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(UK) The Gloves are on for HMRC: What did we learn from the Great Annual Savings Sanction Hearing?

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Yesterday saw the end of a three-day sanction hearing for the restructuring plan (the "Plan") of the Great Annual Savings (GAS) company, with Justice Adam Johnson reserving his judgment and importantly, his decision on whether to exercise cross-class-cram-down to sanction the Plan for a later date.

As we discussed in our recent blog, the Plan has generated widespread interest, with HMRC actively opposing the sanction of the Plan on a number of grounds. After facing the fate of cram-down in *Houst,* HMRC made the decision to argue their case in court this time round and in the words of their Counsel: are no longer shouting from the side lines and are on the pitch, actively resisting the Plan.

So what were HMRC's reasons for opposing the Plan?

In *Houst,* HMRC's opposition to that plan was mainly concerned with points of policy. However, as was clear by the lengthy written submissions provided by Counsel for HMRC, their opposition to this Plan was substantial and went significantly beyond objection on the basis of their preferential status

HMRC will be better off in the relevant alternative

One of the questions which needs to be considered by the court in deciding whether to exercise its cross-class-cram-down power is whether any members of the dissenting class of creditors will be worse off under the proposed plan, as compared to the relevant alternative (the "no worse off" test). In the case of GAS, the relevant alternative would be a formal insolvency process (likely an administration) and on this basis, HMRC argued the following:

- that GAS had deliberately engineered the financial reports to make it appear that, on the face of it and in monetary terms, that HMRC would be better off under the terms of the Plan. HMRC took the court through in detail, various errors which they had identified in the Plan and emphasised particularly their concerns as to the valuation process which had been carried out in relation to the book debts (which they argued would likely have a much greater recovery in the relevant alternative).

- HMRC would lose the opportunity for an office holder to investigate alleged antecedent transactions and bring claims for wrongful trading or misfeasance if the Plan was sanctioned. HMRC emphasised how this issue in particular tied into a wider public policy point, as they voiced concern about the conduct of the individual directors and that they would not be held to account for their actions (i.e., alleging that the directors had continued to trade GAS to the detriment of the Crown).

- HMRC disputed the fact that they would be better off under the Plan on the basis that due to their status as secondary preferential creditor, they would make a far greater recovery under a formal insolvency process. This argument was supported by their attack on the Plan's financials and the success of any third-party claims which could be brought in the relevant alternative, which would result in further recoveries for HMRC.

The Plan is unfair

HMRC voiced to the court that if the Plan were to be sanctioned, then this would result in a clear departure from the absolute priority rule. Specifically, HMRC argued that:

- The "eradication" of HMRC's debt and the distribution of the restructuring surplus was key, with HMRC stating that as no new equity was being injected into the Plan (as was the case in *Houst),* the resulting distribution (with the secured lender and director shareholders being the parties that would benefit from the success of the Plan) was unfair and importantly, that this reversed the absolutely priority rule.

- HMRC contrasted their position with that of the secured lender (on the basis that they were both in-the-money creditors) and argued that they were both taking a haircut, however, the secured lender had significantly more to gain under the Plan as compared to what HMRC would receive. Ultimately, HMRC argued that it could not be correct and GAS could not justify why HMRC would receive a lower return than non-critical unsecured creditors, such as the shareholder directors who would benefit despite injecting no new equity and therefore, not contributing to the value creation which the Plan envisaged.

Points of policy

What underpinned and sat alongside all of these arguments was the implication by HMRC (as well as the other opposing creditors) that GAS is a "*miscreant*" company and in particular, HMRC alleged, that the Plan was a deliberate use of the cross-class cram down mechanism to eradicate HMRC's debt.

HMRC argued that if the court were to sanction the Plan, this would have wider implications and result in a message to other directors that trading to the detriment of the Crown is something that you can get away with.

HMRC also pointed to significant interest in this hearing from the SME community and potentially the number of Plans that would also seek to "eradicate" HMRC's debt if the Plan were to be sanctioned.

What did GAS say?

Although HMRC made a number of criticisms about GAS, the viability of the Plan, its directors and their conduct, GAS's Counsel was able to answer these, with the key headlines being:

- As to the no worse off test, Counsel for GAS said it had discharged the burden that creditors would be no worse off under the Plan and if HMRC wished to take this point further it was appropriate for HMRC to produce their own valuations.

- Considering fairness, Counsel for GAS drew the court's attention to the fact that when dealing with fairness, the court has to consider whether the scheme is a fair one that the court could reasonably approve. The court does not need to consider whether this is the *best* scheme that GAS could have put forward.

- As to HMRC's preferential status, other than in a liquidation and administration, they do not have any peculiar financial status that sets them apart from other creditors in a restructuring plan.

- In relation to the issue of the suggested unfair treatment between HMRC and the secured lender, Counsel for the company argued that it is important to set out the distinction between the secured lender's position and HMRC: HMRC are not being exposed to the risk involved in implementing the Plan. The secured lender benefits from being first in line and would make significant recoveries in the relevant alternative, however, their recoveries under the Plan hinge on its implementation being ultimately, a success.

- As for the numerous allegations against the directors of company regarding their conduct, the company adamantly denied these. It was stressed that even though not all Crown debt was paid on time, these payments were still made and therefore, this was not a deviant company who set out to trade at the expense of the Crown.

Wait and See

One thing is for sure, HMRC came out with their gloves on for this Plan and depending on the outcome, it would not be surprising to see HMRC actively oppose future restructuring plans which seek to cram them down and "eradicate" Crown debt.

However, it is important to note that HMRC made it clear throughout their argument that their strong stance against this Plan was in part due to the specifics of this case, with reference to their concern over the years of mismanagement by the senior leadership of GAS.

Nevertheless, the points raised regarding the distribution of the restructuring surplus in the context of no new equity being injected and a Plan which seeks to cram down HMRC are likely to be of wider application for companies who seek to implement restructuring plans going forward.

What remains to be seen is whether Justice Adam Johnson finds merit in what HMRC argue and

agrees that HMRC will be better off in the relevant alternative and whether he views the Plan to be prejudicial and unfair. With the winding up petition (which HMRC has presented against GAS) adjourned for three weeks time, we can expect his decision shortly.

Isabella Tee authored this article.

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