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CDH
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# Compromise – dead duck or forgotten hero?

Many years ago, compromises were a *"hot"* way of restructuring companies in financial difficulties. This was particularly because of the tax benefits this procedure offered. Alas, these benefits are long gone. But compromise is still around as a formal procedure and in fact has been updated under the new Companies Act. It languishes in a single section (s155) at the end of the chapter dealing with business rescue, so most people seem to have forgotten that it exists.

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# Compromise – dead duck or forgotten hero? *...continued*

In certain circumstances it may be the best way to proceed and should never be overlooked as a potential debt restructuring option. In fact, considering it is better described as a "*scheme of arrangement*" and it may well be possible to preserve tax advantages if correctly structured.

What advantages does compromise offer, if any?

The big advantage is that it is the most informal way to restructure a company's affairs, and therefore theoretically the cheapest and fastest.

In essence, compromise is a procedure which enables a company to negotiate with all its creditors and bind them to a debt restructuring arrangement agreed to by the required creditor majority. It is worth noting that the company does not have to offer a compromise to all classes of its creditors, nor does a company have to be insolvent to make such an offer. In fact, companies could make arrangements with creditors by agreement which may not even require the formality of a scheme to be sanctioned under the section.

Like business rescue, compromise does not require court involvement at the initiation and approval stage, but does require court recognition, by way of application, to bind all creditors after approval. So the court must sanction the scheme in its discretion. It would be unusual for a court to undermine the wishes of the creditor majority which has voted in favour of such a scheme. This being said, the court may reject a scheme approved by creditors on grounds of public policy or "*commercial morality*".

If it is so simple, why is it not used more often? There are a few reasons.

Firstly, the step is initiated by board resolution on notice to all creditors. It will usually involve an admission that the company is unable to pay its debts. This is an act of insolvency which could initiate hostile liquidation proceedings – so it is risky. There is no protection to the company once it initiates the process - unlike business rescue.

Secondly, approval of compromise schemes requires high voting thresholds of the class of creditors to whom the compromise is offered. Approval must be by 75% of aggregate claim value at voting date of each class of creditor.

Thirdly, creditors vote separately on the proposed scheme by "*class*", and this is a term which lacks absolute clarity. The most accepted definition is that a class of creditors means creditors whose rights are similar enough to consult for their common interest, but the boundaries between different classes of creditors may not always be clear. The distinction is not necessarily confined, for example, to concurrent or secured creditors as there may be divisions within these classes.

A proposed compromise scheme is required by the Companies Act to contain certain information – a kind of "*business rescue plan lite*". This ensures that creditors are given sufficient information to make an informed decision. Class meetings themselves should be conducted with a level of formality to ensure due process. Companies may wish to appoint an independent "*receiver*" to assist them in implementing the scheme, and to assure creditors that it will be done correctly and transparently.

Compromise therefore can work effectively when a company has close relationships with its significant creditors and can place some level of trust in their co-operation. An example of where this could be effective is where there are investors and/or creditors who may wish to put in more money to clear historic trade debt at a discount for the future benefit of the company.

When boards are facing future trading difficulties they should at least consider if the debt structure of their company is such where compromise may be the simplest and most effective way to restructure debt, and to secure the company's future.

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