue finance despite encumbrances.[66] In contrast, micro and small businesses, often highly leveraged and reliant on bank financing, struggle to obtain rescue finance without personal guarantees, even if viable.[67] Difficulties in collateralising assets without agreements

[59] For the definition of a moratorium debt see IA 1986, s A53(2).
[60] IA 1986, s174A.
[61] IA 1986, Sch B1, para 64A.
[62] John Wood, *The Interpretation and Value of Corporate Rescue* (EE 2022) 119-120.
[63] George Triantis, 'A Theory of the Regulation of Debtor-in-Possession Financing' (1993) 46 Vand. L. Rev. 901, 916.
[64] Aurelio Gurrea-Martinez, 'Debtor-in-Possession Financing in Reorganisation Procedures: Regulatory Models and Proposals for Reform' (2023) 24 European Business Organization Law Review 555–582, 557.
[65] McCormack, 'Super-priority' (n 24) 705; George Triantis, 'A Free-Cash-Flow Theory of Secured Debt and Creditor Priorities' (1994) 80(8) Virginia Law Review 2155-2168, 2162-2163.
[66] Payne and Sarra (n 6) 202.
[67] Ibid.

from pre-filing secured creditors and negative pledge clauses complicate matters. This highlights the need for super-priority in rescue finance to address these issues.[68]

5. Problems with existing legal solutions

The existing legal framework operates under the premise that rescue financiers will be compensated from floating charge assets and granted priority over them. Therefore, the availability of floating charge assets is crucial for rescue financiers. However, issues arise owing to the ambiguity in charge classifications, the growing use of fixed charge and receivables financing, the treatment of floating charges and restrictions imposed by negative pledges.

5.1 The difference between fixed and floating charges

Courts have long struggled to differentiate between fixed and floating charges, creating practical challenges for advising creditors.[69] The *Siebe Gorman & Co Ltd v Barclays Bank*[70] ruling significantly influenced commercial law for over three decades by establishing that receivables under charge agreements were fixed charges. However, *Re Spectrum Plus Ltd* (*Spectrum*)[71] shifted this perspective, clarifying that a charge is fixed if the creditor has control and floating if the company retains control of the assets. Worthington observed that even before *Spectrum*, receivables were generally subject to floating charges,[72] highlighting the long-standing ambiguity in this area of law.

The recent case of *Re Avanti Communications Ltd*[73] has taken a more nuanced approach towards the characterisation of charges, which renders the differentiation between fixed and floating charges even more opaque. The assets in question – satellite network filings, satellite equipment, and ground station facilities – were deemed fixed charges despite the debtor company's retained control. There was a perception from *Spectrum* that there needs to be a total prohibition towards the use of assets for them to be fixed charges, but Mr Justice Edwin Johnson in *Avanti* states that this is not the correct interpretation of *Spectrum*. The judge here applied the two-stage test that came from *Agnew v Commissioner of the Inland Revenue*,[74] thus *Avanti* suggests that the element of control is more convoluted than it was previously understood. This decision is potentially expanding the range of assets considered under fixed charges and consequently decreasing the pool of assets that would fall under floating charges.[75]

There have been more recent developments regarding the distinction between fixed and floating charges following *Avanti*, demonstrated in the case of *UKCloud Ltd*.[76] In this case, the assets in question were IP addresses. The relevant debenture did not explicitly designate whether the charge over these assets was fixed or floating, nor did it expressly include IP

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[68] Gerard McCormack, *The European Restructuring Directive* (EE 2021) 139.
[69] See Richard Calnan, 'Floating Charges: A Proposal for Reform' (2004) 9 JIBFL 341.
[70] [1979] 2 Lloyd's Rep 142.
[71] [2005] UKHL 41; [2005] 2 Lloyd's Rep. 275
[72] Sarah Worthington, 'An 'Unsatisfactory Area of the Law' — Fixed and Floating Charges Yet Again' (2004) 1 International Corporate Rescue 175, 182.
[73] [2023] EWHC 940 (Ch).
[74] [2001] 3 WLR 454.
[75] This decision has been explored further in Sarah Worthington, 'Fixed and floating charges: still favouring absolutism over multi-factored nuance' (2023) 9 JIBFL 583.
[76] [2024] EWHC 1259 (Ch).

addresses in the agreement. *UKCloud* applied the two-stage test, consistent with the approach in *Avanti*, and concluded that the assets were subject to a floating charge.

These recent cases highlight why issues around asset classification are resurfacing after a pause since *Spectrum*. One reason is the rise of modern assets, such as digital assets, which complicates whether company assets are fixed or floating charges, creating legal uncertainty for advising creditors.[77] Another key factor that has likely renewed the debate over fixed and floating charges is the return of Crown preferential claims.[78] With Crown claims, floating charge holders now rank lower with a portion of the floating assets allocated to satisfying these claims.

This issue of classification of assets is important since both *Avanti* and *UKCloud* were brought before the court to clarify where creditors rank in terms of priorities and to determine whether insolvency expenses can be covered from the relevant assets. If the pool of assets available to floating charge holders decreases, it significantly complicates the full repayment of insolvency expenses, including rescue finance. This represents the *first problem* arising from the ambiguity of whether the assets are covered by fixed or floating charges, in the context of introducing a rescue finance regime.

Lawyers often recommend their clients to opt for fixed charge assets over floating charges.[79] This impacts distressed companies by limiting their ability to secure rescue finance, which is crucial for rescue financiers relying on repayment from floating charge assets. Frisby notes that "To the extent that the entirety of the corporate estate is covered by what is or resembles fixed-charge security, it may be that insolvency practitioners find the task of formulating and pursuing a rescue outcome somewhat more Byzantine than in different times".[80] In essence, a company with only fixed charge assets and no floating charge assets faces reduced prospects for rescue, as fixed charge holders are *not required to* contribute to rescue efforts.

The blurred lines between fixed and floating charges creates a *second problem*: rescue financiers face greater uncertainty regarding their prioritisation, as they will only have priority over floating charges. While they should not be prioritised over fixed charge holders, clarity regarding their position is essential. This clarity is currently obscured by the disparity between charges. Notably, administration expenses are sometimes voluntarily paid from fixed charge assets.[81] Therefore, when introducing statutory super-priority, it is crucial to incentivise this practice to avoid negative implications.

5.2 Factoring and invoice discount agreements

If security or priority cannot be obtained, the chances of collecting necessary funds to rescue a company are low.[82] This issue has been exacerbated by the rise of asset-based lending over the

[77] Paul Fradley, 'The spectre of Spectrum: after Avanti and the sliding scale of floating to fixed charges' (2023) 8 JIBFL 517; For the concerns prior to *Avanti* see: Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3rd edn, Hart Publishing, 2020) 313.

[78] The Crown preference return was announced through the HM Treasury, Budget 2018 (HC 1629, October 2018), para 3.87 and returned on the 1st of December 2020 through the Finance Act 2020, s 98-99.

[79] Gullifer and Payne (n 77) 313.

[80] Sandra Frisby, 'Not quite warp factor 2 yet? The Enterprise Act and corporate insolvency (Part 1).' (2007) 22 B.J.I.B. & F.L. 327-331, 331.

[81] Akintola, *Creditor Treatment* (n 2) 72.

[82] Vanessa Finch, *Corporate insolvency law: perspectives and principles* (2nd edn, CUP 2009) 637.

past thirty years, which has now become common practice for many companies.[83] There has been a significant increase in factoring and invoice discounting arrangements,[84] where financiers hold ownership of the receivables.[85] This means their returns are unaffected by the company's insolvency, as they are not part of the waterfall of priorities.[86] These quasi-secured creditors do not compete with other creditors in insolvency,[87] making factoring and invoice discounting appealing because they offer reduced risk and greater certainty.[88] Receivables financing reduces securitisation costs, facilitates faster growth,[89] and avoids litigation costs associated with fixed or floating charges.[90] These agreements can strengthen a company's financial structure in times of solvency and benefit receivable financiers. However, they can hinder efforts to secure rescue finance during insolvency, as limited assets pose a particular challenge for SMEs that rely heavily on receivables.[91]

Armour predicted after *Spectrum*, that receivables financing would continue to increase.[92] The rise in receivables financing was also a response to redistributive policies in commerce.[93] Armour's prediction has proven accurate, as many company receivables that would have otherwise been floating charges are now covered by factoring agreements.[94] Uncertainties that include the ongoing ambiguity in asset classifications can be unsettling for the commercial world, thus creditors opt for a factoring agreement instead of risking their position if the company defaults. Consequently, the uncertainties that come from the recent decisions of *Avanti* and *UKCloud*, along with the *volte-face* on Crown who now enjoy preferential status are both expected to lead to a further increase in asset-based lending,[95] reducing floating charge assets in insolvency scenarios.

Therefore, as company assets become more fragmented, it presents challenges for insolvency practitioners (IPs) in formulating effective restructuring strategies and discourages rescue efforts. For instance, the administrator may find no assets available for disposal, further complicating rescue negotiations. Asset fragmentation can trigger conflicts among creditors,

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[83] UK Finance, 'SME finance in the UK: past, present and future' December 2018 https://www.ukfinance.org.uk/system/files/UK-Finance-SME-Finance-in-UK-AW-web.pdf accessed 28 June 2024.

[84] Fidelis Oditah, *Legal Aspects of Receivables Financing* (Sweet & Maxwell 1991) 11, 33-34, 50-55; Book debts and receivables can be used interchangeably. A company has the authority to sell/assign its book debts instead of creating a security over them. Such book debts are sold at a discount in comparison to its face value. This transaction is usually called factoring or invoice discount agreements. In a factoring agreement, the factor assumes responsibility for managing the company's credit evaluation and the process of collecting outstanding debts. In an invoice discounting agreement, it is the company that is responsible for collecting its receivables, acting an agent of the financier.

[85] Receivables (or book debts) are sums of money owed to the company from customers/clients as the result of the sale of its goods or services: that is considered as a crucial company asset. See Richard Calnan, *Taking Security: Law and Practice* (3rd edn, Jordan Publishing 2013) 116, 137.

[86] Sandra Frisby, 'Of rights and rescue: a curious confluence?' (2019) Journal of Corporate Law Studies 39-72, 45-46.

[87] Sarah Worthington, *Proprietary Interests in Commercial Transactions* (Clarendon 1996) Chapter 2.

[88] Adrian Walters, 'Statutory Erosion of Secured Creditors' Rights: Some Insights from the United Kingdom' (2015) 2015 U Ill L Rev 543.

[89] Sandra Frisby, 'Not quite warp factor 2 yet? The Enterprise Act and corporate insolvency (Part 1).' (2007) 22 B.J.I.B. & F.L. 327-331.

[90] John Armour, 'Should We Redistribute in Insolvency?' in Joshua Getzler and Jennifer Payne (ed.), *Company Charges: Spectrum and beyond* (OUP 2006)

[91] Gullifer and Payne (n 77) 316.

[92] John Armour, 'Should We Redistribute in Insolvency?' (n 90).

[93] Ibid.

[94] Kayode Akintola, 'What is left of the floating charge? An empirical outlook' (2015) 7 JIBFL 404.

[95] Stephen Davies, Kavan Gunaratna, 'Crown preference, Corona and the continued assault on floating charge lending' (2020) 5 JIBFL 306; Caroline Sumner, 'Rescue, Recovery & Renewal' (2019) 2 CRI 72.

making coordination difficult for IPs and fostering conflicting interests among stakeholders.[96] Receivables financiers, lacking security over the company, may be less inclined to assist in rescue attempts.[97] This contrasts with situations where financiers have security, as they may have a vested interest in preserving the company/business.[98]

When a company pursues rescue finance, creditors inevitably scrutinise the potential of floating charge assets to offset costs in the event of insolvency. However, this becomes complex if a significant portion of assets is already tied up in factoring and invoice agreements. This complication amplifies the difficulty of repaying rescue finance, as traditional practice mandates it is the floating charge assets that should settle such expenses. This issue highlights the necessity of addressing the challenge should the statutory super-priority, proposed in this article, be implemented.

5.3 The treatment of floating charge holders

Even in a situation where the floating charge holders are not the rescue financiers (which is usually the case),[99] administration expenses are top-sliced from their assets.[100] According to redistributive policy, the prescribed part,[101] and preferential creditors,[102] are also paid out of the floating charge assets, aiming to mitigate the further disadvantage of unsecured creditors.[103] However, insolvency expenses can be substantial, often depleting the entire pool of floating charge assets, leaving both floating charge holders and unsecured creditors unpaid.[104] The absolute priority order of distribution is suggesting that a stakeholder running lower in the waterfall will only be paid if the creditors running higher have been fully satisfied.[105] Consequently, there may be little, if anything, remaining for creditors positioned below insolvency expenses, and sometimes even within that category. This situation can potentially expose rescue financiers to losses as well.

A new super-priority, which might be seen as 'discriminating' against existing floating charge holders, could be justified and should not have the same effects typically associated with redistributive policies. The first justification arises from the extensive control that floating charge holders have in an administration. This is because they can appoint an administrator

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[96] John Armour, Audrey Hsu, Adrian Walters, 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings' (December 2006) Insolvency Service Report, 21.
[97] Ibid.
[98] Some attempts to address this issue include banning assignment clauses in security agreements, preventing companies from entering into factoring or invoice discounting agreements. However, the Business Contract Terms (Assignment of Receivables) Regulations 2018 (SI 2018/1254) limit the use of such clauses, with exceptions mainly applying to large companies. While this might pose challenges for financially distressed companies seeking rescue, it is a sensible development for solvent companies aiming to grow, as it promotes a more fluid market for receivables.
[99] Payne and Sarra (n 6) 184.
[100] Gullifer and Payne (n 77) 316; Paterson, 'Finding our way' (n 40) 253.
[101] IA 1986, s 176A.
[102] IA 1986, s 40, 175, 386 and Sch. 6.
[103] Most of the suppliers in a company are unsecured creditors and are usually small and medium-sized enterprises, and one reason for the existence of a redistributive policy is to provide to them some kind of protection.
[104] The City of London Society, 'Secured Transactions Reform: Fixed and Floating Charges On Insolvency' Discussion Paper 2, February 2014 https://www.citysolicitors.org.uk/storage/2014/02/20140219-Secured-Transactions-Reform-Discussion-Paper-2-Fixed-and-floating-charges-v2.pdf accessed 28 June 2024.
[105] Riz Mokal, 'Liquidation Expenses and Floating Charges – The Separate Funds Fallacy' [2004] LMCLQ 387, 397-398.

out-of-court,[106] and although the administrator is usually appointed by the company/director,[107] floating charge holders retain their control through having a say in the identity of the administrator.[108] This control allows floating charge holders to select an administrator aligned with their interests, ensuring adherence to their preferences for securing future business prospects.[109] Unlike other appointors, floating charge holders can appoint an administrator without the requirement to prove the company's insolvency.[110] This reduces costs for floating charge holders and allows administration to begin proactively, before insolvency occurs.

The second justification stems from IA 1986, Sch B1 para 70, which allows floating charge holders to challenge the administrator's actions in court if they believe these actions unfairly harm them.[111] This ensures floating charge holders retain control and hold the administrator accountable. However, courts typically respect the 'business judgement rule,' known in the UK as 'commercial decision' or 'commercial judgement,'[112] meaning they avoid intervening in directors/administrators' decisions unless necessary. [113] This was upheld in the case of *Davey v Money*[114] and subsequent challenges,[115] indicating that the administrator's judgement usually prevails *unless* the creditors' wishes are completely overridden.[116] That said, administrators are unlikely to act against floating charge holders' wishes or secure rescue finance without consent.[117] The significant influence exerted by floating charge holders during administration can impede rescue finance, given that the current legal rescue finance solutions predominantly depend on floating charges. However, it is evident that implementing super-priority would not adversely affect their interests.

5.4 Negative pledges

Unencumbered assets could attract rescue financing, though negative pledges complicate matters. Negative pledges in existing finance agreements prevent additional lending or security without creditor consent. McDaniel argues that these pledges sometimes obstruct rescue by not allowing new creditors to obtain security,[118] although this is not always true, as new financing can increase company value and creditor recovery. However, negative pledges can lead to increased transaction costs and creditor holdout, as they prohibit granting new creditors priority

[106] IA 1986, Sch B1, para 14.
[107] IA 1986, Sch B1, para 22; On data regarding the initiation of administration see: Akintola, 'What is left of the floating charge? (n 94).
[108] IA 1986, Sch B1, para 26 and 36.
[109] Gullifer and Payne (n 77) 320.
[110] *Re Care People Ltd* [2013] EWHC 1734 (Ch).
[111] IA 1986, Sch B1, para 74.
[112] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch) at [754]; *Merchantbridge & Co Ltd v Safron General Partner 1 Ltd 2* [2011] EWHC 1524 (Comm) at [25].
[113] *Re T & D Industries plc* [2000] 1 WLR 646; *Re CE King Ltd* [2000] 2 BCLC 297; *Re Uno plc* [2004] EWHC 933 (Ch); [2006] BCC 725 at [157]; Andrew Keay, Joan Loughrey, 'The concept of business judgment' (2019) 39 Legal Studies 36-55, 41, 47; David Milman, 'Insolvency office-holders: recent developments and future possibilities' (2018) 412 Co. L.N. 1-54; John Wood, 'Insolvency office-holder discretion and judicial control' (2020) 6 JBL 451-475.
[114] [2018] EWHC 766 (Ch).
[115] *Moulds Fencing (Torksey) Ltd v Butler* [2020] EWHC 2933 (Ch); *Kebbell v Hat and Mitre plc* [2020] EWHC 2649 (Ch).
[116] If that is the case the courts can remove the administration which is what happened in *Clydesdale Financial Services Ltd v Smailes* [2009] BCC 810.
[117] Sarah Paterson, 'The Insolvency Consequences of the Abolition of the Fixed/Floating Charge Distinction' (January 2017) Secured Transactions Law Reform Project Discussion series, 7.
[118] Morey W McDaniel, 'Are Negative Pledge Clauses in Public Debt Issues Obsolete?' (1983) 38 The Business Lawyer 867, 879.

or security over existing assets without consent. Overriding these restrictions may require negotiating with existing creditors or amending debt agreements, increasing complexity and costs.[119] Creditors with negative pledge protections may exploit their leverage to obstruct or delay a company's rescue efforts, knowing their approval is necessary for any alterations to the company's capital structure. This can create a holdout problem, where these creditors refuse to cooperate, making it challenging for the company to negotiate with new creditors or restructure its debts effectively.[120] Given that negative pledges can pose challenges in raising rescue finance, section 7 will present potential solutions to address these issues.

6. Past consultations and recommendations on rescue finance

The UK government has grappled with the issue of rescue finance on multiple occasions, highlighting the significance of finding a viable solution. Similarly, the EU has emphasised the importance of addressing this issue, as evidenced by its proposals within the Restructuring Directive. Therefore, before exploring the proposed solutions for rescue finance in England, it would be prudent to outline the primary arguments for and against a dedicated rescue financing regime, as developed in past consultations/recommendations.

One of the earliest recommendations, dating back to the 1993 DTI/Insolvency Service proposals, suggested a super-priority moratorium loan. These proposals were abandoned in 1995 over worries about creditor exploitation and reckless lending.[121] This loan would have allowed directors to raise funds while subordinating existing creditors and prioritising trading costs. However, there were concerns it might encourage creditors to finance struggling companies with poor viability, unnecessarily extending the life of failing businesses[122] and further disadvantaging existing creditors. [123]

In 1999[124] and in 2000,[125] while considering a rescue finance regime, concerns emerged that companies would fail without it. There was strong support for addressing this issue, though caution was advised against replicating the US model, given the cultural differences.[126] Banks were reluctant to allow funding that would take priority over their debt,[127] and many believed that super-priority status required judicial involvement.[128]

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[119] Sarah Paterson, 'Private Equity in Distress and the Incentives of Collateralised Loan Obligations' (2024) Current Legal Problems 1-35, 4.

[120] For the holdout problem see Horst Eidenmüller, 'Trading in times of crisis: formal insolvency proceedings, workouts and the incentives for shareholders/managers' (2006) 7 European Business Organization Law Review 239; Lynn M. LoPucki, 'Bankruptcy Contracting Revised: A Reply to Alan Schwartz's New Model' (1999) 109 Yale LJ 380; Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale LJ 857.

[121] Department of Trade and Industry/Insolvency Service, 'Company Voluntary Arrangements and Administration Orders',1993; Department of Trade and Industry/Insolvency Service, 'Consultative Documents: Revised Proposals for a New Company Voluntary Arrangement Procedure',1995.

[122] This is a concern that has been raised by the following article: Tsioli (n 25); For the drawbacks on extending the life of a doomed company see: Michelle White, 'The Corporate Bankruptcy Decision' (1989) 3 J Econ Persp 129; Michelle White, 'Does Chapter 11 Save Economically Inefficient Firms?' (1994) 72 Wash U LQ 1319; James White, 'Death and Resurrection of Secured Credit' (2004) 12 American Bankruptcy Institute Law Review 139.

[123] Finch, *Corporate insolvency law* (n 82) 662.

[124] Insolvency Service, 'Encouraging company rescue – a consultation', June 2009.

[125] Insolvency Service/ Department of Trade and Industry, 'A Review of Company Rescue and Business Reconstruction Mechanisms', 2000

[126] Ibid p 33.

[127] ibid p 54.

[128] Ibid p 61.

The House of Lords recommended including super-priority in the Enterprise Bill 2002, but the government rejected this.[129] McKnight described the exclusion of super-priority in administration as regrettable.[130] The government argued that decisions on providing finance should be left to the market, viewing it as a commercial rather than a legal issue.[131] Concerns were also raised about an increase in factoring and invoice discounting agreements if a statutory super-priority was introduced.[132] The Society of Practitioners of Insolvency suggested that existing security rights should remain unaffected,[133] except for floating charge holders and preferential creditors, a view this article agrees with. The 2009 consultation further explored whether financiers should have priority over administration expenses.[134]

In the 2016 Insolvency Service consultation, which proposed the introduction of rescue finance, 73% of respondents opposed the super-priority aspect.[135] Some believed that viable companies should fund their own rescues without extra support.[136] Concerns included potential negative impacts on the lending environment, such as increased borrowing costs and adverse effects on floating charge holders. R3 opposed the proposals, arguing that companies with real prospects would not lack rescue funding.[137]

Many respondents to the ICG 2018 recommendations believed that the UK already has "a satisfactory market for rescue finance", as financiers are considered part of administration expenses.[138] However, the ICG 2018 report highlighted the need to address rescue finance to improve companies' chances of survival. They thought that convincing existing creditors to provide extra finance is challenging without unencumbered assets, and it is even harder for new creditors, especially if a negative pledge exists. Both the 2016 consultation and the ICG 2018 report recommended overriding negative pledges to address this issue. Despite this, the rescue finance recommendations from ICG 2018 were not implemented through CIGA 2020.

Article 17(4) of the directive states "Members states *may* provide that grantors of new or interim financing are entitled to receive payment with priority in the context of subsequent insolvency procedures in relation to other creditors that would otherwise have superior or equal claims". This article offers flexibility for member states to determine whether to adopt super-priority measures, acknowledging the complexity involved. While such a provision aligns with practices in the US and Singapore, it has not gained widespread acceptance as a norm in Europe.[139]

Developments in EU jurisdictions, such as France and Germany, reflect a softer EU approach towards enhancing rescue finance mechanisms. France offers stronger protections for rescue financiers compared to Germany though. Ordinance No. 2021/1193 of 15 September

[129] Lord Hunt, HL Debates, vol. 638, column 788, 29 July 2002.

[130] Andrew McKnight, 'The Reform of Corporate Insolvency Law in Great Britain—The Enterprise Bill' (2002) JIBL 17(11) 324-335, 327.

[131] Vanessa Finch, 'The Dynamics of Insolvency Law: Three Models of Reform' [2009] Law and Financial Markets Review 438-448, 441.

[132] Stephen Davies (ed.), *Insolvency and the Enterprise Act 2002* (Jordans 2003) 25.

[133] Ibid.

[134] Insolvency Service, 'Encouraging company rescue – a consultation', June 2009.

[135] Insolvency Service, 'A Review of the Corporate Insolvency Framework: A consultation on options for reform the Corporate Insolvency Framework response form', 25 May 2016; Insolvency Service, Summary of Responses: A Review of the Corporate Insolvency Framework, September 2016, p 11.

[136] Ibid.

[137] R3, 'A Review of The Corporate Insolvency Framework (July 2016) R3 Response' 2.

[138] Department for Business, Energy & Industrial Strategy, 'Insolvency and corporate governance: Government response', 26 August 2018, paras 5.179 and 5.180.

[139] McCormack, *The European Restructuring Directive* (n 68) 141; For more about Singapore's position see Gerard McCormack, Wai Yee Wan, 'Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's restructuring and insolvency laws: opportunities and challenges' (2019) 19 Journal of Corporate Law Studies 69-104.

2021 introduced debtor-in-possession financing provisions in French insolvency procedures.[140] Specifically, Article 31, applicable to the standard "sauvegarde" procedure, mandates that new financing must be noted in the company's recovery plan and grants these funds repayment priority over secured and unsecured pre-petition claims, though not over employees' claims or court costs.[141] Article 18 provides similar priority for new financing in the accelerated "sauvegarde accélérée" procedure. This indicates that while steps have been taken to enhance the rescue finance regime, super-priority has not been fully implemented. In Germany, the Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts (StaRUG)[142] provides protections for rescue financiers during restructuring processes that for example allow new financing to be incorporated into the restructuring plan. However, rescue financiers do not receive priority status as part of these protections unless specifically agreed upon in the plan.

Although the UK is not bound by the directive, it is still important to have a competitive regime that foreign companies can use and that other countries can use as an example. Staying ahead of other EU countries in insolvency law developments could solidify England's position as a leading destination for investment and business activity, particularly in challenging economic times. Given that Cyprus and Ireland's legal systems are based on common law and include fixed and floating charges, some super-priority proposals could be relevant for them as well. Both countries have adopted the directive but have taken a soft approach to rescue finance provisions, excluding super-priority.[143]

7. Circumstances in which statutory super-priority should be introduced

This section emphasises the importance of introducing super-priority under specific requirements that include the 'right of first refusal' for existing creditors, providing cautions as regards to the treatment of fixed charges as well as dealing strategically with factoring agreements and negative pledges. These conditions are designed to create an environment conducive to securing rescue finance, navigating legal complexities, and effectively balancing creditor interests.

7.1 Statutory priority of rescue finance and 'pre-emption' right of existing creditors

There is a concern though that the initiation of super-priority might dilute the rights of existing creditors and reduce their recovery prospects in an insolvency.[144] There is also a caution that statutory super-priority rescue financing might result in an 'overinvestment'. Overinvestment occurs because new investors, assured of their super-priority status, might inject excessive capital without sufficient scrutiny, potentially leading to inefficient allocation of resources and

[140] Paul Omar, 'Protecting new and interim financing: The stakes are high!' Autumn 2022, Eurofenix, 26-27.

[141] Joanna Gumpelson, Philippe Dubois, Dorine Chazeau 'Restructuring & Insolvency Laws & Regulations France 2024' <https://iclg.com/practice-areas/restructuring-and-insolvency-laws-and-regulations/france#:~:text=ICLG%20%2D%20Restructuring%20%26%20Insolvency%20Laws%20%26,employees%20and%20cross%2Dborder%20is> accessed 6 August 2024.

[142] § 12 StaRUG.

[143] In Cyprus it was adopted as part of examinership, which is a debtor-in-possession court-led procedure. Cyprus largely copied the older version of the Irish examinership procedure in 2015. see Companies Law (CAP. 113) s 202IE. For the definitions that Cyprus uses on rescue finance see CAP. 113, s 202N; Similarly in Ireland, rescue finance has been introduced as part of examinership. See Companies Act 2014, s 539 and 541.

[144] This concern can be detected generally in the consultations on rescue finance. See section 6.

further financial distress.[145] There is however a recommended solution to these problems that might arise.

If rescue financiers are given super-priority, to avoid the discontent and suspicion of existing creditors, finance can be asked from them first and if they say no, the company would be allowed to identify a new financier.[146] This approach balances the interests of both existing and new creditors. Existing creditors retain the opportunity to protect their position by offering additional funds. If they choose to opt out, new financiers can step in with the safety of super-priority, ensuring that the company still receives the necessary financing. Doctrinally, parallels may be drawn with the pre-emption rights of existing shareholders when new equity is sought for companies.[147] Similarly, giving existing creditors the first option to provide rescue finance respects their stake and mitigates dilution concerns. By granting existing creditors this right, it ensures that their interests are protected and that any further investment aligns with the overall rescue goals of the company. Moreover, by providing a clear pathway for new financiers if existing creditors decline, it maintains the incentives for new financiers to participate, while also mitigating the risk of overinvestment by allowing existing creditors to retain control.

Owing this to the current market dynamics distressed debt investors sometimes provide financial support to struggling companies by purchasing their debt at discounted prices.[148] This form of 'rescue finance' involves taking on the existing liabilities of the distressed company instead of injecting new capital, something that might begin to look akin to the anomalies of leveraged buyouts in insolvency contexts. In this scenario, there is a risk that investors may prioritise extracting value from the distressed company's assets to recoup their investment, leading to company asset stripping.[149] However, the right of first refusal in rescue finance allows existing creditors to provide support before external investors, mitigating the risk of such practices and safeguarding the company's assets.

Given the administrator's increased responsibilities, granting them the power to authorise rescue finance that includes super-priority would be suitable. The UNCITRAL Legislative Guide on Insolvency Law agrees with this as it emphasises the importance of the insolvency representative's evaluation.[150] However, this evaluation often requires court approval or creditor consent, especially when it impacts secured creditors.[151] This ensures transparency and protects all involved parties. The proposed super-priority, which includes the 'right of first refusal' by existing creditors, adds an additional layer of protection for existing creditors. Consequently, court oversight may appear redundant, despite suggesting accountability. While court oversight might imply accountability, doubts persist in practice regarding its effectiveness given the influence of 'commercial judgment'. If the administrator approves super-priority, courts are unlikely to frequently challenge them. Also, relying on courts to

[145] For the overinvestment problem see: Ayotte and Skeel (n 13).

[146] Recommended by Kayode Akintola and David Milman in Sarah Paterson, 'The Insolvency Consequences of the Abolition of the Fixed/Floating Charge Distinction' (January 2017) Secured Transactions Law Reform Project Discussion series, 15.

[147] CA 2006, s 561; This right is more relevant to public company shareholders, see CA, s 569.

[148] For more on distressed debt investors or 'vulture funds' as they use to be called see Sarah Paterson, 'Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards' (2014) 14(2) Journal of Corporate Law Studies 333-365.

[149] For a more detailed analysis on leveraged buyouts in insolvencies see Mika J. Lehtimäki, 'Intercreditor Agreement and Contractual Restructuring of LBOs' (2023) ECFR 547-590.

[150] UNCITRAL Legislative Guide on Insolvency Law 2005, pp 113-118 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf accessed 28 May 2024. This report highlights the importance of rescue finance. In this report the terminology used for rescue finance is 'post-commencement finance'.

[151] Ibid.

balance creditors' rights might not be feasible, as it demands time and resources, which are even scarcer for smaller companies. [152]

The question at hand is who should be responsible for granting rescue finance ex-ante, while the company is undergoing rescue preparations. Given that directors maintain their duties under such circumstances, they could bear that responsibility. However, additional checks and balances by courts should be implemented when the rescue finance amount exceeds a certain threshold, as directors may not always possess the same level of expertise as administrators. This approach would help avoid unnecessary court costs for minor loans, while ensuring court involvement for larger loans in the absence of an administrator. This recommendation is suitable for the Part A1 moratorium as well, where currently the monitor is responsible for allowing rescue finance.

7.2 The use of fixed charge assets

It has been argued in the past, that the administrators' work is linked to fixed charge assets too, thus a rescue process could arguably not only be funded from the floating charge assets.[153] The rationale behind this argument is that having access to funds from fixed charges increases the chances for securing rescue finance, as more assets will be available.[154] This idea has been supported by the City of London and Calnan, who recommended that if insolvency expenses are to be paid from all company assets, a cap should be set on the percentage that can be taken from these assets.[155] This might tackle the present challenges arising from the unclear distinction between fixed and floating charges, which hinder accessing rescue finance. However, it could also bring about new issues.

Implementing a shift that prioritises rescue financiers over fixed charge holders, or require them to provide funding, would pose challenges, potentially conflicting with established jurisprudence and legislation. Therefore, the argument is that rescue financing should *neither* take priority over fixed charges *nor* be obligated to fund the rescue in any way. The current status quo of floating charge inroads practice is justified by the control floating charge holders retain during administrations. However, the same justification cannot be applied to fixed charge holders, as they do not have equivalent control in administrations.[156] Without a court order or the consent of fixed charge holders, their assets cannot be disposed by the administrator,[157] therefore funding the rescue finance through those assets, if not voluntary, would be a statutory breach and would also come into conflict with the notion of fixed charges in general. If fixed charge holders were to be forced to pay for the insolvency expenses, it would effectively render them as 'unsecured creditors'. Fixed charge holders have agreed in that debenture to have the control of those assets, thus there will be conflict with their debenture agreement, unless the debenture is drafted to cover the whole property. Not being able to handle any of the company assets would paralyse the company in either solvency or insolvency as the assets will not be

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[152] R3 (n 137) 23.
[153] Gullifer and Payne (n 77) 316.
[154] Riz Mokal, Corporate Insolvency Law: Theory and Application (OUP 2005) Chapter 6.
[155] The City of London Society, 'Secured Transactions Reform: Fixed and Floating Charges On Insolvency' Discussion Paper 2, February 2014 https://www.citysolicitors.org.uk/storage/2014/02/20140219-Secured-Transactions-Reform-Discussion-Paper-2-Fixed-and-floating-charges-v2.pdf accessed 28 June 2024; Calnan, 'Floating Charges' (n 69) 341.
[156] Gullifer and Payne (n 77) 317.
[157] IA 1986, Sch B1, para 71(3); The chargee or security holder retains their priority and in the case of non-floating charge holders, they are the first ones to have access on proceeds of the disposal.

available for usage.[158] Forcing fixed charge holders to fund the insolvency expenses could lead to the abandonment of fixed charges altogether. Creditors might seek alternative, less intrusive methods to ensure repayment, such as asset-based lending. This shift could fundamentally alter the landscape of corporate financing and security interests.

To address the lack of floating charge assets, insolvency expenses are often covered by voluntary funding from fixed charge creditors.[159] Fixed charge creditors are incentivised to provide this funding because it grants them greater control over the insolvency process, as their consent becomes necessary for incurring expenses.[160] This control enables them to monitor and limit the expenses, so preventing administrators from engaging in disproportionate spending.[161] This arrangement typically happens when the assets used to satisfy the fixed charge holder's claim are not at risk, ensuring funds are available to pursue value-maximising strategies for the benefit of all creditors.[162] More sophisticated lenders tend to support rescue efforts aimed at preserving and enhancing value.[163] Franks and Sussman's research suggests that banks prioritise maintaining the going-concern value of companies through restructuring rather than opting for liquidation.[164] In the presence of 'lazy banks', a fixed charge holder might be more inclined towards liquidation, thus creating a liquidation bias problem.[165] However, when the company shows genuine potential for rescue, even 'lazy banks' may be inclined to contribute, emphasising the importance of aligning market assessment with the proposed statutory super-priority.

7.3 Dealing with factoring and invoice discounting agreements

To ensure the effectiveness of the proposed super-priority, it is crucial to address the increasing prevalence of factoring and invoice discounting agreements by regulating them. Walton and Umfreville argue that "such factoring agreements need to be characterised as assignments by way of security rather than absolute assignments and thereby become publicly registrable".[166] This would entail registering such agreements with Companies House as security. Under this framework, the priority of creditors would be established based on the timing of their security registration, rather than outside an insolvency procedure, as is presently the norm.[167] This would alleviate one of the main hurdles for IPs, which is finding distributable assets and "avoiding the punitive and often indefensibly high fees charged by debt factor."[168] Essentially, securitising factoring and invoice discounting agreements would address concerns about super-

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[158] See John Armour, 'The Chequered History of the Floating Charge' (2004) 13 Griffith L Rev 25, 27; Gabriel Moss, 'Fictions and Floating Charges: Some Reflections on the House of Lords' Decision in Spectrum', in Joshua Getzler and Jennifer Payne (ed.), Company Charges: Spectrum and beyond (OUP 2006).
[159] Akintola, *Creditor Treatment* (n 2)166.
[160] Ibid 95, 166.
[161] Ibid 96; It must be noted though that the Kempson Report and eventually the initiation of binding fee estimates has to a certain extent addressed the issue of administration costs. See Elaine Kempson, 'Review of Insolvency Practitioners' Fees: Report to the Insolvency Service' (July 2013), IR 2016, r 18.16 and r 18.30; The Statement of Insolvency Practice 9 was revised to be in line with the developments on fee estimates.
[162] Akintola, *Creditor Treatment* (n 2)166.
[163] Ibid 154.
[164] See Julian Franks, Oren Sussman, 'Financial Distress and Bank Restructuring of Small to Medium Size UK Companies' (2005) 9(1) Review of Finance 65-96.
[165] Ibid; Sarah Paterson, *Corporate Reorganization Law and Forces of Change* (OUP 2020) 119-220.
[166] Peter Walton, Chris Umfreville, 'Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration' University of Wolverhampton (2014) 84-85.
[167] On the registration system see CA 2006, Part 25.
[168] Peter Walton, 'Fixed and floating charges: the Great British Fund-Off?' (2015) 1 JIBFL 3, 6.

priority potentially leading to an increase in asset-based lending.[169] Therefore, limiting alternative means of financing would enhance the potential for successful rescue efforts and improve distribution prospects for all creditors.[170]

7.4 Overcoming negative pledges

There are some possible ways to deal with the effect of negative pledges during administrations to make rescue finance more accessible. Through dealing with negative pledges, it would speed up the rescue and help overcome holdouts. The argument here is that current regime already contains doctrinal grounds to allow administrators to set aside negative pledges. The first one is that, when existing creditors with a negative pledge refuse to provide rescue finance, if the administrator believes that a new creditor finance is in the interests of whole body of creditors,[171] then the administrator can apply to the court for directions[172] where the new finance might be allowed. Since the administrator is an officer of the court, they normally cannot allow a breach of a negative pledge as they need to act honourably towards that creditor.[173] Thus, through the second way administrations can be protected from any claims about inducing a breach of contract, which arise from the *Said v Butt*[174] rule. This is because the administrator is the company's agent as well.[175] A caution must be raised here though since if administrators knowingly override a negative pledge that would not be suggesting good faith. If their intentions are bona fide though their actions will be justified. If none of these options aid the administrator and the company, then access to the defence of justification should be given to both.[176]

Allowing breaches of negative pledges in insolvency might trigger some ex-ante effects. This could reduce the overall willingness of creditors to lend, particularly to higher-risk companies, and shift preferences towards alternative means of safeguarding their credit. A worrying consequence is that it would further fragment the company assets as creditors would pursue different means of safeguarding their position. It could also lead to higher borrowing costs, increased legal and negotiation complexities, and potential impacts on financial stability and market perceptions. However, Paterson states that: "Breach of covenant will be an event of default, entitling the lender to demand repayment of the loan. In general, however, lenders will not want to exercise this right because, unless the debtor has the cash on hand to repay the loan or is able to refinance it, demanding repayment may very well lead to an unplanned bankruptcy, and a value-destructive transaction, such as a break-up of the business and sale of the assets."[177] Since the insolvency of a company will not benefit the creditors with a negative pledge, while the value asset maximisation will, which can happen in a rescue procedure, these creditors would rarely hinder rescue finance. Therefore, the ex-ante effects of allowing breaches of negative pledges would be minimal.

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[169] It would also address the interference with the principle of freedom of contract caused by the prohibition of ban on assignment clauses. For more on this see: Hugh Beale, Louise Gullifer, Sarah Paterson, 'A case for interfering with freedom of contract? An empirically- informed study of bans on assignment' [2016] 3 JBL 203-230.

[170] Law Commission, Consumer Prepayments on Retailer Insolvency, Law Com No 368, 2016, para 8.33; Akintola, *Creditor Treatment* (n 2)111.

[171] An administrator has the duty to act in the best interests of creditors as a whole: IA 1986, Sch. B1, para 3(2).

[172] IA 1986, Sch. B1, para 63.

[173] IA 1986, Sch. B1, para 5; *ex parte James* (1874) 9 Ch App 609.

[174] [1920] 3 KB 498; The authorities which confirm that this rule would apply to administrator and protect them in a case of breach of contract are *Lictor Anstalt v Mir Steel UK Ltd* [2011] EWHC 3310 (Ch); [2012] Bus LR D84 para [54] and *SCI Games Ltd v Argonaut Games Plc* [2005] EWHC 1403 (Ch).

[175] IA 1986, Sch. B1, para 69.

[176] Lightman, et al. (n 42) 371.

[177] Paterson, 'Private Equity' (n 121) 4.

8. Conclusion

The complexities surrounding rescue finance demand a comprehensive and balanced approach to address the challenges faced by financially distressed companies. The article advocates for statutory intervention, arguing that the current market frequently fails to rescue potentially viable companies because creditors often misjudge their recovery prospects, problems which can arise from information asymmetry and debt overhang. These factors lead to underinvestment and fewer successful rescues. Smaller companies face even greater challenges securing rescue finance, given their limited resources and bargaining power. Thus, statutory measures like super-priority rescue finance are recommended to address these market failures, providing better conditions for rescue financing while still requiring viability assessments.

The current legal framework, where rescue finance is paid from floating charge assets as part of administration expenses, is often ineffective. This is primarily because the increasing use of fixed charges and receivables financing agreements reduces the availability of assets for rescue finance. This inadequacy supports introducing super-priority, incentivising creditors to provide essential funding. For this article, super-priority means priority over all debts except those held by fixed charge holders. While encouraging fixed charge holders to voluntarily fund rescue processes is beneficial, they should not be obligated, given the legal and practical challenges. However, their involvement can provide them with greater control over the insolvency process, potentially maximising asset value and aligning with long-term strategies.

To introduce super-priority effectively, the article recommends implementing certain conditions to avoid conflicts between existing and new creditors, as this was a primary concern that previously led the government to hesitate on the matter. To address this issue, the article suggests initiating a statutory super-priority for rescue finance while giving existing creditors the first option to provide funding. This approach aims to balance the interests of both existing and new creditors, ensuring that existing creditors can safeguard their positions. It also mitigates concerns about overinvestment and dilution.

This article suggests implementing safeguards to build trust and create favourable conditions for creditors to fund viable business rescues and prevent opportunism. Addressing issues that obstruct effective implementation of super-priority, such as factoring agreements and negative pledges, is also important. Regulating factoring and invoice discounting agreements as security and requiring their registration can improve transparency and priority in insolvency, facilitating better access to distributable assets. Managing the challenges posed by negative pledges is crucial for making rescue finance more accessible. Allowing administrators to breach negative pledges under certain conditions can expedite rescues, though this must be done carefully to maintain creditor confidence.

In conclusion, developing a robust rescue finance regime in England necessitates a careful balance between market-driven solutions and targeted legislative measures. Payne and Sarra highlight that: "In practice, however, in jurisdictions that have rescue finance in place, the market mechanism persists, even with statutory provisions enacted, because lenders will not lend into a hopeless situation."[178] This underscores the importance of legislative measures complementing, rather than replacing, market forces.

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[178] Payne and Sarra (n 6) 201.