NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

Q2 2021

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To our clients and friends:

Welcome to the Q2 2021 edition of the *International Restructuring Newswire*. Before turning to the contents of this issue, I want to personally invite each of you to the INSOL International Virtual 2021 conference. Consisting of more than 40 speakers, the international event will be held over three days in June. I will be chairing a session on June 10 on the critical topic of **"Diversity, Equity and Inclusion and the Insolvency Profession".** Joining me on the panel will be some preeminent practitioners in our field. We will discuss the results of a newly conducted survey by INSOL designed to gauge diversity among the senior ranks of the insolvency profession. After discussing the results of the survey, we will go on to assess what changes, if any, should be addressed by the profession. I hope many of you will be able to attend.

Now to this issue: We have articles surveying recent developments in no fewer than five countries. In the United States, on the 15th anniversary of the enactment of the Model Law on Cross-Border Insolvency as Chapter 15, we present our annual survey of new case law in the US. These decisions have far-reaching influence in the more than 50 countries that have enacted the Model Law. In Canada, we look at developments in the use of a corporate "arrangement " as an alternative to the CCAA insolvency regime. Recent developments in new restructuring laws are examined in both Germany (under the StaRUG) and the Netherlands (under the WHOA). And, in focusing on the UK, we look at the first use of the cross-class cram-down under the CIGA. Acronyms anyone? Count them — four in this paragraph alone!

Enjoy the issue.

Howard Seife
Global Head
Bankruptcy, Financial Restructuring and Insolvency

In the news

International Corporate Rescue

Scott Atkins, Francisco Vazquez, Eric Daucher and Dr. Kai Luck published an article in *International Corporate Rescue* (Volume 18, Issue 1) entitled "Contagion Liability Risk in the United States and Australia for Parent Entities Arising from the Insolvency of a Subsidiary."

California Bankruptcy Journal

Rebecca Winthrop co-authored an article in *California Bankruptcy Journal* (Vol. 35 Cal. Bankr. J. No 3 (2020)) entitled "So Many Troubled California Health Care Districts, So Many Have Filed Chapter 9 – Lessons To Be Learned."

INSOL International

March 4, 11 and 18, 2021
Howard Seife chaired INSOL International's Latin America Virtual Seminar which covered the latest news and developments in cross-border restructurings in Latin America. David Rosenzweig spoke at the March 11 session on a panel that considered why certain Latin American companies (particularly airlines) are utilizing Chapter 11.

Webinar: 2021 Conference of Chief Bankruptcy Judges (Ninth Circuit)

March 24, 2021
Rebecca Winthrop moderated a webinar panel on "Virtual Trials and Electronic Submission of Evidence" for the 2021 Conference of Chief Bankruptcy Judges, Bankruptcy Clerks and Bankruptcy Lawyer Representatives (Ninth Circuit).

Norton Rose Fulbright Webinar

April 29, 2021
Sylwia Marie Bea, Regina Rath, Philippe Hameau, Rudelle Guillaume will speak on "The New Restructuring Regimes in Europe – Opportunities and challenges for stakeholders in the US." Andrew Rosenblatt will moderate the panel.

INSOL International

June 8 – 10, 2021
Howard Seife will chair a panel session at the INSOL International Virtual 2021 conference. The panel will speak on "Diversity, Equity and Inclusion and the Insolvency Profession."

ABI Southeast Conference 2021

July 29 – August 1, 2021
Jason Boland will be a speaker on an energy panel at the ABI Southeast Conference at the Breakers in Palm Beach, Florida.

Canada: Recent developments in third party releases under corporate plans of arrangement

Evan Cobb

In Canada, most insolvent businesses in need of restructuring still elect to proceed under traditional insolvency statutes including, most commonly, the *Companies' Creditors Arrangement Act* (CCAA). However, Canadian corporate laws also provide alternatives to implement a targeted restructuring of aspects of a corporation's debt structure. This alternative corporate restructuring transaction is referred to under Canadian corporate law an 'arrangement'

In recent years many restructuring corporations have favoured the more streamlined approach of a corporate arrangement. The benefits of the corporate arrangement mechanism, if used for an appropriately structured transaction, can be: (i) reduced professional costs; (ii) expedited implementation; (iii) minimized impact on ongoing operations; and (iv) a reduction in the perceived stigma sometimes associated with insolvent restructurings.

Because corporate arrangements are often used as an alternative to a restructuring plan under the CCAA, restructuring debtors will look to import favourable elements of typical CCAA restructuring processes into corporate arrangements. This is often feasible as the *Canada Business Corporations Act*, under which most corporate arrangements will proceed, provides the supervising court broad powers to make interim or final orders it thinks fit.

It is not unusual for a corporate arrangement proceeding to include, for example, a limited stay of proceedings while the proposed arrangement is being structured and implemented, or the appointment of a foreign representative to apply for recognition in foreign jurisdictions, including under Chapter 15 in the United States.

Other relief that is typical in an insolvent restructuring under the CCAA is not particularly well-suited to a corporate arrangement process. For example, there is no specific authority in corporate statutes to grant charges to secure interim 'DIP' financing, and there is no specific authority to disclaim contracts under corporate statutes or to run claims allowance/objection processes. These types of relief are generally seen to be outside of the scope available in a corporate arrangement. As a result, corporations with significant and immediate liquidity issues or those requiring extensive operational modifications to restructure successfully will usually utilize the more expansive mechanisms available under the CCAA and Canada's other insolvency statutes.

Many restructuring companies will seek to implement broad non-consensual releases and waivers of claims against and amongst various third parties connected to the corporation as part of their restructuring process, whether under the CCAA or under applicable corporate arrangement statutes. The releases and waivers can provide an important fresh start and/or protections for affected parties involved in or supporting or contributing to the restructuring process. Substantial case law has developed around the availability of these releases and waivers in insolvency proceedings. The exact scope of third party releases and waivers available under corporate arrangements, however, remains an open question, as shown in a recent decision in the arrangement of *iAnthus Capital Holdings, Inc*.

Releases in insolvency proceedings

Releases are a common aspect of restructuring plans under the CCAA. Even very broad releases of claims against or amongst third parties can be justified if the court is satisfied they are appropriate based upon a number of established factors aimed at determining: whether the releases are rationally connected to the resolutions provided by the restructuring plan; whether the releases will benefit creditors generally; and whether the releases are or are not overly broad.

In appropriate circumstances, broad releases have been granted in CCAA restructuring plans in favour of the debtor's

former auditors and advisors, former directors and officers, parent companies, and a variety of other parties who may face liability as a result of their past involvement with the debtor.

Claims arising from conduct such as fraud or wilful misconduct are typically excluded from these releases. In the case of releases in favour of the directors of the debtor company, claims for misrepresentations to creditors or wrongful or oppressive conduct are also limited.

The availability of these releases is viewed as an important aspect of the restructuring process because the parties receiving the benefit of the release are often contributing something of value to the restructuring and, in return for that contribution, expect to receive finality with respect to issues involving the debtor. In addition, there is often value to the debtor company itself in obtaining finality with respect to claims involving stakeholders so that the debtor company will not become re-engaged in any such claims that may be brought against those third parties in the future.

Third party releases in insolvency proceedings have facilitated a broad variety of restructurings where a key element of the restructuring process is the resolution of outstanding litigation against third parties. A common structure involves a financial contribution by some or all of those parties being released to a pool of funds that will be available to satisfy, in whole or in part, certain of the claims being released.

Third party releases in corporate arrangement proceedings

Concordia International Corp.

In a 2018 decision, the Ontario court considered third party releases in an arrangement of *Concordia International Corp.* under the *Canada Business Corporations Act.*

This arrangement involved: (i) the restructuring of approximately CAD$4 billion of secured and unsecured debt, reducing outstanding indebtedness by approximately CAD$2.4 billion, and (ii) the investment of new equity by way of a private placement, all through a corporate arrangement.

The arrangement included releases in favour of various parties in connection with the debt and debt documents, the equity of the corporation, the private placement and the arrangement proceedings. The court confirmed that releases in favour of third parties could be approved in a corporate arrangement proceeding. In its decision approving these releases, the court highlighted a number of the factors generally applied when considering such releases in CCAA insolvency proceedings, such as:

- whether the parties to be released from claims were necessary and essential to the restructuring of the debtor and contributed in a tangible and realistic way to the arrangement;
- whether the claims to be released were rationally connected to the purpose of the arrangement and necessary for it;
- whether the arrangement could succeed without the releases;
- whether the releases benefitted the debtors as well as the creditors generally; and
- whether the creditors voting on the arrangement had knowledge of the nature and the effect of the releases.

The court also granted certain additional relief commonly granted in CCAA insolvency proceedings deeming third parties to have waived defaults arising out of, among other things, the arrangement, and limiting the recourse in certain litigation by equity holders to the proceeds of any available insurance policies.

The decision in *Concordia International Corp.* suggested an increased harmonization of the relief available to restructuring debtors under insolvency statutes and corporate arrangement statutes, further increasing the attractiveness of corporate arrangements, even in circumstances where third party releases and related relief are required.

iAnthus Capital Holdings, Inc.

The scope of releases available under a corporate arrangement and the decision in Concordia International Corp. itself were recently considered by the Supreme Court of British Columbia in connection with the arrangement of *iAnthus Capital Holdings, Inc*.

iAnthus presented an arrangement under the Business Corporations Act (British Columbia) that restructured the secured and unsecured notes and equity of the corporation and provided releases in favour of, among others, current and former officers, directors, employees, shareholders, auditors, financial advisors, legal counsel and agents.

The British Columbia court considered the decision in *Concordia International Corp.* but did not accept that the principles applicable to third party releases in a CCAA proceeding should apply in an arrangement proceeding under corporate legislation.

The court noted that the provisions of corporate legislation regarding arrangements serve different purposes and operate differently than the CCAA:

> *iAnthus* relies on *Concordia International Corp.*, 2018 ONSC 4165 at paras. 37-52 where, in the context of an arrangement proposed pursuant to s. 192 of the [*Canada Business Corporations Act*], the court applied principles developed under the CCAA in deciding that third-party releases were appropriate.
>
> I do not accept this reasoning.
>
> The CCAA is a statute that deals with insolvent corporations. It permits a company to propose a compromise arrangement with its creditors. It is skeleton legislation establishing judicial powers and procedures to address, outside of bankruptcy, the enormous variety of scenarios under which a corporation's liabilities exceed its assets; in consequence, its provisions are given a broad and generous interpretation.
>
> Despite some common terminology – both statutes contemplate "arrangements" – the arrangement provisions of the [*Business Corporations Act* (British Columbia) and the *Canada Business Corporations Act*] serve different purposes and operate differently than the CCAA. The purposes and inquiries engaged by a corporate arrangement are more focused. It is central to an arrangement under the CCAA that substantive rights will be compromised; that is not the case under corporate arrangement legislation.

The court concluded that, at least under the British Columbia corporations statute, third party releases in arrangements should be limited to those releases that are <u>truly ancillary</u> and the substantive positions of third parties are protected. Notably, the court did not have to determine whether such broader releases would be available under the federal *Canada Business Corporations Act*. This is an open issue based upon the court's statements about corporate arrangements generally.

At a subsequent hearing, the court approved a narrower release that was targeted so that: (i) claims brought by any person in connection with the plan of arrangement, the arrangement proceeding before the court or the restructuring support agreement were released; and (ii) in all other cases, the parties bound by the release were the same parties benefitting from the proposed arrangement. It appears the revised releases were determined by the court to be truly ancillary to the proposed arrangement.

Practical implications of *iAnthus*

The *iAnthus* decision will be welcomed by parties seeking to implement a restructuring that requires third party releases under the corporate statute of British Columbia and under Canada's federal corporate statute. The decision reinforces the availability of third party releases in appropriate circumstances.

The decision does, however, introduce questions regarding the appropriate scope of those releases under corporate arrangements in Canada.

The earlier decision of the Ontario court in *Concordia International Corp*. suggested that the principles applicable to third party releases in CCAA proceedings should apply, making a corporate arrangement equally as attractive as a CCAA restructuring on this issue. However, corporations considering restructuring in situations where third party releases are a material concern will need to give careful consideration to the impact of *iAnthus*, which may support a narrowing of the releases available under corporate statutes.

This consideration will be relevant in situations where, for example, the restructuring seeks to resolve litigation claims by a company's stakeholders against third parties such as the company's advisors or current and former officers and directors, or where the restructuring seeks to deem outstanding contractual defaults to be cured. While these types of provisions may be reasonably connected to the restructuring and acceptable for the purposes of a CCAA restructuring, the decision in *iAnthus* suggests a narrower view on appropriate releases and waivers may also be considered by the court in a corporate arrangement context.

Evan Cobb is a partner in our Toronto office in the firm's financial restructuring and insolvency group.

DeepOcean – the first UK cross-class cram-down case under the Corporate Insolvency and Governance Act 2020

James Stonebridge

Norton Rose Fulbright recently advised a syndicate of lenders to DeepOcean Group Holding B.V., a leading provider of subsea services for the oil & gas and renewables industries, on its successful restructuring via inter-conditional Restructuring Plans (under the new Part 26A of the UK Companies Act 2006). In the Q4 2020 Issue of our *International Restructuring Newswire*, our partner Mark Craggs wrote on the UK's new Part 26A – see "Lighting up the CIGA." With DeepOcean, we now have the first ever use of the cross-class cram down under CIGA, representing what has been described as arguably the most significant development in English restructuring law since schemes of arrangement were introduced in 1870. Mr Justice Trower sanctioned the Restructuring Plans on 13 January 2021.

Background

The Restructuring Plans and the cross-class cram down mechanism was introduced by the Corporate Insolvency and Governance Act 2020 (**CIGA**) in June 2020. The basic purpose of Part 26A (Restructuring Plans) is described in the Explanatory Notes to the legislation and its comparison to schemes of arrangement (under Part 26 of the Companies Act 2006) which reads as follows (with emphasis added):

> "*These provisions will allow struggling companies, or their creditors or members, to propose a new restructuring plan between the company and creditors and members. The measures will introduce a "cross-class cram down" feature that will allow dissenting classes of creditors or members to be bound to a restructuring plan. This means that classes of creditors or members who vote against a proposal, but who would be no worse off under the restructuring plan than they would be in the most likely outcome were the restructuring plan not to be agreed cannot prevent it from proceeding.*
>
> *These provisions introduce a new Part 26A into the Companies Act 2006: Arrangements and Reconstructions for Companies in Financial Difficulty (a "restructuring plan"). The new Part represents the culmination of the policy work undertaken since a restructuring plan procedure for companies was consulted on as part of "A Review of the Corporate Insolvency Framework", published in May 2016.*
>
> *In schemes of arrangement creditors (and sometimes members) are divided into classes (based on the similarity of their rights, which may vary significantly across a company's creditor base) and each class must vote on the proposed scheme. If all classes vote in favour of the scheme (requiring 75% by value and a majority by number of each class), the court must then decide whether to sanction it. Not all creditors or members of a company need to be included within a scheme. A company may propose a scheme in such a way as to exclude some creditors or members from it. Those creditors or members who are not bound by the scheme retain their existing rights.*
>
> *The new restructuring plan procedure is intended to broadly follow the process for approving a scheme of arrangement (approval by creditors and sanction by the court), but it will additionally include the ability for the applicant to bind classes of creditors (and, if appropriate, members) to a restructuring plan, even where not all classes have voted in favour of it (known as cross-class cram down). Cross-class cram down must be sanctioned by the court and will be subject to meeting certain conditions. As is the case with Part 26 schemes, the court will always have absolute discretion over whether to sanction a restructuring plan. For example, even if the conditions of cross-class cram down are met, the court may refuse to sanction a restructuring plan on the basis it is not just and equitable. As long as the eligibility criteria for the new moratorium are met, it will also*

be available (but not mandatory) to use whilst the company develops a restructuring plan thereby providing a streamlined restructuring process and allowing a restructuring plan to be developed free from enforcement action.

While there are some differences between the new Part 26A and existing Part 26 (for example the ability to bind dissenting classes of creditors and members), the overall commonality between the two Parts is expected to enable the courts to draw on the existing body of Part 26 case law where appropriate."

The DeepOcean case

The DeepOcean group operates in Europe, the Americas and Africa and focuses on the inspection, maintenance, repair and decommissioning and subsea construction work. The company operated two separate businesses in the UK, with one of these comprising a cable laying and trenching business operating from Darlington and the Port of Blyth. The cable laying and trenching business was operated by three companies incorporated in England and Wales and the centre of main interests of these companies was in the UK. The parent of the DeepOcean group is DeepOcean Group Holding BV, which is a Dutch incorporated company.

The UK businesses had underperformed for many years with the consequence that it required funding from the wider DeepOcean group. This was only exacerbated by COVID-19. The creditors of the UK companies comprised, firstly, financial creditors under a facilities agreement, which had the benefit of a comprehensive security package. Secondly, there were certain claims due to a landlord. Thirdly, there were claims by two vessel owners in respect of vessels which were on long-term charters that had been guaranteed by the Dutch parent, DeepOcean Group Holding BV. Finally, there were unsecured creditors who did not fall into the categories described above. There were also a number of claims that other members of the DeepOcean group intended to continue to fund and discharge including employee claims, liabilities for tax, intercompany claims and certain claims relating to ongoing projects of the group.

The Restructuring Plans were proposed with the primary aim of facilitating the restructuring and solvent wind down of the Plan Companies in order to provide a better return to certain creditors than the likely alternative and to ensure the continued survival of the wider DeepOcean group. As part of these plans, the wider DeepOcean group provided a cash injection to enhance the dividends that would otherwise be payable to creditors as it was in the wider group's interest to avoid an uncontrolled insolvency of the UK business. The Restructuring Plans provided for different treatment for the different categories of creditors. The Restructuring Plans provided for releases of claims against the three English companies. The plans also contained mechanisms for the agreement of claims and the inclusion of a bar date. The evidence produced to the court in the form of a detailed entity priority model (**EPM**) showed creditors would receivable a better result than in the event of the "relevant alternative". In relation to the relevant alternative, which is defined under CIGA essentially to mean whatever the court considers would be most likely to occur if the Restructuring Plan was not sanctioned, the EPM considered two scenarios. The first was one where all group companies entered into insolvency. The second is one where the wider-group considered it could no longer fund the UK companies and as a result the UK companies would enter into administration or liquidation, which in turn would lead to a bankruptcy filing of DeepOcean Group Holding BV and certain other group entities, (but that the core of the DeepOcean group business would be able to continue). The evidence supported the view that the second of those scenarios was the more likely as the wider group would stop supporting the UK companies whilst preserving the ongoing survival of the remainder of the group. Accordingly, at the sanction hearing (see below) the court found that the appropriate counter-factual and "relevant alternative" was the second alternative.

As part of the Restructuring Plan procedure there are two court hearings, the first hearing is the convening hearing where the court considers the following:

(a) jurisdictional requirements as to the availability of the Restructuring Plan procedure. In this case the position was straightforward for the English companies although at the time of the convening hearing there were issues, which the court did not need to determine at that stage, which were first whether a Restructuring Plan is an insolvency proceeding so as to oust the application of the Recast Judgments Regulation and secondly, whether the Restructuring Plans were effective to deliver third party releases, in each case in relation to DeepOcean Group Holding BV as guarantor of the ship charters. The Court decided that these issues were more properly to be addressed at the sanction hearing. Subsequent to the DeepOcean case, the issue of what is an insolvency proceeding came before the English court on Gategroup's proposed restructuring where the Court held for the purposes of the bankruptcy exclusion to the Lugano

Convention, a Restructuring Plan was an insolvency proceeding (see, *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch));

(b) whether the companies had satisfied the requirements to be able to propose Restructuring Plans – being (i) that the companies had encountered or were likely to encounter financial difficulties that were affecting or may affect their ability to carry on as going concerns and (ii) that the purpose of the plans was to eliminate, reduce, prevent or mitigate the effect of these financial difficulties. On these points the English Court was satisfied that, notwithstanding the Plan Companies would not continue as going concerns but in due course would be solvently liquidated, there is no requirement that the Plan Companies have to continue as going concerns after the plans are sanctioned. In particular, Mr Justice Trower at the convening hearing (*In the Matter of Deepocean 1 UK Limited v In the Matter of Deepocean Subsea Cables Limited v In the Matter of Enshore Subsea Limited* [2020] EWHC 3549 (Ch) stated "it is doubtless the case that some of the focus of Part 26A is on enhancing the ability of a company to carry on business as a going concern there is no reason to consider that that is the only purpose for which relief can be granted". Therefore, although a criteria for use of the Restructuring Plan is that the company's financial difficulties affect or may affect its ability to carry on as a going concern, there is no requirement that the company should have to carry on as a going concern as a result of the plan being approved and therefore plans can be used to effect, for example, a run-off arrangement;

(c) the composition of the classes, which for these purposes the Court agreed should comprise the secured creditors, the landlord, the vessel owners and all other unsecured creditors;

(d) any other issues which might cause the court to refuse to sanction the plans (other than the merits or fairness which fall to be dealt with at the sanction hearing); and

(e) practical issues regarding the adequacy of notice, documentation and proposals for meeting of creditors.

On the basis that the Court was satisfied on the points described, the Court approved the convening of creditors' meetings to approve the Restructuring Plans. Prior to the sanction hearing on 13 January 2021, DeepOcean reached a compromise with the landlord and the vessel owners. However, for one of the English companies they did not at the creditors' meeting achieve the requisite 75% in value level of support. Therefore in order for the Restructuring Plan for that company to proceed, the cross-class cram-down needed to be engaged. There are two conditions to approval of the cross-class cram-down. Condition A is that the court is satisfied that, if the compromise or arrangement is approved, none of the dissenting class would be "any worse off" (which the Court considered to be a broad concept) than they would be in the "relevant alternative" and Condition B is that the compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors present and voting who would receive a payment or have a genuine economic interest in the relevant alternative. The court in its judgment at the sanction hearing (see I*n the Matter of Deepocean 1 UK Limited v In the Matter of Deepocean Subsea Cables Limited v In the Matter of Enshore Subsea Limited* [2021] EWHC 138 (Ch)) said that an applicant company for a Restructuring Plan will have a "fair wind behind it" if it seeks an order to sanction a plan where these two conditions are satisfied.

In DeepOcean the court was satisfied that the return to creditors was above that in the relevant alternative. Secondly, as the plan had been approved by an assenting class (being the secured creditors) who would make a recovery in the event of the relevant alternative they had a genuine economic interest (even though the amount the secured creditors would have received in the relevant alternative would have been relatively small) so as to satisfy Condition B. Accordingly, both Condition A and Condition B were found to have been established.

Even if both conditions to cross-class cram-down are satisfied, the Court still needs to be satisfied that it should exercise its discretion to approve the Restructuring Plans. On the evidence, the court was satisfied that it was appropriate exercise of its discretion to approve the plans. Further, although the turnout at the creditors' meetings for the unsecured creditor classes was low, the Court ruled that this did not make it inappropriate to invoke the cross-class cram-down. The next discretionary factor the Court considered was what has come to be called the "horizontal comparison" that the Court will often consider when considering an unfair challenge to a company voluntary arrangement, which compares the treatment of creditors under the CVA inter se, i.e. between classes. In the case of a Restructuring Plan which provides for differences in treatment of creditors, the Court will consider whether those differences are justified and in particular the Court will be concerned that there has been a fair distribution of the benefits of the restructuring between those classes who have agreed the plan and those who have not. In DeepOcean, as the assets being made available under the plan to distribute to the dissenting class came from other group companies, the Court felt it was up to those companies to apportion that contribution in such manner as they saw fit.

In addition, the Court considered as part of the sanctioning whether there was any cause for concern as to how the plan would operate as a mechanism for varying creditor rights and effecting a distribution. Finally, as part of the decision whether to sanction the plans, the Court was required to be satisfied as to whether the plans would be substantially effective in relevant jurisdictions outside of England and Wales. In this case and in light of the agreements that have been reached with the vessel owners, it was no longer necessary for the plan companies to demonstrate that the plans would be recognised in the Netherlands. Accordingly, the Court was satisfied that it should exercise its discretion and sanctioned the three Restructuring Plans.

Conclusion

Although this case marks the first of its kind, it will not be the last. In many respects, a number of the difficult issues around cross-class cram-down remain to be resolved, but there is no doubt the use of cross-class cram-down as a restructuring tool under English restructuring law is now firmly established. Stay tuned for additional developments.

James Stonebridge is a partner in our London office in firm's financial restructuring and insolvency group.

Germany adopts its own restructuring scheme - distressed M&A transactions in the context of Germany's new StaRUG-scheme

Dr. Sylwia Maria Bea

Until January 1, 2021, the only restructuring options available to distressed companies in Germany were either judicial insolvency proceedings (with or without self-administration) or purely consensual out-of-court restructurings with the consent of all creditors. Although restructuring can often be achieved through out-of-court negotiations, there is always the risk of individual dissenting creditors or minority shareholders taking actions that threaten the success of such restructurings.

With Germany's new *Act on the Stabilization and Restructuring Framework for Businesses (StaRUG)*, a path has now been created as of January 1, 2021, which provides a pre-insolvency restructuring proceeding with court involvement and the possibility of orders/regulations that will bind the affected creditors. In other European countries, such proceedings have long been the order of the day. In Germany, the English *scheme of arrangement* has often been cited as an example of this type of process. In particular, the low entry requirements for this procedure have led to a wide range of pre-insolvency applications in the UK and certain other common law jurisdictions.

The initial practical experience with and uses of StaRUG are currently underway in the German market. Despite its recent vintage, it is clear that StaRUG will have an important impact on the design and structures of future distressed M&A transactions in Germany, which in the past have taken the route of an out-of-court restructuring. This is particularly relevant in the case of complex stakeholder and financing situations, the lack of a company succession solution or for the purpose of portfolio streamlining, cash generation through carve-out transactions or through separation of non-core assets. In Germany, the current distressed markets are those directly affected by the COVID-19 pandemic (i.e. tourism, hospitality, aviation, mechanical/plant engineering, sports, retail and leisure) and in addition, the so-called "zombie" companies with limited and reduced financial flexibility and declining debt capacity. Companies with a need for start-up financing or otherwise with refinancing difficulties are also subject to distress.

General impact of the StaRUG-scheme on the M&A process

First of all, management is in charge of the StaRUG-scheme. However, upon application or, under certain conditions, ex officio, a so-called restructuring officer (*Restrukturierungsbeauftragter*) can be appointed. Nevertheless, the restructuring officer has a more supervisory and supportive function. Therefore, a fundamental change is the far-reaching freedom of management to shape and organize the entire M&A process as part of the restructuring. In this phase, however, the management is still bound by the instructions of the company's shareholders. At the same time, the interests of creditors, and in particular secured creditors, must nevertheless be taken into account by management. In particular, the M&A process in a StaRUG framework should not be used by management to delay and drag out the restructuring process to the detriment of creditors or to implement measures that endanger or disadvantage creditors. Such measures could cause the StaRUG-scheme to fail during the subsequent judicial review stage. At a minimum, the creditors must be placed in a better position than they would have been without the proposed StaRUG-scheme.

Pursuant to StaRUG Section 29, the company's access to the StaRUG restructuring framework is available as of the company's *imminent* illiquidity. However, the distressed company must be neither illiquid nor over-indebted, which legally would require management to commence an insolvency case within a short time period (e.g., between three to six weeks). This means that the initiation of the StaRUG-scheme itself - with or without an M&A process - can only occur with the consent of the shareholders. In contrast, the M&A process in a traditional insolvency proceeding in Germany involves strict rules and control by an administrator following the commencement of the case. In a StaRUG scheme, it is possible to work out a more flexible or tailor-made solution and takeover strategy in advance of the StaRUG filing. Although the focus is likely to be primarily on financial restructurings, this can certainly be flanked by operational restructurings as a reaction to either the financial or operational causes of the distress.

The possibility of early initiation of a debt-equity swap pursuant to StaRUG Sec. 7 (4) also offers an interesting restructuring option in the context of a lender's loan-to-own strategy, which could result in the complete loss in the value of equity. In addition, all other permissible measures under company law, such as (i) a capital reduction or increase, (ii) the use of in-kind contributions of equity, (iii) subscription rights or (iv) the payment of compensation to departing shareholders, are also possible in a StaRUG restructuring plan. These measures could be agreed in advance with a potential new investor or acquiror. The broad portfolio of options thus significantly increases the attractiveness of the target company for potential suitors.

Above all, financial acquirors (e.g., private equity companies or hedge funds) should be best positioned to benefit from StaRUG. While strategic acquirors usually take greater risks in distressed M&A transactions due to their better knowledge of the industry and ability to conduct due diligence quickly and efficiently, financial investors are expert at minimizing risk through creative transactions. Thus, financial investors could benefit from StaRUG's flexibility in allowing the company and acquiror to shape a transaction in the restructuring plan under the StaRUG-scheme.

The StaRUG-scheme addresses the issue of dissenting creditors by creating the right to cross-class cram down. In this context, a variation of the absolute priority applies, i.e. overruling of a dissenting creditor class is only possible if the members of the class have an appropriate share in the so called plan's "value" (*Planwert*). However, there are exceptions that provide the court with much leeway; for example, different treatment of creditors of the same rank is possible if this appears "appropriate" in the individual case. Dissenting creditors can therefore no longer rely on a successful hold-out strategy under the StaRUG-scheme.

In addition, intra-company third-party collateral or credit support (such as guarantees or letters of comfort) can also be included as part of the restructuring plan, which can lead to significant simplifications in M&A transactions within complex (holding) structures.

By utilizing a stabilization order (the so-called moratorium), secured lenders can be denied access to their collateral for an initial period of three months. The maintenance of the status quo offers a decisive time advantage for both the value calculations and the M&A transaction discussions and can mitigate disruptive factors in the M&A process.

With regard to the selection and implementation of restructuring measures, including an M&A process, the general duties remain in force for the managers of the target company, including the applicability of the "business judgement rule." However, an additional set of duties arises during the preparation and execution of an M&A transaction in the StaRUG-scheme. Management must adapt its actions since the necessary weighing of interests shifts more in favour of creditor interests as the crisis deepens.

Ultimately, the new StaRUG procedure offers significant advantages in distressed M&A situations, not only as compared to an out of court acquisition, but also compared to a distressed transaction in a traditional German insolvency proceeding. Preservation of value is likely to be significantly enhanced as a result of the new StaRUG process.

Advantages and disadvantages of the StaRUG-scheme for the individual M&A stakeholders

In the preparation and implementation of a restructuring pursuant to the StaRUG-scheme, the interests of the main acting parties in an M&A process are impacted differently.

Management

Similar to a self-administration procedure, management of the company benefits from the contribution of its own know-how, which allows it to respond in the best possible way to the needs of the distressed company. In addition, the StaRUG-scheme opens up the possibility of de-leveraging the company without the consent of all creditors. However, once the StaRUG restructuring matter has been notified to the court, management is exposed to additional liability risks as well as tension between creditor and shareholder interests. The restructuring must be aligned with the interests of creditors, which may also limit the discretion of management. This can give rise to considerable uncertainties for management. The need for solid legal support for management becomes clear and is critical.

Shareholders

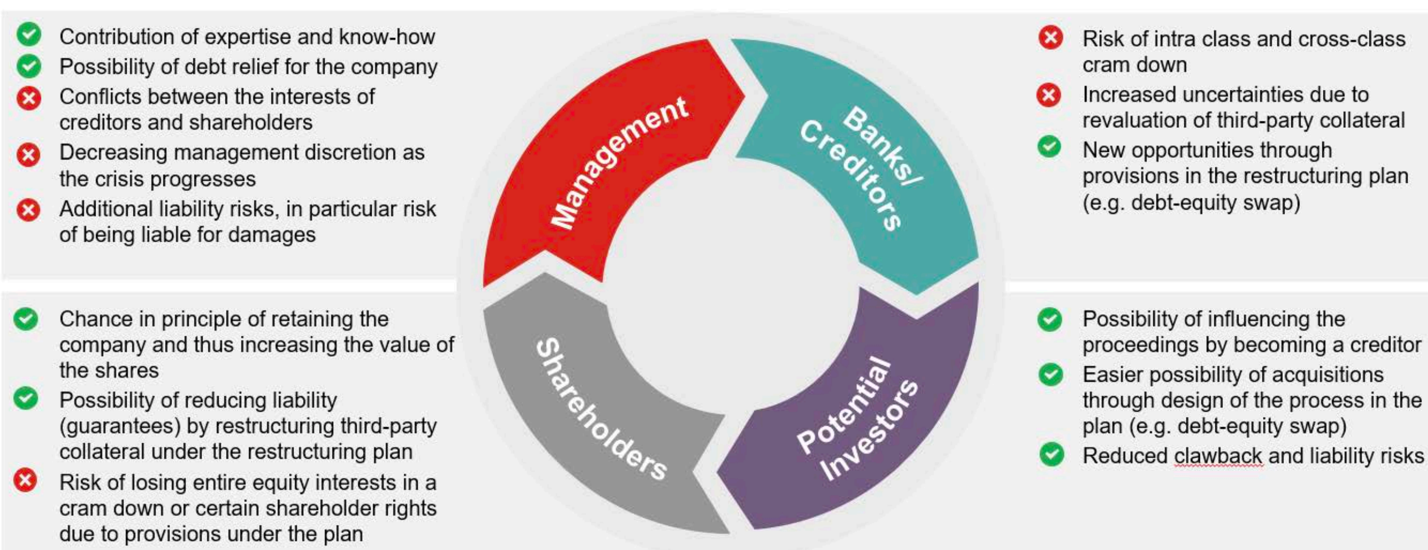
The StaRUG procedure offers various potential advantages for the company's shareholders. As a result of the ability to achieve debt relief and further restructuring measures, the possibility of preserving the going concern value of the company is enhanced, which in turn can increase the value of the shares. In addition, liabilities of the shareholders due to guarantees can be significantly reduced through the restructuring of intracompany third-party obligations. However, there certainly are disadvantages to shareholders including the potential for restriction of shareholder rights contained in the restructuring plan or at worst the loss of their equity interests entirely as part of a cross-class cram down.

Investors/Acquirors

Investors or acquirors are able to have a direct impact on the course of StaRUG proceedings and thus on the structure of the entire transaction by way of an acquisition of claims. By means of a debt-equity swap, they would have the opportunity to obtain an equity position against the will of certain subordinate creditors or minority shareholders. As part of the restructuring plan, existing financing and collateral could also be restructured in a simplified way. Further advantages include the reduced risks of insolvency clawback and liability (discussed below) if the transaction is structured appropriately.

In addition, M&A transactions outside of the traditional insolvency proceedings offer the advantage of avoiding reputational damage, both for the investor and the company.

Stakeholder analysis in the context of StaRUG



Clawback and liability privileges for new financings

The possibility of clawback or other liability regularly creates considerable uncertainty for the purchaser in a distressed out of court M&A transaction, as they are often unable to assess the extent to which the acquisition or simply new or interim financing in favor of the target company may be subject to clawback or liability risks in a subsequent insolvency case. This uncertainty may well last for several years, as the statute of limitations for a statutory clawback claim is three years and the possible subsequent insolvency administrator is not required to declare in advance that they will exercise the right of clawback. The StaRUG-scheme, however, offers new investors a "safe harbor" in principle with corresponding privileges under StaRUG Sections 89, 90. Indeed, new financing – in the form of debt and/or equity – can be expressly included in the restructuring plan and is safe harbored from any clawback risk in the event of subsequent insolvency proceeding.

Safe harbour during the pendency of the restructuring case

As a rule, a clawback claim under German insolvency law not only requires that creditors were disadvantaged by the transaction, but further specific requirements, including the knowledge of the opposing party (in this case the investor) of the debtor's illiquidity, the debtor's intent to disadvantage creditors and the knowledge of such intent on the part of the opposing party. Whether a transaction caused a creditor disadvantage is difficult to assess in complex and multi-part M&A transactions. Clearly, a disadvantage can result from the lack of adequacy of the purchase price and the resulting reduction in the value debtor's assets. Further, creditor disadvantage may exist if a transaction alone has made it more difficult for creditors to gain access to the company's assets and enforce their obligations.

The StaRUG restricts the scope of application of the so-called actual intent clawback (*Vorsatzanfechtung*). Thus, pursuant to StaRUG Section 89, an act cannot be found to be taken with intent to disadvantage creditors solely based on the fact that a party to the legal act had knowledge of the pendency of the StaRUG restructuring case or the use of StaRUG proceedings or instruments.

Thus far, however, the question remains unclear as to whether a mere interim financing for the purpose of preparing for a possible transaction under StaRUG, e.g. a bridge loan, falls within the protection of the safe harbor.

Privileges in the case of acts in execution of the plan

In addition, pursuant to StaRUG Sec. 90, the provisions of a legally confirmed restructuring plan and acts performed in execution of such a plan are only open to clawback if the confirmation of the plan was based on incorrect or incomplete information provided by the debtor and the investor was aware of this incomplete or incorrect information. This restriction on clawback claims does not apply to subordinated claims (*nachrangige Forderungen*) or securities of the shareholders themselves. The aim is to address the risk that the plan will fail contrary to expectations. The restriction is therefore limited to the period until sustainable restructuring (*nachhaltige Restrukturierung*) is achieved. The requirement of sustainability refers to the implementation of the plan. Consequently, the creditors or new creditors included in the plan do not benefit from any further protection against a clawback if insolvency occurs later for other reasons.

There are some uncertainties in the StaRUG-scheme, such as the definition of "sustainable restructuring" (*nachhaltige Restrukturierung)*, which may pose challenges for the contracting parties. Further questions are also likely to arise with regard to the relevant clawback period. The examination of possible insolvency clawbacks remains a case-by-case decision by the bankruptcy official. It also remains to be seen to what extent future case law will require the submission of a so-called restructuring opinion (*Sanierungsgutachten IDW S6*) as evidence of the knowledge of the possible intent to disadvantage creditors in M&A transactions in the context of StaRUG proceedings. This would certainly not be conducive to StaRUG transactions as an IDW S6 expert opinion has higher requirements than StaRUG and also results in a time delay as well as further costs.

Although there are some challenges as outlined above, in principle the court-confirmed restructuring plan under the StaRUG-scheme can be used as a safe harbor for new debtor or equity financings, e.g. in the context of an M&A process. The possibility of clawbacks is made significantly more difficult. It can be assumed that this will have a positive effect on the willingness of any investors to buy.

Summary

The various advantages of an acquisition in the context of a StaRUG-scheme explained above clearly outweigh the possible risks. In particular, the ability to better preserve the value of the company while avoiding the stigma of insolvency and/or the possibility of acquiring the equity outside of a formal insolvency proceeding over the objections of individual/all creditors and shareholders is a powerful tool for both the company and the new investor or acquiror.

Although there currently are some untested areas in the interpretation of the law, particularly with regard to liability and clawback claims, we predict that many distressed companies will nevertheless go down the path of a StaRUG-scheme in connection with an M&A transaction and attempt to solve any potential challenges or disadvantages with the legal instruments available. In any case, future developments under StaRUG remain exciting.

Dr. Sylwia Maria Bea is partner in our Frankfurt office in the firm's financial restructuring and insolvency group.

The Dutch scheme is tested and works

Koen Durlinger

On 1 January 2021, the Act on Court Confirmation of Extrajudicial Restructuring Plans, also referred to as the 'Dutch Scheme' (*Wet Homologatie Onderhands Akkoord*, "WHOA") entered into force.

In the Q1 2020 and Q4 2020 issues of our International Restructuring Newswire, we published articles on the Dutch Scheme, which introduces a pre-insolvency restructuring mechanism in the Netherlands.

The WHOA introduced for the first time in the Netherlands an effective restructuring mechanism outside of formal bankruptcy proceedings. The Dutch Scheme is based on elements of both the US Chapter 11 and UK schemes of arrangement procedures.

Overview

Since its enactment this year, there have already been 16 judgments concerning restructuring plans under the Dutch Scheme that have been rendered (and published) by several Dutch courts, which have analysed several elements of the new restructuring tool.[1]

As a general note, the judgments are composed in a very clear and comprehensive manner, and consider all elements relevant for the requests in a step-by-step manner. This allows parties and practitioners to quite easily compare the reasoning of the courts on specific points.

In this article, we discuss some of the court decisions relating to:

- confirmation of restructuring plans
- appointment of restructuring experts
- cooling-off periods
- lifting of attachments
- termination of onerous contracts
- permission to obtain emergency financing
- certain interim decisions

The WHOA provides for a dual-track approach, meaning that at the very start of the (formal) process, the debtor will have to choose to follow either the public procedure or the confidential procedure set out in the WHOA. Most of the judgments to date relate to confidential procedures, so it is not possible to determine the specific debtors to which they relate, but in some of the published judgments, the debtor entities were disclosed and more information is available.

Confirmation of plans

The courts have considered three plans to date, two of which have been confirmed, and the other was rejected.

First WHOA confirmed plan – 19 February 2021

The first confirmation decision was given within two months of the new law coming into force. The decision related to two companies, Jurlights B.V. and its parent Jurlights Holding B.V. Jurlights developed audio-visual technical productions for large-scale events globally. In early 2020, the activities of the company came to a standstill as a result of the various Government measures that were implemented as a result of the COVID-19 pandemic. After an initial reorganisation of its business, Jurlights proposed a plan in mid-2020, which was not approved by the creditors. At the end of December 2020, Jurlights proposed a new plan to its creditors in expectation of utilising the Dutch Scheme to be enacted effective as of 1 January 2021. The plan was proposed to three classes of creditors the '*retentor*'[2], the Dutch Tax Authorities and the unsecured creditors. The retentor and the class of unsecured creditors voted in favour of the plan within the voting deadline. The Dutch Tax Authorities informed the debtor, albeit after the deadline for voting lapsed, that it agreed to the plan. After Jurlights had obtained the support of the creditors, a request for confirmation was submitted to the Dutch court.

The court found that it was reasonable to expect that Jurlights would not be able to continue paying its debts without the plan and that, absent the restructuring, the only alternative would be bankruptcy. The court also found that the creditors were sufficiently informed and were given an adequate opportunity to vote on the plan, and that the class formations were correct.

1 This article discussed the judgments published by the Dutch courts up to and including 18 March 2021.

2 A 'retentor' is a lienholder, who has possession of and can hold on to an asset of the debtor until (for example) their invoices are paid.

One dissenting creditor objected to the confirmation, stating, among other things, that its invoice pre-dated the COVID-19 pandemic and that it would be worse off under the plan than in the event Jurlights were to be declared bankrupt. The former argument was irrelevant in considering whether or not the plan was eligible for confirmation. On the latter point, the court concluded (on the basis of the submission of Jurlights) that the creditors were better off under the plan than in the event of a bankruptcy and therefore declined to reject the confirmation on the basis of the arguments raised by the dissenting creditor.

Despite the contentious aspects of this case, the full (formal) process was completed within six weeks; the starting declaration was filed with the court on 11 January 2021, and the plan was confirmed by the court on 19 February 2021.

The court noted that Jurlights and its parent submitted a joint restructuring plan to their creditors, but instead should have presented two separate plans before asking the court to confirm these plans. The court did however take a pragmatic and lenient approach on the basis that it must have been clear to the creditors that in substance there were two separate plans and given that all creditors of the parent voted in favour. This approach was taken as the Dutch Scheme legislation only entered into force recently and the law, in the words of the court, may not be entirely clear on this point. However, the court noted that the law does not technically allow for combined or joint plans (other than to the extent group guarantees are restructured). Practitioners and debtors should pay heed to this point in future WHOA proceedings.

Second WHOA confirmed plan – 10 March 2021

In another case, the debtor omitted one (unsecured) creditor and failed to invite that creditor to vote on the plan. However, that creditor was later included in the plan and invited to vote nevertheless. Initially, the creditor voted against the plan, but after further discussion the creditor changed its vote and agreed to the plan. The court ruled that the plan could not be formally declared binding on that creditor because it was not included in the plan before the voting by the other creditors.

The question arose whether the omitted creditor would receive better treatment than the other unsecured creditors (that were included in the plan) in an "unjustifiable manner." The omitted creditor would receive better treatment because its claim would be left unaffected as a result of the creditor being omitted, whilst the claims of those creditors that were placed in the same class in which the omitted creditor should have been placed would be compromised.

The court held that, although the omitted creditor was not included in the plan formally, in substance it was not treated differently from the other unsecured creditors that were included in the plan, because the debtor and the omitted creditor concluded a separate agreement outside of the plan by means of which the debt owed to the omitted creditor was restructured equally to the debts owed to the unsecured creditors that were part of the plan.

The court confirmed the plan and declared that the plan was not binding on the initially omitted creditor on the basis that said creditor received equal treatment because of the separate agreement reached.

The first rejected plan

The court rejected a plan presented by an entrepreneur operating as a sole proprietor. According to the entrepreneur, the financial distress was caused by his illness and in addition the economic impact of the COVID-19 pandemic. The court rejected the plan for several reasons.

First, the plan was initially submitted to unsecured creditors and the Dutch Tax Authorities, but the debtor asked that the court confirm the plan only as to the unsecured creditors. The reasoning given by the debtor was that the amount of the Dutch Tax Authorities' claim was unclear, as it could decrease or increase compared to the amount stated in the plan. As a result, the request for confirmation deviated from the scenario on which the voting creditors had based their decision.

Second, the information that was provided by the debtor contained severe gaps and inaccuracies. Among other things: in the list of creditors that was presented, not all names of the actual creditors were included, not all claim amounts were correctly specified, not all relevant contingent debts were presented to the creditors and the existence of a secured creditor was left unmentioned.

Last but not least, the debtor did not present the results of a business viability study to its creditors, which indicated that the business would not be viable. This study was undertaken in the context of a prior application for funding by the municipality of The Hague, which was denied on the basis of the results of that study. The court considered that, although in principle it would be up to the creditors to form a view as to whether the business of the debtor would be viable post-restructuring, the court found itself competent, on the basis of the results of the business viability study, to determine that the business would not be viable post-restructuring. After all, the Dutch Scheme is intended to prevent *viable* businesses (or parts thereof) from becoming bankrupt. On that basis, the court rejected the plan.

Finally, the court was not satisfied that creditors would have voted in favour of the plan if they had been presented with all of the correct and complete information.

This case shows that although the Dutch courts take a pragmatic and accommodating approach when applying the Dutch Scheme, the Dutch courts seek to protect the interests of creditors involved on the basis of the creditor protection mechanisms provided in the new legislation. A proper preparation of the plan and the information to be presented to the creditors and/or shareholders involved is of crucial importance.

Appointment of restructuring experts

To date, five requests for the appointment of a restructuring expert have been handled by the Dutch courts. A restructuring expert can either be appointed at the request of the debtor or at the request of its creditors, shareholders or a statutory works council or workplace representative (i.e., labour representatives) set up for the debtor's business.

The requests to the courts so far have been made by the debtors themselves. In that scenario, a restructuring expert can be appointed in the event it is reasonably expected that the debtor will not be able to continue paying its debts. The restructuring expert is, whether or not appointed at the request of the debtor itself, required to prepare the plan on behalf of the debtor. The restructuring expert needs to be someone who can perform their duties effectively, impartially and independently. In one judgment, the court stated that the restructuring expert should be someone who brings the various parties in the restructuring together and facilitates negotiations and ensures that the process runs smoothly. If a proposed restructuring expert meets these general criteria, and the procedural rules of the courts have been adhered to by the debtor, the courts have shown in three decisions a willingness to appoint a restructuring expert.

In those decisions where the appointment of a restructuring expert was denied, the debtor either did not submit sufficient proposals from various prospective restructuring experts as prescribed by the procedural rules of the courts, or the request was not made with a view to preparing a restructuring plan, but rather to assist the debtor in bringing its books and record-keeping into order (which is not the statutory purpose of a restructuring expert under the WHOA). The decision by the courts to reject appointing restructuring experts in those cases is not surprising.

Declaring a cooling-off period

In four of the decisions that are publicly available to date, the court rendered a decision on the declaration of a cooling-off period. A cooling-off period or, in more international terms, a moratorium can be declared by the court at the request of the debtor (or the restructuring expert) if it is *prima facie* shown that it is necessary to continue the business of the debtor while the plan is being prepared. This may be the case in the event it is reasonably expected that if a cooling-off period is not declared, the debtor runs a significant risk of either one of its creditors or shareholders filing for its bankruptcy, or taking recourse or enforcement actions. During the cooling-off period, such rights of creditors and shareholders are suspended.

A cooling-off period is only declared by the courts if the debtor shows that either (i) it has proposed a plan to its creditors and/or shareholders, or (ii) it has committed to propose a plan within two months from the request for a cooling-off period, or (iii) where a restructuring expert has been appointed. In one case in which none of these requirements was met, the court denied the request for the declaration of a cooling-off period (and a request to lift attachments).

In deciding whether or not a cooling-off period should be declared, the court is required to consider whether the cooling-off period is in the interests of the creditors and that the interests of those who are (temporarily) prevented from taking action during such cooling-off period are not substantially affected. The courts take a pragmatic approach in this regard by taking the view that the cooling-off period is indeed in the interests of the creditors if they can expect a better recovery under the plan than in the event of a bankruptcy of the debtor (in circumstances where a cooling-off period is not declared).

Interestingly, in one of the decisions, the court declared a cooling-off period in the context of a process in which a liquidation plan (rather than a restructuring plan) was prepared. One of the creditors stated that a cooling off period was improper under the WHOA since the business was not intended to continue and an orderly wind-down was envisaged (and, actually, the business of the debtor was no longer operating). The court, however, ruled that the Dutch Scheme provides for the possibility of both restructuring plans and liquidation plans, and that in line with the apparent purpose of the WHOA, a cooling-off period could also be granted where the Dutch Scheme involves a liquidation plan to facilitate an orderly wind-down of the debtor.

In another decision, the court specifically exempted from the cooling off period one of the secured creditors who had a disclosed right of pledge over account receivables.

Lifting of attachments

Attachments levied can be lifted by the court at the request of the debtor (or the restructuring expert), if it is *prima facie* shown that the interests of those who levied the attachments are not substantially affected.

Where the court has lifted attachments on equipment and inventory, it was stated that although the interests of those who levied the attachments were affected, the court was of the view that their interests were not affected substantially, given that the equipment would only be used to a limited extent and therefore its value would not (substantially) decrease. Furthermore, the court considered that if the debtor could not freely sell its inventory in this case, the chances of a successful restructuring would be very limited. This would likely result in imminent bankruptcy, in which those who had levied the attachments would not be able to recover any amounts because the attachments would cease to exist in the event the debtor is declared bankrupt.

Termination of onerous contracts

In the *Jurlights* case, the court allowed the debtor to terminate the lease of three printers which would otherwise expire in December 2023. The lease of the printers was on onerous terms to the debtor and the printers were not needed post-restructuring. In order not to leave the lessor completely empty-handed, the debtor was required to include the damages claim of the lessor (equal to the rent under the lease until initial expiry) in the restructuring plan, as is prescribed by the new law.

Emergency financing

To date, the court has only been requested once for permission for the debtor to obtain emergency financing. On the basis of the WHOA, the debtor (or its restructuring expert) can apply for permission of the court to enter into agreements (or commit other legal acts). Permission is to be granted by the court if the relevant agreement is necessary to continue the business during the preparation of the plan, and it is reasonably expected to be in the interests of the creditors and the interests of individual creditors are not substantially affected. If the permission of the court is obtained, it eliminates the clawback risk in respect of such transaction in the event the restructuring fails and the debtor is declared bankrupt.

Interestingly, the one judgment allowing the debtor to obtain financing did not mention any security being granted in exchange for the emergency financing. However, another judgment relating to the same debtor's restructuring indicates the emergency financing was (factually speaking) granted on an unsecured basis. As a result, one may query whether it was necessary to obtain the permission of the court since unsecured financing will not usually be at risk of clawback.

Interim decisions

Under the Dutch Scheme, the debtor or the restructuring expert (if appointed) can ask the court to render an interim decision in respect of matters that are relevant for achieving a plan. For example, prior to the plan being put up for voting, the court may be asked to give a binding decision on the class formation as presented by the debtor or restructuring expert. This is of (great) importance because an incorrect class formation would result in a restructuring plan not being approved by the court.

Under the Dutch Scheme, certain groups of creditors that have the same rank may be treated differently under a plan by being placed in separate classes. If the less favourably treated class votes in favour of the plan with the required majority, then of course such plan can be confirmed by the court. Even if the less favourably treated class does not vote in favour of the plan, the plan can nevertheless be confirmed where reasonable grounds exist for the unequal treatment.

In one case, the court was asked to give a binding interim judgment on whether or not there was a reasonable ground to treat creditors with claims that arose before a certain cut-off date differently than creditors with claims that arose after that cut-off date. The court answered this question in the affirmative. The reasoning of the court was that the liabilities incurred after the cut-off date were necessarily incurred, and if they had not been incurred, bankruptcy of the debtor would have been unavoidable. Against that background, the court decided that there were reasonable grounds to leave the claims of the creditors after the cut-off date out of the plan (and hence unaffected) while restructuring the claims of the creditors of before the cut-off date.

Conclusion

Many features of the WHOA have been tested within the first three months of the legislation being introduced. The courts have shown a pragmatic and lenient approach in handling the various requests made, whilst safeguarding the interests of the creditors and/or shareholders involved. From the first published cases, we can conclude that the Dutch Scheme is working effectively, which bodes well for Dutch companies in need of a first class restructuring tool.

We will continue to monitor the published cases on the Dutch Scheme and share updates in due course.

Koen Durlinger is a senior associate in our Amsterdam office in the firm's financial restructuring and insolvency group.

Overview of the key Chapter 15 decisions in 2020

Francisco Vazquez and Emma Persson

Fifteen years ago, in 2005, the US became the ninth jurisdiction to adopt the Model Law on Cross-Border Insolvency, which provides a mechanism pursuant to which a foreign insolvency, liquidation, or debt restructuring (known as a "foreign proceeding") may be granted recognition under Chapter 15 of the Bankruptcy Code. The number of jurisdictions adopting a version of the Model Law has been steadily increasing and in 2020, Brazil and Myanmar joined, bringing the total to 53 jurisdictions enacting a version of the Model Law.

Over the course of the past 15 years, US courts have addressed numerous issues in Chapter 15 cases. Given the international origin of Chapter 15, a foreign court may consider a US court's decision in determining whether to grant relief in its home country. There are, however, conflicting decisions on several issues in the US. For example, in the Second Circuit, which includes New York, a foreign proceeding can be recognized only if the foreign debtor satisfies the statutory debtor eligibility requirements applicable to plenary bankruptcy cases in the US. Other jurisdictions, including the bankruptcy courts of Delaware and most recently, the US Bankruptcy Court for the Southern District of Florida, have refused to impose the Bankruptcy Code's debtor eligibility requirements on a Chapter 15 debtor. *See In re Viacao Itapemirim, S.A.*, No. 18-24871-BKC-RAM, 2020 Bankr. LEXIS 634, at *3-4 (Bankr. S.D. Fla. Mar. 10, 2020).

This "year in review" article focuses on some of the significant decisions issued by the US courts in 2020. Part I of this article begins with a discussion of a trio of decisions elaborating on the standards for recognition of a foreign main and foreign nonmain proceeding. Part II examines a bankruptcy court's decision to enforce a foreign debt restructuring. Finally, Part III concludes with a discussion of the implication of Chapter 15 on certain litigation issues.

Recognition of a foreign main or foreign nonmain proceeding under Chapter 15

Under Chapter 15, a foreign proceeding shall be recognized, if (i) the foreign proceeding is a foreign main or foreign nonmain proceeding, (ii) the petition for recognition was filed by a foreign representative, and (iii) the petition satisfies certain procedural requirements. If all three criteria are satisfied, the petition for recognition must be granted, unless recognition would be "manifestly contrary" to US public policy. Many Chapter 15 decisions are focused on the first requirement—whether the foreign proceeding is a foreign main proceeding or a foreign nonmain proceeding. In 2020, the US Bankruptcy Court for the Southern District of New York addressed the issue in the corporate and individual debtor context.

A foreign main proceeding is a foreign proceeding pending in the country where the debtor has the center of its main interest or "COMI." Chapter 15 does not define COMI, but the location of a corporate debtor's registered office is presumed to be its COMI. In certain circumstances, that presumption may be rebutted by other facts, including location of the debtor's headquarters; the location of those who manage the debtor; and the location of the debtor's assets. A foreign nonmain proceeding is a proceeding pending where the debtor has an establishment, which is defined as "any place of operations where the debtor carries out a nontransitory economic activity." In the Second Circuit, which includes New York, a court will generally analyze a debtor's COMI as of the date of the filing of the Chapter 15 petition.

In 2020, the US Bankruptcy Court for the Southern District of New York analyzed requests for recognition of a foreign main proceeding and a foreign nonmain proceeding in connection with the cross-border restructuring of the "Constellation Group," a group of entities that operate offshore and onshore oil and gas rigs and drillships. In the first case discussed below, the bankruptcy court did not find sufficient evidence to rebut the presumption that the company's registered office was the debtor's COMI and granted recognition to a proceeding pending in the British Virgin Islands as a foreign main proceeding and issued an order enforcing its BVI plan that mirrored the terms of its affiliates Brazilian plan. *See In re Olinda Star Ltd.*, 614 B.R. 28, 33 (Bankr. S.D.N.Y. 2020). Likewise, the same bankruptcy court granted recognition to a Brazilian proceeding of a Luxembourg affiliate as a foreign nonmain proceeding. Both cases reflect that it will generally be difficult to overcome the presumption that a debtor's COMI is where it is registered or incorporated.

A. Recognition of a foreign main proceeding in *Olinda Start Ltd.*

Olinda Star Ltd. is incorporated in the British Virgin Islands and is a member of the Constellation Group. Certain members of the Constellation Group, including Olinda Star, commenced reorganization proceedings ("*recuperação judicial*") in Brazil, and filed Chapter 15 cases in the US. Thereafter, the Brazilian court entered an order formally accepting the majority of the members of the group as debtors in Brazil. The Brazilian court, however, dismissed the Brazilian proceedings as to Olinda Star because, according to the court, Olinda Star was not eligible to be a debtor in Brazil. Consequently, the US bankruptcy court dismissed Olinda Star's initial Chapter 15 case.

Following the dismissal of its Brazilian restructuring proceeding and the initial Chapter 15 case, Olinda Star filed a "soft-touch" provisional liquidation in the BVI to implement a scheme of arrangement that mirrored the Brazilian restructuring plan. Generally, in a soft-touch provisional liquidation, the directors retain the day to day control of the company, but court-appointed liquidators are entrusted with the pursuit of actions outside of the ordinary course of business, including a restructuring. In connection with its restructuring efforts and the BVI proceeding, Olinda Star filed a new Chapter 15 case and requested (i) recognition of the BVI proceeding as a foreign main proceeding and (ii) an order enforcing the BVI scheme in the US.

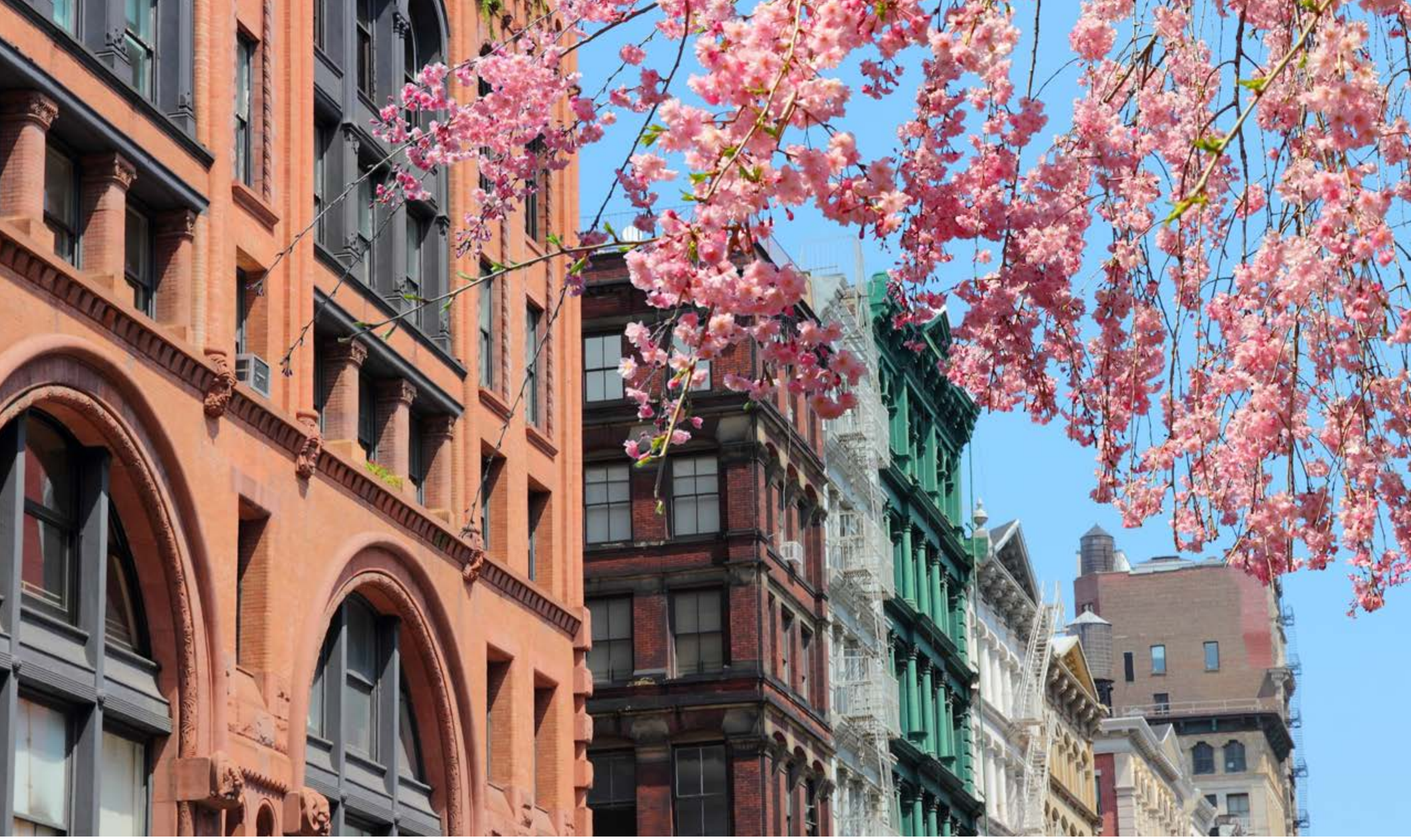
As an initial matter, the bankruptcy court noted that because Olinda Star was incorporated in the BVI, Olinda Star's COMI was presumed to be the BVI. There were, however, certain facts that supported a finding of COMI elsewhere. In particular, the operational management team was located in Brazil, the company's treasury function was in Panama, its sole director resided in the Cayman Islands, and its primary asset was an oil drilling rig vessel then drifting in the Bay of Bengal. Nevertheless, the court found that, as of the date of the Chapter 15 filing, the BVI court-appointed joint provisional liquidators actively managed Olinda Star's assets, as evidenced by, among other things, the fact that the provisional liquidators regularly hosted meetings with creditors and the debtors' sole director, all in the BVI. Moreover, the company was subject to the BVI's laws, regulations, and jurisdiction. According to the court, this fact weighed in favor of finding COMI in the BVI. Further, the court found that creditors and third parties' expectations supported finding COMI in the BVI. In particular, the debt documents reflected that Olinda Star was incorporated in the BVI and expressly included references to the BVI's insolvency laws. Finally, creditor support for the BVI scheme further bolstered a finding that the BVI was Olinda Star's COMI.

Upon recognition of the BVI proceeding, the bankruptcy court issued an order enforcing the BVI scheme in the US The US court determined enforcement of the scheme was necessary and appropriate as required under Chapter 15. Further, according to the court, the decision whether to enforce a foreign debt restructuring "boils down to a question of the appropriateness of granting comity" to the restructuring. In this instance, the court, noting that the US and the BVI share common law traditions and similar due process values, concluded that creditors had notice of the BVI proceedings and had a full and fair opportunity to be heard on scheme related issues.

B. Recognition of a foreign nonmain proceeding in *Serviços De Petróleo Constellation S.A*.

US courts have regularly held that the distinction between foreign main and foreign nonmain proceeding may not be significant because a court can grant substantially the same relief in both instances. In that regard, the same judge from the US Bankruptcy Court for the Southern District of New York in the Olinda Star decision also issued an order enforcing a Brazilian restructuring plan of a Luxembourg member of the Constellation Group after recognizing its Brazilian proceeding as a foreign nonmain proceeding. *See In re Serviços De Petróleo Constellation S.A.*, 613 B.R. 497, 513 (Bankr. S.D.N.Y. 2020).

In contrast to Olinda Star, the Brazilian court concluded that Arazi S.à.r.l, a company registered in Luxembourg, was a proper debtor in Brazil. Accordingly, the US bankruptcy court addressed Arazi's Chapter 15 petition for an order granting recognition to the Brazilian proceeding as a foreign main or foreign nonmain proceeding. In this instance, the court could not recognize the restructuring proceeding as a foreign main proceeding because the debtor's COMI was not in Brazil. Indeed, Arazi's COMI was presumed to be in Luxembourg, where it was registered. Moreover, according to the US court, there were insufficient facts to rebut the presumption. In particular, the court found that the COMI factors mentioned above weighed in favor of finding COMI in Luxembourg. In particular, the court emphasized that Arazi was a special purpose holding and financing company for the Constellation Group whose nerve center was in Luxembourg. In addition, its headquarters and the people that managed Arazi were



located in Luxembourg. Moreover, Luxembourg law was the most relevant law governing Arazi's disputes because Arazi, as a Luxembourg corporation, was subject to Luxembourg laws, regulations, and jurisdiction. Finally, creditors reasonably expected that Arazi would be subject to a Luxembourg insolvency proceeding given statements made in Arazi's debt documents. Accordingly, Luxembourg (and not Brazil) was Arazi's COMI. However, all of Arazi's assets, which, as an investment vehicle, included its equity interests in joint ventures and associated entities that own and operate floating production, storage, and offloading vessels, were located in Brazilian waters. According to the court, these non-transitory ties were sufficient to find an establishment in Brazil. Therefore, the court recognized the Brazilian proceeding as a foreign nonmain proceeding. Following recognition of the Brazilian proceeding, the bankruptcy court summarily issued an order enforcing the Brazilian restructuring plan, noting that the relief requested by Arazi is not limited by the fact that Arazi's bankruptcy is recognized as a foreign nonmain proceeding.

C. A foreign proceeding cannot be recognized where an individual does not have a habitual residence nor carries out "nontransitory economic activity"

Chapter 15 provides that an individual's habitual residence is presumed to be its COMI. In a case involving a Russian citizen, the US District Court for the Southern District of New York, affirmed a finding by the bankruptcy court denying recognition of a Russian insolvency proceeding as a foreign main proceeding. *See Rozhkov v. Pirogova (In re Pirogova)*, 612 B.R. 475, 479 (S.D.N.Y. 2020). In this matter, a creditor commenced an insolvency proceeding in a Russian court against an individual, a Russian citizen who had been a permanent US resident since 2008. Following his appointment, the Russian trustee filed a petition under Chapter 15 for recognition of the Russian proceeding as a foreign main or foreign nonmain proceeding. The bankruptcy court dismissed the petition finding that the debtor did not have sufficient ties to Russia. In 2020, the district court affirmed the bankruptcy court's decision that the Russian trustee failed to demonstrate the debtor's COMI was in Russia. The court noted that the debtor had business dealings in Russia, but they occurred long before the commencement of the Chapter 15 case. Indeed, according to the court, the debtor's residency in the US, lack of travel to Russia since she fled the country years prior, and minimal remaining contacts with Russia, underscored the fact that Russia was no longer her COMI. For similar reasons, the court affirmed the bankruptcy court's finding that the debtor did not have an establishment in Russia. Specifically, the US court noted that the trustee failed to demonstrate that the debtor had a "place of operations" or carried out "nontransitory economic activity" in Russia as of the date of the Chapter 15 petition. Although the debtor still owned an apartment in Russia, she neither lived in, visited, nor managed the apartment as of the date of the Chapter 15 filing.

US courts may grant additional relief after a foreign plan has been enforced in the US

As noted above, a bankruptcy court may, following recognition of the foreign proceeding, enter an order enforcing a foreign debt restructuring in the US if the relief is appropriate and necessary to effectuate the purposes of Chapter 15 and to protect the assets of the debtor and the interests of creditors. In addition, a court may grant such relief only if the interests of creditors and other interested entities, including the debtor, are "sufficiently protected." A US court will generally give significant weight to the due process accorded to creditors in the foreign proceeding. US courts have generally been receptive to issuing orders enforcing Brazilian restructurings, and did so again in 2020. *See In re Lupatech S.A.*, 611 B.R. 496, 497 (Bankr. S.D.N.Y. 2020).

In 2016, a Brazilian court approved a restructuring plan for Lupatech S.A. and certain affiliates, a group of oil and gas service and component providers. Thereafter, the US Bankruptcy Court for the Southern District of New York issued an order recognizing the Brazilian proceeding as a foreign main proceeding and enforcing the Brazilian plan in the US. Following an appeal in Brazil, the Brazilian plan was annulled. Consequently, the US court suspended its order enforcing the plan in the US. Lupatech, however, proposed a modified plan that was approved by creditors and the Brazilian court. The US bankruptcy court, in turn, issued an order enforcing the modified plan and granting additional relief, including authorizing certain US parties to take any "ministerial actions" required under the amended plan. Thereafter, the Lupatech debtors entered into new debt documents and obtained Brazilian court orders (i) adjusting the flow of distributions to creditors under the modified plan, (ii) implementing a new arrangement for the payment of fees and expenses of certain US parties, and (iii) modifying the form of certain distributions contemplated under the plan. The debtors requested an order from the US court enforcing the orders from the Brazilian court.

According to the US court, the enforcement of those Brazilian court orders was necessary to effectuate the purposes of Chapter 15 and to protect the interests of creditors. In particular, the Brazilian orders provided for the payment of the indenture trustee's fees and expenses. Absent the relief requested, it was unclear whether the indenture trustee would take the necessary steps under the plan to facilitate distributions to creditors. Thus, Lupatech's plan could not be fully consummated without a US court order enforcing the Brazilian court orders.

US litigation by foreign representatives

Upon recognition of a foreign proceeding, the foreign representative will have access to the courts in the US. Consequently, a foreign representative may pursue claims against other parties in US federal and state courts. As demonstrated by the district court's decision in *Principal Growth Strategies v. Platinum Management*, 615 B.R. 529, 533 (D. Del. 2020), US courts appear willing to defer to a foreign representative's choice of forum. Following recognition of certain Cayman Island proceedings as a foreign main proceeding by the Bankruptcy Court for the Southern District of New York, the foreign representatives asserted fraudulent transfer and constructive trust claims under Delaware state law and similar claims under Cayman Island law against certain defendants in Delaware state court.

The defendants argued that the Delaware state court litigation was "related to" the Chapter 15 bankruptcy case, and sought removal of the matter to another forum—US federal district court. The foreign representatives, however, successfully argued that the matter should remain in state court by relying on the mandatory abstention provision found in 28 U.S.C. § 1334(c)(2). That statute, which is "based on comity," essentially provides that a US district court shall abstain from hearing a proceeding based on state law if it can be timely adjudicated in a state forum of appropriate jurisdiction. The *Principal Growth* court analyzed the factors in *Stoe v. Flaherty*, 436 F.3d 209, 214 (3d Cir. 2006) to find that it was required to abstain from adjudicating the Delaware litigation because (i) the litigation was based, at least in part, on state law claims; (ii) the litigation did not arise under the Bankruptcy Code or in a case under the Bankruptcy Code because the claims asserted could exist outside the context of a bankruptcy case; (iii) the district court's jurisdiction was premised solely on its jurisdiction over bankruptcy cases or related matters (and not diversity or federal question jurisdiction); (iv) an action was commenced in state court, and (iv) the litigation could be timely adjudicated in state court. Finding that it must abstain, the district court remanded the litigation to the state court, concluding that equitable remand was appropriate.

In 2020, US courts also considered several defenses to lawsuits brought by foreign representatives in 2020. *See Link & Assocs. v. Ivany (In re Schonfeld, Inc.)*, 806 F. App'x 743, 744 (11th Cir. 2020); *In re Fairfield Sentry Ltd.*, No. 10-13164 (SMB), 2020 WL 7345988, at *1 (Bankr. S.D.N.Y. Dec. 14, 2020). In *Schonfeld*, following recognition of a Canadian proceeding as a foreign main proceeding under Chapter 15, the trustee of a debtor filed a complaint against the debtor's wife and various entities to recover assets under Florida state law that the debtor allegedly transferred to his wife. There, the defendants moved to dismiss the trustee's complaint based on forum non conveniens. The US bankruptcy court agreed and granted the motion, finding that (i) Canada was an adequate and available alternative forum, (ii) private and public interest factors weighed in favor of dismissal, and (iii) the trustee could reinstated its suit in Canada without undue inconvenience of prejudice. On appeal, the US Court of Appeals for the Eleventh Circuit affirmed the lower courts' decision finding that dismissal was appropriate because the Canadian court was an adequate alternative forum to adjudicate the fraudulent transfer dispute.

In *Fairfield Sentry Ltd.*, the liquidators of Bernard L. Madoff Investment Securities LLC brought (i) avoidance claims under British Virgin Islands law to recover "unfair preferences" and "undervalue transactions" and (ii) constructive trust claims against certain defendants. Certain defendants argued that all claims were barred under the so-called "safe harbor" provision found in US Bankruptcy Code section 546(e), which shields settlement payments or a "transfer payment . . . made in connection with a securities contract from avoidance, where such transfer was 'made by or to (or for the benefit of) a . . . financial institution.'" Section 561(d) of the Bankruptcy Code makes the safe harbor applicable in Chapter 15. The motion to dismiss followed in the wake of the US Supreme Court's decision, *Merit Mgmt. Grp. LP v. FTI Consulting, Inc.*, 138 S. Ct. 883, 888 (2018), wherein the Supreme Court held that the "relevant transfer for purposes of the § 546(e) safe harbor inquiry is the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions."[1] Ultimately, the *Fairfield* court determined the avoidance actions "were made by, to, or for the benefit of a qualifying entity such as a 'financial institution' of a type identified in [the safe harbor provision]," and therefore dismissed the avoidance claims. The US bankruptcy court, however, denied the motion to dismiss the foreign representatives' constructive trust claims, because the claims were based on BVI law and the court determined that the transferees had not identified any statutory language that expressly preempted such constructive trust claims.

Conclusion

The cases above represent the continued activity of US Chapter 15 courts and the expanded Chapter 15 jurisprudence now 15 years on since enactment in the US. Insolvency and restructuring laws and cases are truly global in nature. Given the expansion of the Model Law to many jurisdictions and its international origin, it is likely that more foreign courts will consider the US Chapter 15 jurisprudence when considering future requests for recognition or ancillary relief in their own jurisdictions. Consequently, a US court's decisions in the Chapter 15 context will likely have broad ramifications and will impact how other courts interpret the Model Law.

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1 **Critically, *Merit* abrogated the then-existing Second Circuit precedent that applied the safe harbor provision even when a qualifying entity acted as a "mere conduit" or intermediary.**

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