Technical Bulletin No: 633

**Case:** Myers and Myers v Kestrel Acquisitions Limited and Ors [20156] EWHC 916 (Ch), Sir William Blackburne, 31 March 2015

**Synopsis:** The court was not prepared to imply a term of good faith into the provisions of loan notes where the parties could have included such a term had they so intended. Further, the court was unwilling to find that the company was balance sheet solvent on the basis of its future intention to restructure its liabilities when there was no firm restructuring plan on the table for the court to consider and no evidence a restructuring would be approved.

**Topics covered:** Implied terms; Restructuring; S123 meaning of insolvency

## The Facts

Kestrel Acquisitions Limited (the Company) had issued fixed rate unsecured loan notes (the Notes) to the applicants, Mr and Mrs Myers (the Applicants) by way of consideration for the sale of the Applicants' sub-prime lending business. It had also issued certain unsecured discounted loan notes to certain of the other defendants. The Company purported to make unilateral amendments to the terms attaching to the Notes. The amendments were designed to subordinate the Notes to further notes issued by the Company and to postpone the redemption date of the Notes.

The relevant clause of the Notes provided:

"9.1 The Company may make any modification to this instrument (including, for the avoidance of doubt, to the Conditions) either:-

9.1.1 with the sanction of an Extraordinary Resolution of the Noteholders; or

9.1.2 without the sanction of an Extraordinary Resolution but unilaterally if the modification is consistent in all material respects with any modification being made to the Discounted Loan Note Instrument."

The question for the court was whether the amendments to the terms of the Notes were valid. If they were, the Notes would mature for payment some eight years later than the original maturity date.

The Applicants argued that as a result of the purported amendments the Notes were worthless. They argued that subordination was not permissible and further argued that there was an implied term allowing the Company to modify the terms of the Notes only where the amendment was made in good faith and for the benefit of the holders of both the Notes and the holders of the Discounted Loan Note Instruments as a whole (in this way treating both groups of notes as a single class). They argued that the amendments went beyond the scope of those permitted as the amendments altered the fundamental nature of the Notes.

As well as seeking declaratory relief as to the invalidity of the amendments, the Applicants sought a declaration that the Company and its parent were unable to pay their debts within the meaning of s123 IA 1986 and therefore an event of default had arisen under the terms of the Notes.

The defendants argued that the amendments were valid. They also disputed the Company's alleged insolvency on the basis that it intended to effect a restructuring that would avoid insolvency.

## The Decision

The judge considered the extent to which the Notes could be unilaterally modified in accordance with their terms and the meaning of "modification" in that context. The court noted that it had no power to improve upon the terms of the Notes and was required to construe the terms objectively by looking at the intention of the parties (*Attorney General of Belize v Belize Telecom Ltd* [2009] UKSC 10 considered). The judge noted that had the parties wished to include a good faith caveat in clause 9 of the Notes' terms they could have; as they did not the court could not imply such a term. The documentation was extensive so there had been opportunity to include such a term if the parties had so intended. Moreover the premise of the Applicants' argument that the Notes and the Discounted Loan Instruments should be grouped together as one class was incorrect. The amendments were indeed permissible modifications.

However, the court then considered the issue of what is generally referred to as 'balance sheet insolvency' under s.123(2) IA 1986. Having found no evidence of cash flow insolvency, the question was whether the Company was balance sheet insolvent. Crucially in this case all the parties had accepted that the Company's liabilities far exceeded its assets so that some form of restructuring of the Company's debts would be necessary when the Notes fell due for payment. The only question, therefore, was whether it was permissible for the court to take into account the Company's intention to effect a restructuring when its liabilities fell due for payment (at the end of March 2018) - either by a modification of the rights of the holders of the various classes of loan notes (including the Applicants as holders of the Notes) or by recourse to a statutory scheme of arrangement under Part 26 of the Companies Act 2006.

The judge accepted that a restructuring was necessary and inevitable. However, while there was a willingness on the part of the Company to restructure its liabilities, there was no concrete restructuring plan on the table and there was no evidence to satisfy the court that the restructuring would be approved in any event. On that basis, the judge rejected the argument that the company was not balance sheet insolvent and agreed to make the relevant declaration.

## Comment

This case is interesting not only for the reminder of the grounds upon which the court will be prepared to imply terms into contracts, but also for the confirmation that mere hope or intention to effect a restructuring will not be enough to rebut the presumption of insolvency under s. 123(2) IA 1986. However, it is also important to note that the parties had accepted the necessity for a restructuring, and that no argument was advanced that the Company could grow back into its capital structure. On these facts, if a debtor wishes to convince a court of its solvency, it will need to produce credible evidence of a restructuring plan as well as evidence of support.

In relation to the terms of the Notes, it is important to remember that each case will be considered on its own facts and terms construed in their context. However, where both parties have negotiated terms, the court will be reluctant to impose supplementary terms at a later date. Parties should therefore be clear if they intend any unilateral rights to be exercised reasonably or fairly with regard to the other party's interests.