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Finance & Transactions Insights

HMRC's slice of Italian restaurant's restructuring plan is big enough, finds English Court

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Summary

On 5 July 2023 the English High Court handed down its judgment to *In the matter of Prezzo Investco Limited and In the matter of the Companies Act 2006* [2023] EWHC 1679 (Ch), another case (hot on the heels of *The Great Annual Savings Company Limited* [2023] EWHC 1141 (Ch) (**GAS**) (see our article on that case here) and *Re Nasmyth Group Limited* [2023] EWHC 988 (Ch) (***Nasmyth***)) in which it was asked to 'cram-down' HMRC as a dissenting creditor to a restructuring plan under Part 26A of the UK Companies Act 2006 (the ***CA 2006***).

Unlike its predecessors, the applicant company in this case, Prezzo Investco Limited (***PIL***), the parent of Prezzo Trading Limited (***PTL***), the company which operates the Prezzo chain of Italian restaurants, was able to satisfy the court that it should sanction PIL's proposed plan, notwithstanding HMRC's strong opposition on the grounds of unfairness, as HMRC would still be significantly better off (and paid sooner) under the plan than in the 'relevant alternative' of placing the group into administration.

This case underscores that, despite recent judgments in the UK tax authority's favour, it is not a given that the English Court will refuse to 'cram-down' HMRC where other 'in the money' creditors will receive comparatively better treatment under a plan. In this instance, PIL's majority shareholders who had provided funding under senior secured loan notes would (eventually) be made whole, whilst HMRC would receive 33.5% of its preferential claims and none of its smaller unsecured claims.

Facts

The Prezzo group has been in financial difficulty since 2018. This became more acute as a result of the Covid-19 pandemic and, subsequently, rising supply costs. In March 2023 PIL's board concluded that 47 of the restaurant chain's sites were loss-making and identified a £2m capital expenditure shortfall. By June 2023 PIL had closed and ceased trading from the loss-making sites and PIL and PTL were each cash flow and balance sheet insolvent, with, amongst other creditors, more than £24m owing under senior secured loan notes issued by PIL and almost £12m owing to HMRC.

PIL and its professional advisers formulated a plan under Part 26A of the CA 2006 to restructure its liabilities and those of PTL, to try to enable the business to continue to trade as a going concern, albeit on a significantly slimmed down basis. The 'relevant alternative' to the plan (required to be considered under the cross-class 'cram-down' provisions set out in section 901G of the CA 2006) was the administration of both companies to implement a pre-pack sale to a newly-established entity owned by the secured loan noteholders.

Under the original plan, amounts owed to the noteholders were to be deferred, but not reduced, whilst HMRC would receive a cash payment equal to the value of the floating charge assets in the 'relevant alternative' after payment of the costs of the administration (leaving approximately £1.3m). However, when HMRC indicated that it would vote against the plan, PIL persuaded the secured noteholders to fund an additional £2m payment to the tax authority, and revised the plan accordingly.

PIL applied to the court for sanction of the revised plan, with HMRC still a dissenting creditor. It was not in dispute that Condition A (the 'no worse off' test) and Condition B (approval by 75% of those voting in any class that would receive a payment or have a genuine economic interest) of section 901G of the CA 2006 were satisfied. However, HMRC argued that the court should not exercise its discretion to sanction the plan, as it did not provide for a fair distribution of the benefits of the restructuring to it.

HMRC relied on the recent case law in this area (including *GAS* and *Nasmyth*, in each of which the English High Court refused to 'cram-down' HMRC) in support of its contention, and, amongst other things, drew the court's attention to:

- the substantial size of the HMRC debt which was to be compromised (approximately £11.8m);
- the large portion of that debt (just under £10m) which had a preferential status;

- PIL and PTL had failed to make payments to HMRC whilst preparing the restructuring plan, but continued to make substantial payments to creditors they deemed to be 'critical' arguing that the company had therefore been trading "*at the expense of*" HMRC; and
- its view that PIL had already been trading to the detriment of HMRC and was now proposing to compromise its debts to HMRC, so the court's sanction of the plan would effectively give companies the "*green light*" to use Part 26A of the CA 2006 to avoid their tax liabilities.

In sanctioning the plan, Richard Smith J held that the allocation of benefits under the plan was fair, as it not only preserved the order of priorities which would apply in the 'relevant alternative' (i.e. gave the noteholders' claims priority to those of HMRC), but also saw HMRC paid an amount which was 2.5 times larger than that available to it in the 'relevant alternative' (which was not disputed by HMRC) and represented 33.5 pence in the pound, as compared with 9.1 pence in *GAS* and 4.8 pence in *Nasmyth*.

Moreover, the plan allocated all of the £2m restructuring surplus, being an estimate of the administration costs which would be incurred in the 'relevant alternative', to HMRC and payment was to be made within 30 days of the effective date of the plan, whereas in both *GAS* and *Nasmyth* full payment would have taken up to two years. The 19 days' notice PIL had given it of the scheme hearing and PIL's failure to file its most recent tax return were by-products of its situation, rather than unfair towards HMRC.

Richard Smith J further concluded that, in light of all of the circumstances, PIL had neither been trading "*at the expense of*" HMRC nor was it using a restructuring plan as an "*instrument of abuse*" to avoid its unpaid tax bills.

Insights

- Whilst *GAS* and *Nasmyth* provide that HMRC is a creditor whose "*views deserve considerable weight*" and who should not be 'crammed-down' "*unless there are good reasons to do so*", its interests will not always trump those of other 'in the money' creditors nor justify rejecting a plan for the 'relevant alternative' if that will be more expensive and destroy more value.
- The payment of 'critical' creditors in priority to HMRC (or indeed other creditors which the relevant company deems to be 'non-critical') to preserve value and to try to rescue that company's business as a going concern, is not always unfair or inappropriate.
- The sanctioning of a restructuring plan which reasonably does not treat HMRC as a 'critical' creditor, should not open the floodgates for companies to use Part 26A of the CA 2006 to 'cram-down' their unpaid tax bills (and the court will police this on a case-by-case basis anyway).
- Recent case law in this area is helpful in setting out factors and dicta relevant to the English Court's discretion as to whether to sanction a restructuring plan, but "fairness" is, by its nature, subjective so each case will be determined, to a greater or lesser extent, on its particular facts.

Should you have any questions, please contact
Trevor Wood at twood@vedderprice.com,
Nicholas Pascal at npascal@vedderprice.com,
Henrietta Worthington at hworthington@vedderprice.com,
Samuel Wilson at swilson@vedderprice.com,
or any Vedder Price attorney with whom you've worked.

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Trevor Wood
Partner
+44 (0)20 3667 2944
twood@vedderprice.com

Nicholas J. Pascal
Partner
+44 (0) 20 3667 2930
npascal@vedderprice.com

Henrietta Worthington
Solicitor
+44 (0)20 3667 2905
hworthington@vedderprice.com

Samuel Wilson
Associate
+1 44 (0) 20 3667 2880
swilson@vedderprice.com

Finance & Transactions Group Shareholders

Michael A. Nemeroff
President and CEO
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Chicago

William J. Bettman ....(312) 609 7776
Joseph T. Bueche ....(312) 609 7873
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Marie H. Godush ....(312) 609 7674
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Andrew Torre ....(312) 609 7541
Benjamin O. Williams ....(312) 609 7667

Dallas

William A. Kummerer ....(469) 895 4820
Aaron S. Turner ....(469) 895 4810
Melissa M. Winchester ....(469) 895 4770

London

Andrew B. Harris .... +44 (0)20 3667 2945
Nicholas J. Pascal .... +44 (0)20 3667 2930
Trevor Wood .... +44 (0)20 3667 2944

Los Angeles

Jason W. Reese ....(424) 204 7730

Miami

Kenneth Gerasimovich ....(786) 741 3220

New York

Steven R. Berger ....(212) 407 7714
Robert Goldstein ....(212) 407 7771
Michael C. Nissim ....(212) 407 7790
Denise M. Tormey ....(212) 407 7778

San Francisco

Bradley C. Crawford ....(415) 749 9520

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