Cross border restructurings - INSOL International Channel Islands Seminar

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By: David Ampaw | Sheena Frazer

The INSOL International Channel Islands Seminar took place on 13 September 2017 in Guernsey, where tensions rose high as jurisdictions battled it out for the crown of the "go-to" jurisdiction for cross border restructurings. David Ampaw, a Partner in DLA Piper’s London Restructuring team, spoke in defence of the English scheme of arrangement and in this note we highlight the key challenges to the English scheme of arrangement by reference to the introduction of new scheme rules in Singapore and the Netherlands in particular and consider whether such jurisdictions are likely to attract more business in the scheme arena following Brexit.

Singapore

In May of this year, the Singapore Companies (Amendments) Act 2017 came into force enhancing Singapore’s scheme of arrangement process. The new provisions have significantly strengthened the procedures surrounding schemes of arrangement as a debt restructuring tool, which could make Singapore a more attractive jurisdiction for foreign companies seeking to restructure their debts. Although the new provisions provide for significant court involvement, the Singaporean courts have been granted a wide discretion to assist companies wishing to implement a scheme of arrangement in that jurisdiction.

The provisions enable a foreign company which has "a substantial connection with Singapore" to access a scheme of arrangement in Singapore. When assessing whether there is a "substantial connection" the court will take into account a number of factors including; whether Singapore is the company's centre of main interests; whether the company has substantial assets in Singapore; and whether the company has chosen Singaporean law as the governing law of its transactional contracts. This appears to be similar to the sufficient connection test in the UK.

The new provisions provide extensive moratorium tools to bolster existing provisions so that a company now has the ability to obtain a 30 day automatic moratorium upon filing an application for a moratorium order. This can act as an interim moratorium following which an application for a lengthier moratorium can be heard. Where a moratorium has been granted in relation to a company, members of the debtor group such as subsidiaries and parent companies (including those with no nexus to Singapore) can also apply for a moratorium if they are "playing a necessary and integral role" in the scheme being proposed. Further, the Singaporean courts may also extend moratoriums to creditor actions outside of Singapore, provided that the creditor is based in Singapore or subject to the jurisdiction of the Singaporean court.

Debtor-in-possession (DIP) provisions have also been carried over from the US Chapter 11 process such that the court is able to grant super priority to rescue financiers to the extent such funding is necessary for the business to continue trading or to assist in a successful scheme process.

The Singaporean court has also been given the power to cram down dissenting classes of creditors provided the...
scheme has been approved by the requisite majority of creditors in value and number, and the court is satisfied that a scheme does not discriminate unfairly between two classes of creditors and is fair and equitable. In practice this creates voting thresholds of: (i) majority in number and at least 75% in value with respect to at least one class of participating creditors; and (ii) majority in number and at least 75% in value with respect to participating creditors as a whole.

Further, the new legislation introduces a ‘pre-pack’ type mechanism allowing the court to approve a scheme without a formal creditor meeting where certain requirements are satisfied.

**Netherlands**

On 5 September 2017, the Dutch legislator presented an amended bill on pre-insolvency proceedings in the Netherlands for consultation purposes. The Bill proposes amendments to the Dutch Bankruptcy Act to enable companies in financial distress to propose a composition akin to a scheme of arrangement. The proposed amendments appear to have considered closely both, English schemes of arrangement and US Chapter 11 in presenting for a largely debtor driven process which involves minimum input from the courts. The idea is that this will become a very attractive proposition to companies wishing to force through a composition quickly without third party involvement. It seems likely at this juncture that the new Dutch schemes of arrangements will fall within the scope of Annex A of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (Recast Insolvency Regulation) which applies to proceedings commencing on or after 26 June 2017. As such foreign companies will have to demonstrate that their centre of main interest is in the Netherlands in order to access Dutch schemes of arrangements.

Under the proposed bill, both the debtor and, under certain circumstances, a creditor can propose or initiate a restructuring plan. Like the English scheme, the restructuring plan can be implemented outside formal insolvency proceedings. The restructuring plan can bind all types of creditors and shareholders. It need not include all, but can be directed to only a subset of them. The plan can include third party releases.

Unlike the English scheme, neither a convening hearing nor any creditors meetings are required. The vote can take place electronically. A class has accepted the plan if a 2/3 majority in amount has voted in favour (no head count). Following the vote, the court has to confirm the plan for it to become binding on dissenting parties. The procedure features a Chapter 11-style cram down mechanism, giving the court the power to confirm the plan over the objections of dissenting classes.

The procedure will contain a moratorium, the ability to set aside ipso facto clauses, the power to terminate onerous contracts and the right for the debtor to request the court to give binding early determinations on matters of dispute such as jurisdiction, class formation or valuation.

**Should the UK be worried?**

With jurisdictions like the Netherlands and Singapore adopting provisions similar to those contained in Part 26 of the English Companies Act 2006, foreign companies may begin to consider restructuring tools similar to English schemes of arrangement in other jurisdictions a more attractive proposition. When speaking at the INSOL conference we drew on three recurring themes which immediately manifest themselves on a comparison between the Singapore and Netherlands schemes and the English scheme (and this is a non-exhaustive list - we specifically will not address debtor in possession type financing which appears to be a possibility under the Netherlands and Singapore procedures and warrants a chapter in itself) in turn:

**Moratorium**

Each of the Netherlands and the Singapore schemes provide for some form of moratorium on enforcement where a scheme is proposed in their jurisdiction which should provide some breathing space for the debtor to negotiate and conclude terms with stakeholders and promote the scheme without fear of the premise of the debtors proposal collapsing through asset grabs by disgruntled creditors.

English schemes have operated reasonably well without a moratorium to date. Bankruptcy theory tells us that a moratorium is essential to prevent creditors from taking individual enforcement action to take assets before the
restructuring can be implemented but many authors have drawn the distinction between situations where there is a potential restructuring which stakeholders believe in as opposed to an insolvency situation which is terminal and will lead to a liquidation. Mechanisms such as lock-ups and standstills will often support situations where there is some prospect of a negotiated solution. As regards financial creditors, finance documentation creates a barrier to enforcement without significant consensus so, for example, under Loan Market Association Documentation there will need to be an instruction from “Majority” creditors, similarly in bond documentation there will usually be a “no action” type clause preventing enforcement by an individual creditor and enforcement will require a significant proportion of bondholders to instruct a trustee to accelerate. In such circumstances financial creditors are not necessarily locked in due to the presence of a buoyant secondary market for distressed debt certainly in Europe and the US in particular. Cases such as Bluecrest Mercantile NV v Vietnam Shipbuilding Industry Group [2013] EWHC 1146 (Comm) whereby the court confirmed that, although a scheme carries no automatic stay, a company proposing a scheme may apply for a stay on action by creditors on a case by case basis, provided, among other things, that the scheme is reasonably likely to succeed illustrate the ability of English courts to utilise wide-ranging case management powers to help promote the purpose of the scheme. That said undoubtedly some form of tailored moratoria may be useful in more hostile situations depending on the demands of those circumstances.

Cross Class Cram Down

While other jurisdictions (e.g. US Chapter 11) allow restructurings to go ahead without the consent of entire classes, there is no single mechanism which allows this to occur under English law. Both the Netherlands and Singapore procedures envisage some ability to impose a cross class cram down. The English scheme of arrangement can only be imposed on dissenting creditors within a class; there is no possibility of a cram down across classes unless the scheme is used in combination with pre-packaged administration to transfer the business and assets to a new entity (NewCo) and each affected, and therefore included, class of creditors is granted rights (whether as debt, equity or some combination of the two) in NewCo. Unaffected creditors’ claims are left whole but those unaffected claims remain against the now valueless corporate shell. Unaffected creditors are those whose rights the scheme does not affect, or a valuation of the company’s assets establishes that a particular class of creditors has no economic interest in those assets, as they could not expect any return if the assets (presumably the company’s business) were sold. In the latter case, in an economic sense, those creditors have been “crammed down”, by, in effect, being left behind. Whilst there is an ability for creditors to dispute the valuation methodology at the sanction hearing the use of this mechanism leads to disputes over valuation with the result that financial creditors are consistently unable to ascertain absolutely whether they are “in the money” or “out of the money”. Some form of cross class cram down, incorporating some guidance around valuation methodology when imposing a plan on dissenting creditors, might assist in removing this uncertainty in the English scheme context.

Recognition

Recognition appears to be the largest concern but of course we do not yet know what the UK’s post-Brexit deal will look like but there are a number of means by which recognition of English schemes going forward might be effected.

Generally, an English court will accept jurisdiction over schemes of foreign companies if (i) the scheme is likely to be effective and achieve its purpose and (ii) the foreign company has a “sufficient connection” with the English jurisdiction. It is the first limb where significant concerns may arise in a post-Brexit world. In establishing whether the scheme is likely to be effective and achieve its purpose, the English court will consider whether the scheme would be recognised in any relevant foreign jurisdiction where the distressed company’s assets are located. The English court will not want to sanction a scheme that could not be enforced locally. The court has often considered the European law as a basis for recognition.

Regulation (EU) 1215/2012 (recast) (Recast Regulation) provides that “a judgment given in a Member State shall be recognised in the other Member States without any special procedure being required.” The reference to judgments would capture court orders relating to schemes for foreign companies. Post-Brexit, the English courts will lose this basis of recognition as schemes of foreign companies would not be enforceable in Member States as the order sanctioning the scheme would no longer be approved by a court of another Member State.

However, the European Regulation (EC) 593/2008 on the law applicable to contractual obligations (“Rome 1 Regulation”) has also been used as a basis for establishing recognition. Rome 1 Regulation provides that the
governing law of a contract also governs “the various ways of extinguishing obligations, and prescription and limitation on actions” in relation to that contract. Accordingly, if the parties have agreed English law to govern a particular contract, then English law can take effect in dealing with extinguishing the debt under that contract. It follows that the English court would consider a scheme presented by a foreign company where the underlying debt instruments are governed by English law. Whilst Rome 1 Regulation would cease to apply in the UK post-Brexit, it would continue to have effect in the other Member States and does not rely on the actions of one Member State court being enforced in other Member State courts. Consequently, the English courts may look to continue their reliance on the Rome 1 Regulation as a basis of recognition in a post-Brexit climate. Depending on the terms of Brexit (and how it is negotiated) there is still room for a backlash at a lack of reciprocity which might manifest itself in Member States rejecting the Rome 1 Regulation principles particularly if there is no COMI shift to England and Wales in the relevant restructuring.

There are other routes to recognition of course being principally:

- **The UNCITRAL Model Law on Cross Border Insolvency** (the Model Law) will provide a framework for recognition of cross border insolvency proceedings post-Brexit. However the Model Law’s applicability is largely untested in the EU as, excepting the UK, it has been adopted in very few European jurisdictions.

- **The Hague Convention on the Choice of Court Agreements 2005** (the Hague Convention) to which the EU has signed up and which therefore binds all Member States. The Hague Convention promotes the allocation of jurisdiction where an exclusive choice of court agreement has been entered into by parties to a transaction. Where exclusive choice of court agreements exist, the Hague Convention imposes obligations on ‘designated courts’ of those states which have signed and ratified the Hague Convention (Convention States). These obligations are:
  - a Convention State’s courts are obliged to hear any case brought before them which is covered by the choice of court agreement, if they are the ‘designated court’
  - a Convention State’s courts are obliged to refuse to hear any case if they are not the ‘designated court’
  - a Convention State’s courts are obliged to recognise and enforce the judgment of another Convention State’s courts if the second court is the ‘designated court’

  The Hague Convention offers an option for filling the gap left by the Rome I Regulation but it is not a perfect fit. Firstly, upon leaving the EU, the UK will need to accede separately to the Convention in order for it to apply. Secondly, the Hague Convention’s application to exclusive choice of court agreements may limit its utility in the context of schemes where relevant debt documents usually contain so called “asymmetrical” jurisdiction clauses.

- **The Lugano Convention 2007** (the Lugano Convention) provides for mutual recognition and enforcement of judgments between EU and European Free Trade Association (EFTA) members. The UK is currently party to the Lugano Convention as part of the EU and would need to accede to EFTA post-Brexit to benefit from it. Should the UK become an EFTA member as part of its Brexit negotiations, it could use the benefit of the Lugano Convention to address the question of effectiveness of schemes outside England and Wales but in practice accession to EFTA and therefore the Lugano Convention is unlikely. With accession might come the UK having to accept the principle of free movement of individuals and certain EU regulations without its current influence over EU rules. Oft quoted as reasons for the Brexit “leave” vote are concerns over migration and disillusionment with the workings of the EU and accession to EFTA would arguably sit at odds with these reasons.

- **Private international law** is likely to become of more significance post-Brexit in terms of recognition of schemes of non-English companies but will rely on a fact dependent approach and analysis to determine effectiveness of the scheme.

**Conclusion**

It is no secret that the vast majority of loan origination documentation is governed by English law. The large body of precedent, stable, predictable outcomes and a large body of experienced restructuring professionals and judiciary in the UK is what gives the UK part of its competitive advantage as a place to restructure a business. Track record, as well as language and creditor base, is arguably what has led to the UK taking restructuring work away from other countries around the globe. Many of these factors might not change overnight but there is rightfully uncertainty around Brexit such that jurisdictions such as the Netherlands and Singapore (and others) may increasingly be seen as more credible places for locally based businesses to restructure.