Analysis of the UGL/DTZ Deal and the Role of CY Leung from the Perspective of Corporate Rescue

The sale by DTZ Holdings plc of its assets (including all its subsidiaries and trademarks) to UGL in December 2011 involved intricate issues of company and insolvency laws. It was carried out by way of a mechanism called “pre-pack sale”. Such mechanism is rather unique in England and not very well understood by the public, especially those outside England. This article explains the basics of a “pre-pack sale” and the legal issues involved in the transaction, in particular the role of CY Leung.

What is a “pre-pack sale”?

A “pre-pack sale” is a mechanism of corporate rescue that has become popular in England since the Enterprise Act of 2002. When a company is insolvent, but its underlying business is still a viable one, the management of the company may try to work with the major creditors to rescue the underlying business by selling it to a third party (sometimes it could be the company’s management) in an attempt to realize the maximum value of the business and use its sale proceeds to repay the creditors (as far as possible). Usually this process will yield nothing for the shareholders. But, when properly carried out, it could yield a much higher return to the general creditors than an ordinary liquidation process or other corporate rescue methods (such as scheme of arrangement).

The key of a “pre-pack sale” is that it has to be effected by an “administrator” of the company appointed by the court. Before the court appointment, the administrator (at that time called the “administrator-in-waiting”) has already worked out with the major creditors, company management and the intended purchaser the detailed terms of the sale. After the terms of the sale have been agreed upon, the company will make an application to the court to appoint the “administrator-in-waiting” as the “administrator”. Then, the administrator would have the power to sell the assets of the company to the intended purchaser. The sale proceeds would be used to repay the creditors, and the holding company will usually be wound up and the shareholders get nothing.

Problems with Pre-pack Sale and Safe Guard for Creditors/Shareholders

The major problem of pre-pack sale is the lack of transparency. Apart from the company’s top management, the major creditor, the intended purchaser and the administrator-in-waiting, little would be known by the outside world about the terms of the sale before the application
is made to the court for the administrator’s appointment. And the sale is usually completed immediately after the appointment, leaving no time for any objections to be raised.

In order to safeguard the fairness of the process, the Association of British Recovery Professionals issued a statement of practice – SP 16, which requires administrators to disclose details of the sale to the general creditors as soon as possible after the sale to justify the pre-pack sale and satisfy the creditors that their interests have been duly taken care of. Such information to be provided include:-

1. The consideration for the transaction, terms of payment, and any condition of the contract that could materially affect the consideration;

2. If the sale is part of a wider transaction, a description of the other aspects of the transaction;

3. Any connection between the purchaser and the directors, shareholders or secured creditors of the company.

Although SP 16 only requires the administrator to disclose these matters after the sale, the court, when considering the application for appointment of administrator, will expect the lawyers to disclose them in the application.

Although many professionals and academics regard the safeguard of SP 16 as insufficient, at least the disclosure will allow the court, when considering the application to appoint administrator, to consider if the “pre-pack sale” is really in the best interest of the creditors, and creditors still have a chance (albeit not a very practical one) to challenge or seek remedies against the company’s management or the administrator if they find out, after the disclosure, that they have been unfairly treated.

The UGL/DTZ sale

The UGL/DTZ sale was such a pre-pack sale. According to disclosed information, after its largest shareholder’s failed attempt to acquire DTZ, the management of DTZ started to look for alternative buyers in October 2011. On 8 November 2011, DTZ announced that UGL was the “preferred bidder”. Probably around that time, RBS, DTZ’s major creditors, its advisor Ernest and Young (who was subsequently appointed as administrator) and UGL started to work on the detailed terms of the sale. In the morning of 4 December 2011, a Sunday, the application was made to the English High Court for the appointment of administrator (EY). At 5.02 pm, the judge issued the appointment order. The “pre-pack sale” was immediately completed and announced. On 5 December 2011, Monday, DTZ was delisted from the London Stock Exchange.
The sale proceeds of 77.5m pounds, was, of course, insufficient to pay off RBS (owed 106m pounds) and other creditors. The shareholders got nothing from the sale.

The UGL/CY Leung side deal

The UGL/CY Leung side deal, in the form of a 6-page letter, was signed by CY Leung in Hong Kong on 2 December 2011. It is obviously part of the conditions of the sale and is one of the matters to be disclosed under SP 16. UGL chairman Richard Leupen told Fairfax Media that: “RBS and their advisers were aware of the arrangements and RBS agreed to the resulting reduction in the purchase price of DTZ, to offset the payment to CY Leung….”

There are conflicting reports as to whether EY, RBS and the board of DTZ were aware of the side deal and their detailed knowledge. At this stage, it is impossible to reach a definite view one way or another. However, when Mr. Leupen said “it was a confidential arrangement, which is standard business practice for such non-poach, non-compete regimes…”, he is definitely wrong. It is hard to imagine that EY would not be aware of the deal unless the parties involved (UGL and CY Leung and other directors who knew) deliberately concealed it from EY. EY had a professional duty to disclose the deal under SP 16. If it knew of the deal and failed to disclose it, it would probably face disciplinary action against it. Moreover, it could be guilty of deliberately misleading the English High Court when the application was made for its appointment as administrator.

Possible Breach of Fiduciary Duty

A director’s fiduciary duty to the company entails that he would not put himself in a position of conflict of interest with the company. It is also well established under common law that when a company is insolvent, such duty is owed to the creditors of the company instead of its shareholders.

UGL chairman Mr. Leupen acknowledged that the price paid for DTZ was reduced correspondingly by the payment to CY Leung. If he took less, the creditors took more. If he were to be paid 3million pounds (instead of 4 millions), the creditors would have gotten one million pounds more. As such CY Leung was obviously in a position of conflict with his company. Unless he had disclosed such conflict to RBS and EY and obtained their approval, he would be in breach of his fiduciary duty to his company.

On the other hand, if EY and RBS knew of the side deal and approved it, CY Leung would not be in breach of fiduciary. EY’s failure to disclose would still be a breach of professional duty but likely to be regarded as a mere technical breach with no real victims.