Intercreditor release: European Directories landmark judgment finds for Senior Lenders

Executive summary

On 22 October 2010, the Court of Appeal unanimously overturned the first instance High Court decision of Mrs Justice Proudman in HY Luxembourg S.A.R.L & Anr v Barclays Bank PLC & Ors [2010] EWHC 2406 ruling in favour of the Senior Lenders’ interpretation of an intercreditor release provision which lies at the heart of a senior-led restructuring plan for the European Directories group.

The Court of Appeal held that a “commercially rational construction” had to be given to the intercreditor release provision in order to enable an enforcement sale of the entire European Directories group to a purchaser free and clear of guarantee, security and debt liabilities which accords with the overall scheme of the intercreditor arrangements and would allow for the maximisation of value to all stakeholders from such sale. The High Court had adopted an extremely narrow and limited construction of the intercreditor release provision ruling that only an obligor company whose shares were themselves the subject of a direct enforcement disposal by its immediate holding company could be released from security and liabilities.

The Court of Appeal judgment is a landmark decision for a number of completed and pending restructurings in the European market clarifying the scope of an intercreditor release provision which was not uncommonly used in ‘pre-credit crunch’ leveraged debt financing transactions.

It will undoubtedly give added comfort to ‘in the money’ secured creditors seeking to implement enforcement sales of corporate groups on a going concern basis, free and clear of existing liabilities.

The judgment also affirms the commercial approach to contractual interpretation adopted by the Supreme Court last year In Re Sigma Finance Corp.,1 and the willingness of the English courts to continue to preserve the established priority relationship between senior and junior creditors recognised in previous cases such as My Travel2, IMO Car Wash3 and Redwood.4

The Senior Lenders were advised by Linklaters LLP restructuring and insolvency partners Rebecca Jarvis and Yen Sum and litigation partner Christopher Style.

2 Re Bluebrook Limited and others [2009] EWHC 2114 (Ch)
3 Redwood Master Fund Ltd and others v TD Bank Europe Ltd and others [2002] EWHC 2703 (Ch)
4 Re MyTravel Group plc; Fidelity Investments International plc v MyTravel Group plc [2004] EWCA Civ 1734

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The European Directories group

The European Directories group of companies is one of the largest directory services businesses in Europe. The business of the group is carried on by numerous operating subsidiaries all of which sit below European Directories (DH6) B.V. (DH6), the immediate holding company of European Directories (DH7) B.V. (DH7) and which itself is a holding company below which resides all of the companies in the operating group.

The group is currently financed by a number of credit facilities with the priority and ranking of these facilities regulated by the terms of an intercreditor agreement (the Intercreditor Agreement). Outstanding liabilities under such facilities amount to approximately €1.34 billion of priority senior liabilities (including first lien liabilities and hedging liabilities) (the Senior Debt), €130 million of second lien liabilities (the Second Lien Debt), €400 million of mezzanine liabilities (the Mezzanine Debt) and €305 million of PIK liabilities (the PIK Debt).

The Senior Debt, Second Lien Debt and Mezzanine Debt are guaranteed and secured by DH6 and the material operating subsidiaries of DH7 (the Obligors). The Second Lien Debt, the Mezzanine Debt and the PIK Debt are contractually subordinated to the Senior Debt under the terms of the Intercreditor Agreement.

The senior lender restructuring proposal

The restructuring proposal put forth by the Senior Lenders contemplates:

1. DH6 being placed into administration in England and an administrator carrying out a sale of the shares of its subsidiary DH7 (and therefore, a sale of the entire group under DH7) to a new holding company structure owned by the Senior Lenders (Newco);

2. Barclays Bank PLC as security trustee (the Security Trustee) transferring the Senior Debt, the Second Lien Debt and the Mezzanine Debt to Newco pursuant to the transfer provisions set out in Clause 15.2(c) of the Intercreditor Agreement;

3. the Security Trustee effecting a release of the guarantees and security provided by the Obligors pursuant to the release provisions set out in Clause 15.2(b) of the Intercreditor Agreement; and

4. the Senior Lenders receiving new debt instruments from the post-restructured group.

It was the second and third steps above which led two second lien lenders (the Second Lien Claimants and the Respondents) to seek a declaration in the High Court as to the Security Trustee’s power to release guarantees and security and transfer liabilities under the Intercreditor Agreement. The Second Lien Claimants argued that the senior-led restructuring plan incorporating steps 2 and 3 above abused the powers given to the Security Trustee under the Intercreditor Agreement because in the context of a sale of the shares of DH7 by DH6, the priority senior lenders may only instruct the Security Trustee to release the security and liabilities in respect of DH7 and not of any of its subsidiaries without the consent of each of the secured creditors including the junior lenders.
The intercreditor release provisions

As the wording of the release provisions in clause 15.2(b) and transfer provisions in clause 15.2(c) are materially the same, the parties’ arguments centred on the proper construction of the release provisions noting that the same arguments applied to the transfer provisions.

The authority of the Security Trustee to release guarantees and security under Clause 15.2(b) requires two primary conditions to be met:

1. **Is there a sale or disposal of all of the shares held by an Obligor in the capital of an Obligor or any holding company of that Obligor?** Under the senior-led restructuring plan, the envisaged disposal was by DH6 (an Obligor) of its shares in DH7 (both an Obligor and a holding company of its Obligor subsidiaries) which the parties agreed sat squarely within the parameters of the first part of Clause 15.2(b).

2. Provided that the first-part of Clause 15.2(b) is met then Clause 15.2(b) authorises “any release of the Obligor or holding company” by the Security Trustee. It was the construction of this second part of Clause 15.2(b) which was at the crux of the declaration sought by the Second Lien Claimants.

The Second Lien Claimants argued that this language operated to allow only one level of release preventing the Security Trustee from releasing the security and liabilities of any Obligor whose shares were themselves not the subject of a direct disposal by its immediate holding company (i.e. only DH7 could be released). The Senior Lenders, the Security Trustee and European Directories argued for a broader construction pointing out that such a narrow construction was at odds with both the clear scheme of the Intercreditor Agreement, agreed by all parties at the outset of the transaction, which recognised the priority and subordination of the various tranches of debt as well as the commercial purpose of striving to maximise the return of value to stakeholders in an enforcement scenario by allowing a sale of the group to a purchaser unencumbered by liabilities.

The High Court decision

On 23 September 2010, the High Court found in favour of the narrow construction of the intercreditor release provisions set forth by the Second Lien Claimants.

Mrs Justice Proudman ruled that the Intercreditor Agreement allowed only for “one layer of release” preventing the Security Trustee from releasing the guarantees and security as well as transferring the liabilities of Obligor companies whose shares were not themselves the subject of a disposal by their direct and immediate holding companies. In effect, only DH7 could be released from its guarantee, security and debt liabilities under the proposed restructuring plan.

The Court of Appeal judgment

On 22 October 2010, the Court of Appeal unanimously set aside Mrs Justice Proudman’s first instance judgment, which has the effect of allowing the proposed restructuring plan to go ahead as is.

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5 [HHY Luxembourg S.A.R.L & Anr v Barclays Bank PLC & Ors (2010) EWHC 2406 at 31.](#)

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Commercial purpose vs. natural meaning

Lord Justice Longmore, Lord Justice Jacob and Mr Justice Kitchin agreed with the arguments put forth by Antony Zacharoli QC (for the Security Trustee) that the right approach was to look at the language of Clause 15.2 in light of the commercial purpose of the Intercreditor Agreement.

Lord Justice Longmore referred to Lord Mance’s dictum from In Re Sigma Finance Corp. that “the conclusion [of the lower courts] attached too much weight to what the courts perceived as the natural meaning of the words... and too little weight to the context in which that sentence appears and to the scheme of the [document] as a whole.” He also referred to Lord Hoffmann’s dicta in Investors Compensation Scheme Ltd. v West Bromwich Building Society and Chartbrook Ltd. v. Persimmon Homes Ltd requiring the court to consider the meaning that the document would convey to a ‘reasonable commercial person’.

The Court of Appeal held that “the more commercially rational argument” was to construe the intercreditor provisions as permitting a release of all Obligor companies in the group where the shares being disposed of were those in their direct or indirect holding companies.

Reflecting the priority and ranking in the intercreditor

The Court of Appeal rejected the argument made by the Respondents that the parties to the Intercreditor Agreement had expressly negotiated a very limited release and that Clause 15.2(b) required them to either sell each company in the group structure individually or else to bargain with the Respondents to permit a sale of the Group involving a broader release. Lord Justice Longmore held that in a complex financing structure of this nature it would turn the order of priority and ranking in the Intercreditor Agreement between the senior and other creditors “on its head”.

Maximising value for stakeholders

Lord Justice Longmore commented that none of the parties to the Intercreditor Agreement could have intended that a going concern sale of the Group could only be affected by individual and piecemeal sales of group companies and individual releases of liability because this would be costly, value destructive and amount to an “exercise in futility.”

The Court of Appeal also noted that the consequence of the “negotiation” argument put forward by the Respondents was that one creditor could stymie the entire restructuring process by holding out and refusing to consent unless they were paid off in full. This would create hold-out positions for those at the bottom of the intercreditor waterfall which again contradicted the agreed order of priority and ranking in the Intercreditor Agreement.

The Court of Appeal refused the Respondents permission to appeal to the Supreme Court.

7 [1998] 1 W.L.R. 896
8 [2009] 1 A.C. 1101
9 Barclays Bank plc and others v. HHY Luxembourg S.A.R.L. and others (report pending, 22 October 2010).
10 Ibid.
11 Ibid.
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