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Case No: CR-2018-005470

IN THE HIGH COURT OF JUSTICE
BUSINESS & PROPERTY COURTS
BUSINESS LIST (ChD)

Rolls Building
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Fetter Lane
London EC4A 1NL

Wednesday, 4 July 2018

BEFORE:

MR JUSTICE BIRSS

IN THE MATTER OF: HOUSE OF FRASER (FUNDING) LIMITED

RICHARD FISHER & MATTHEW ABRAHAM appeared on behalf of the Company instructed by Freshfields Bruckhaus Deringer LLP

JUDGMENT
(As Approved)

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1. MR JUSTICE BIRSS: This is an application by House of Fraser (Funding) plc ("the Company"), which is an entity within the House of Fraser group. The Company is seeking an order convening a single meeting of scheme creditors to consider and, if thought fit, approve a scheme of arrangement proposed by the company pursuant to Part 26 of the Companies Act 2006. The evidence before the court is in a witness statement of Mr Elliott, the chief financial officer of House of Fraser Group and a director of the Company. There is also a witness statement of Mr Shilson of Lucid Issuer Services, dealing with the notifications and the arrangements and practicalities relating to the meeting.

2. The House of Fraser group is facing a liquidity crisis. The scheme is part of what has been described as an "amend and extend" restructuring arrangement relating to the principal financial instruments issued by two entities within the group, with obligations which are cross-guaranteed by a number of other group companies. The intended effect of this part of the restructuring is first to extend the maturity dates for the relevant instruments, and any claims under the related guarantees, to a common date in 2020; second, to amend the security provisions to enable, if necessary, a further super-senior class of debt to be issued by the company or other group members; third, to implement amendments which relate to the change control provisions in the relevant financial instruments in order to facilitate a sale transaction and further investment in the group; and fourth, to make some other relatively minor amendments which bring the positions under the two principal financial instruments more closely aligned with one another.

3. The scheme has been proposed on what has been described as an "interconditional" basis, with a parallel scheme of arrangement to be proposed by a Scottish company also in the group, which is House of Fraser (Stores) Limited. Approval for that scheme is sought before the Scottish courts. The scheme restructuring is put forward on the basis that the same fee will be payable to all scheme creditors if the scheme (that is the scheme before this court) and the Scottish scheme are approved. Neither this scheme nor the Scottish scheme write off any existing debt.

4. Briefly, House of Fraser was founded in 1849 and is a premium fashion, home and beauty retailer. The group currently operates 58 department stores in the United Kingdom and one in Ireland, which together employ around 5,000 people, in addition to approximately 12,500 concession staff. An indirect majority interest in the group was acquired by a company called Cenbest in 2014. Certain of the group's stores are scheduled to close in and around January 2019 in accordance with certain creditors' voluntary arrangements (CVAs). These CVAs are themselves part of the same overall restructuring as the two schemes.

5. The wider restructuring consists of the CVAs, the two schemes, a sale transaction and further operational restructuring. In the sale transaction 51 percent of the relevant head company in the group at the time of the transaction will be bought by a further company C.banner International Holdings Limited. That sale transaction will involve £70 million worth of further capital investment into the group. The operational restructuring, which is described in the Explanatory Statement, involves redefining and re-launching the House of Fraser brand around a house of brands principle, restructuring the product strategy, making adjustments to the sales channels to align the

online and in-store customer offerings and take other steps to deal with the modern world of retailing in the United Kingdom.

6. According to the evidence, the key factors which have led the company to be in the position it is in are the impact of Brexit on gross margin, costs pressure due to the national living wage, increases in business rates, rent increases and increases in utility prices. Also, fundamentally, competition between online retailing and bricks-and-mortar retailing is another factor which has obviously been of great significance to the position of this group.

7. The group structure consists of a series of companies all under House of Fraser Group Limited. Two of them are material. One is the Company, i.e. the company promoting the scheme before me, and the other is what I have called the Scottish company. They are both members of the group.

8. The key financial instruments with which this scheme is concerned are three. The first one is the SFA (senior facilities agreement). That involves a revolving credit facility of something of the order of £100 million, a sterling loan facility of £125 million and an option on the lender to provide ancillary facilities. The Scottish company is the primary borrower under the SFA, but the scheme Company is one of the guarantors, and so are other members of the Group. As things stand, the Scottish company is currently indebted to a level of approximately £220 million - £225 million.

9. Some of the lenders under the SFA has been described as "the Indian banks". That term includes ICICI Bank UK plc and Access Bank UK Limited. They are some of the lenders under the SFA and they have lent a total of about £26 million. The current maturity date applicable to the Indian banks is 29 July 2018. Under the SFA other lending originally had a termination date which was the same, but it had been agreed to extend that date to 29 July 2019. The agreement to extend it until 2019 did not include the Indian banks. So the Company guarantees a debt of £26 million, approximately, which will be due at the end of this month. That is an important aspect of the position the group finds itself in.

10. The other important financial instrument is “the Notes”. These are governed by a notes indenture with the scheme Company, the English company. The total indebtedness under the Notes is something of the order of £175 million. In a conventional way for notes of this kind, the Notes are held in the form of a global note held by a trustee with the beneficial ownership of the Notes being tradable in various markets. Although the borrower under the Notes is the scheme Company, again there are cross-guarantees across the group, and that includes the Scottish company as one of the guarantors.

11. The third important instrument that is relevant to the finances of the company for the purposes of the issues I have to decide is an intercreditor agreement. I should say there are hedging agreements but they are not material, nor is the short-term facility something I need to be concerned with.

12. The intercreditor agreement was entered into by various companies in the Group and various other entities on 11 August 2015 and is governed by English law. It provides,

by amendment recently made, that the English and the Scottish courts have a non-exclusive jurisdiction to settle any disputes arising under it. The intercreditor agreement governs the position of creditors under the SFA and the notes, as well as other senior secured creditor liabilities defined in the agreement. Importantly, it provides that the liabilities owed to the lenders and the noteholders, amongst others, will all rank *pari passu* in all circumstances without any prior ranking between them. The intercreditor agreement also provides that all the relevant creditors share a common security package, which is defined in more detail in the documents I have seen (but the detail does not matter) pursuant to which the scheme Creditors will share *pari passu* in the proceedings of the enforcement of any transaction security and agree to loss share. The significance of the effect of the intercreditor agreement will become clear in a moment.

13. As I have said the current position is that the debt owed to the Indian banks is due at the end of the month. The evidence before me from Mr Elliott is that it is not likely that the group will be able to pay that debt and that, if that occurs, this will trigger events which, given the terms of the Notes and the SFA, will cause acceleration of all the various indebtedness. The effect will be that as at the relevant date, which one can envisage is in approximately a month's time, the entire indebtedness described above will fall due from the various companies in the group. On the evidence before me the group will then enter some kind of insolvency process of one sort or another.

14. Save for the Indian banks, all the other scheme creditors have consented to the activities that the company and the Scottish company are undertaking to promote these schemes. The position relating to the Indian banks is that while discussions were continuing with them, approximately four weeks ago the Indian banks ceased to engage with those discussions. They have not opposed this application, but nor do they consent to it.

15. An important point made by Mr Fisher is that this application, and indeed the scheme itself, are urgent because of the impending indebtedness to the Indian banks at the end of the month and the effect on cross-guarantees and acceleration.

16. The scheme has four elements already described. I think I have already said that it does not write off any debts. Its fundamental purpose is to facilitate the ongoing viability of the group and, if it can be done, allow it to trade out of its difficulties and maintain its retailing presence in this country, securing further investment as a result of the sale transaction and the ability to invest a further £50 million by way of the super senior debt. I should say, if it is not already clear, what is proposed is that the two groups of creditors under the SFA and the Notes should form a single class for the purpose of voting on the scheme.

17. The legal principles are not controversial. A number of cases have been referred to. The leading case is *Re Hawk Insurance Co Ltd* and the judgment of Chadwick LJ which is regularly referred to, and also Neuberger J in *Re Anglo-American Insurance Co Ltd*. The most significant question the court has to decide on this occasion relates to the class definition.

18. The other important matter I need to consider is whether notice for this hearing has been sufficient in the overall circumstances. I will deal with that. One other aspect that the court needs to consider at this stage is jurisdiction, both as a matter of whether the court has jurisdiction to entertain this application at all, and secondly a point on enforceability under New York law. Neither of those two latter issues are matters which the court needs to decide today, but rather, the practice in this court is that the court will examine whether there is at least any reason to think that this application is futile because there are such obvious problems with jurisdiction or with enforceability.

19. I can say now that, in common with many other schemes that have been promoted in recent years, I will approach the question of jurisdiction by making an assumption which many of my colleagues and indeed I have made in other cases. If I make the assumption that the relevant EU Regulation applies and that the scheme creditors are to be treated as defendants under the Regulation, then since there are UK-based scheme creditors, it follows that if the EU Regulation applies then the court does have jurisdiction. As far as New York law is concerned, I am told that a favourable opinion has been obtained and will be produced at the second hearing, the approval hearing, to indicate that the scheme, if approved, will be enforceable under New York law. Therefore I am satisfied there is no reason to think this application is futile.

20. Dealing with the notice question, although there is no legislative requirement for it, the courts tend to take the view that 14 days' notice of a hearing like this is the minimum which scheme creditors ought to be given unless it is a case of urgency. But this is a case of urgency and, in my judgment, the principles Snowden J described in *Re Inda Kiat International Finance Company BV* [2016] EWHC 246 Ch, 28-30 is applicable. The company is in real financial distress and time is short. Accordingly, although the scheme creditors have only had 12 days' notice of this application and also bearing in mind the nature of the scheme itself (which, although it has great significance for the companies and for the lenders, is not enormously complicated in my judgment), that notice is sufficient. I also take into account the institutional nature of the creditors themselves. They are used to acting quickly if they believe it is in their interests to do so. That they have been notified using the notification mechanisms which apply in the markets in which they trade is another factor that I bear in mind. I am satisfied that the relevant creditors have had sufficient notice.

21. I turn to deal with the question of the class. The first question to ask is what is the appropriate comparator to make in the context of considering the rights of the scheme creditors. The answer in this case is that the proper comparator is insolvency. That is a serious prospect if the scheme is not successful. The insolvency process would be likely to start in about a month's time.

22. The important point is that in the event of insolvency, the maturity dates of the various indebtedness will all accelerate and become the same. Accordingly any difference between the maturity dates of debts to the scheme creditors as they currently stand will cease to be a relevant difference in the relevant circumstance for the purpose of considering the class. In other words even though today the maturity dates of the debts held by the scheme creditors varies considerably, if the scheme does not succeed then in practice the scheme creditors' maturity dates will be identical. Today the Notes expire in 2020 and the extended SFA deadline is 2019. I am satisfied that the

differences in maturity dates as between the Notes and the extended SFA deadline, and the differences between either date and the date applicable to the Indian banks, are not such as create a relevant difference between these creditors as a class. It does not fracture the class.

23. Also, importantly, as a result of the intercreditor agreement, the various creditors ranked *pari passu* in relation enforcement of security.

24. The only other factor to consider, it seems to me, is the difference in interest rates between the two classes of creditor. Under the Notes the interest rate is 5.75 percent over three-month LIBOR, whereas under the SFA, the interest rate is 3.25 percent over LIBOR. I think the LIBOR for the SFA is not the same three-month LIBOR, but for this purpose one can treat the two as the same (although in fact, of course, they are not).

25. In my judgment the correct analysis is the following. If the insolvency was likely to produce a return in the pound in the order of a low number of pennies (say 16 pennies or 6 pennies), and given the term extension in the scheme of about 18 months, then that difference in the interest rates is not sufficient to justify treating those the two sets of creditors as two classes for the purpose of coming together and considering their rights and how they wish to vote on the scheme.

26. On the other hand, if the insolvency was to produce a return of, for the sake of argument, 99p in the pound, then it seems to me that that difference in interest rates, even though the term extension is only about 18 months, could (at least conceivably) make a difference. That is because a party might take the view that they would rather collect 99 percent of their indebtedness now instead of being locked into a given interest rate for a further 18 months. A party locked into an interest rate materially lower than another party might take a different view if they had the prospect of receiving essentially the whole of their indebtedness now, than a party who was going to be locked into an interest rate materially higher than their fellow creditor for the extended term.

27. I appreciate it could be said that these are matters of commercial interest rather than rights, but it seems to me the interest rate is a part of the rights of a scheme creditor and that that analysis is a relevant one. Therefore, it becomes important to consider with a little bit of care what the evidence is about the likely position on insolvency. As the matter was open to me, that evidence consisted of a report from KPMG which does provide that the likely returns in an administration would be about 16p in the pound and on liquidation would be about 6p in the pound. That report is referred to by Mr Elliott.

28. Were it not for one matter, that would be the end of it. However, it was made expressly clear and was rightly drawn to my attention by Mr Elliott and by those appearing in front of me, that the KPMG report is produced to the scheme Company on what has been called a "non-reliance basis" -- in other words, on the footing that KPMG take no responsibility for its accuracy or correctness at all and do not accept that they have any duty of care to the scheme Company for anything in that report.

29. It seems to me that in those circumstances and on an application like this the court cannot place reliance on that material as evidence at all. It is clear that estimating the likely outcomes of insolvency is a matter which is normally provided by expert accountancy evidence, but the court is never going to accept evidence from an expert witness who comes to court, gives their opinion and then explains in the second sentence that that opinion is provided on a "non-reliance basis" where the person receiving it cannot rely on it.

30. I understand Mr Fisher says that evidence of this kind on a non-reliance basis is not uncommon. Well, that may be, but I have never seen it before and I do not believe that it is something that can be taken lightly.

31. I was told that at the hearing that the board were content that the picture painted in the KPMG report represented a fair and accurate description of the company. At that stage there was no evidence from the board, but it was explained to me that evidence would be provided to confirm that. I questioned counsel closely on that basis for the board's view, and left it to be examined exactly what evidence the court was going to be given in the light of my concern. The matter was adjourned briefly and, after the adjournment, Mr Fisher (counsel) was able to explain to me that KPMG had been contacted and explained that they were able to extend their duty of care to the Company, so that the Company could rely on the report solely for the purposes of advancing the scheme. That is a fundamental alteration to the position. Since the Company can rely on the material in KPMG's report for these purposes, so the Company can put it before the court in evidence, and so the court is able to rely on it.

32. I discussed with counsel (and he was taking instructions in the course of doing it) that some minor adjustments to the documents and the orders will need to be made.

33. I am now in a position where I have evidence on which the court can rely that the likely insolvency if the scheme fails is of the kind I have already described. Therefore the difference in interest rates between the two sets of creditors is not sufficient to lead to a conclusion that they should be put into separate classes for the purposes of voting under the Scheme.

34. Accordingly, for all those reasons, I find that the correct definition of classes is that there should be a single class of scheme creditors. I will approve the process to take this forward to an approval hearing. That is my decision.