OUT WITH THE OLD IN WITH THE NEW?

The US and England are jurisdictions that have relaxed rules permitting foreign entities to use their restructuring systems. Analyse and compare the mechanisms, legal rules and case law in both jurisdictions that can be employed by a foreign entity wishing to utilize the US or English law and courts for a restructuring. Also, analyse whether the rulings of the US or English court can be enforced elsewhere?

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INTRODUCTION

1. The historical differences between the US and UK approaches to restructuring reflects a larger policy divide between these two countries. Although both emanating from the common law, in the US a policy decision was taken earlier on to rescue and preserve the businesses of financially distressed companies rather than primarily support an orderly winding down of its affairs; as a result the US adopted a more debtor-friendly regime with rules which inter alia
    (i) ensured that management remained in control of the company[1] even while financially distressed[2]
    (ii) provided for debtors-in-possession financing (DIP Financing)
    (ii) suspended, modified or superseded the rights of secured creditors
    (iii) provided for an automatic moratorium which technically applied worldwide.

2. These highlights of the Chapter 11, Bankruptcy Code 1978 ("Chapter 11"), would have been seen as sacrilegious in 1979 by the then more credit-friendly UK. But, times have changed. The default rule that a company ought to be wound up or restructured in its place of incorporation has now been eroded beyond recognition by new rules on jurisdiction or a more liberal interpretation of old rules. Foreign companies are now looking to jurisdictions to support their objective of trading out of their financial difficulties rather than hasten their demise. The UK is now alive to this fact, but are recent changes to its restructuring law[3] bold enough to ensure that it offers a formidable alternative to the Chapter 11 procedure?

UK SCHEMES OF ARRANGEMENT UNDER THE COMPANIES ACT 2006

3. Until June 2020, foreign companies wishing to restructure their affairs in the UK could do so by seeking the court's sanction to enter into a scheme of arrangement under Part 26 of the Companies Act. Part 26 applied where *"a compromise or arrangement is proposed between a company and its creditors, or any class of them, or its members, or any class of them*"[4] (the "Scheme") and an arrangement was defined as including "*a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods*"[5].

[1] "absent fraud or gross mismanagement" see power point presentation by Professor G. Ray Warner, St John's University.

[2] With some oversight by the US Trustee, the bankruptcy court, creditors' committees etc

[3] While the UK restructuring system includes administration orders and Company Voluntary Arrangement ("CVA") in the interest of brevity this short paper will focus on Schemes and restructuring plans

[4] See section 895 (1) of the Companies Act

[5] See section 895 (2) of the Companies Act 2006

Scheme of Arrangement Mechanism

4. In order to bind the parties to it, the arrangement must be sanctioned by the Court[6] and before the Scheme is sanctioned the Court may order a meeting of the creditors, classes of creditors or members[7] where a vote must be taken to agree the proposed Scheme. Crucially, to approve the Scheme there must be the agreement of a majority in number representing 75% in value of the creditors or class of creditors or members or class of members (as the case may be)[8].

5. Even where the requisite statutory majority is met the court may not sanction the Scheme.

6. Until a scheme is sanctioned it does not bind those not willing to agree to it and the Court does not have the jurisdiction to sanction the Scheme until the voting threshold has been achieved.

7. While Schemes can be useful they can also be easily derailed by a significant minority and its provisions appear to provide less robust protection for a foreign company in financial distress or on the brink of insolvency.

8. This all or nothing approach became increasingly uncompetitive as global attitudes to failing companies became more conciliatory and pragmatic. Foreign companies began to seek out the more innovative remedies offered by Chapter 11 particularly as bankruptcy judges began to take/retain jurisdiction over more and more foreign companies.

UK Corporate Insolvency and Governance Act 2020 ("CIGA")

9. On 26 June 2020, the UK Corporate Insolvency and Governance Act 2020 ("CIGA") came into force. Introduced at the height of the covid-19 pandemic it offered more flexible and innovative restructuring options for businesses experiencing financial difficulties. In addition to temporary measures to respond to the pandemic, CIGA also introduced a number of significant permanent changes including most notably a moratorium which gave directors the ability to retain control of companies while considering restructuring options and the introduction of a "Restructuring Plan".

[6] Section 899 of the Companies Act 2006

[7] See section 896 of the Companies Act 2006

[8] See section 899 (1) of the Companies Act 2006

10. Part 26A restructuring plans are based on the existing Scheme under Part 26 but there are key differences between the two with the newer restructuring plan seemingly adopting elements of the US Chapter Bankruptcy Code, 1978.

Restructuring Plan Mechanism

11. The permanent provisions of the new regime can be found at Part 26A of the Companies Act 2006[9]. Under section 901A of Part 26A the Court will only exercise its jurisdiction to approve the Restructuring Plan under two conditions where " *the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern*" [10] and there is a compromise or arrangement proposed between the company and creditors or members whose purpose is to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties[11].

12. In addition to the requirement that the company is or "is likely to encounter financial difficulties" another important change to the previous Scheme is that in order to approve a restructuring plan the debtor need only show that "*75% in value of the creditors or class of creditors or members or class of members*"[12] approve the plan. The effect of these key changes are to provide a pathway to restructuring for companies in financial distress and to prevent creditors who are greater in number but smaller in value from derailing a restructuring plan.

13. The UK court has the jurisdiction to sanction a foreign company's scheme or restructuring plan. This is a statutory jurisdiction which applies as a result of Part 26 and Part 26A defining a "company" as including any company that is liable to be wound up under the Insolvency Act 1987[13], which under section 221 of the Insolvency Act includes an unregistered company[14].

14. Differing from Part 26, under Part 26A the Court has the power to facilitate reconstruction or amalgamation by granting relief to include the ability to transfer the undertaking or property of the company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person and the continuation by or against the company of any legal proceeding by or against any transferor company[15].

[9] Inserted by section 49 (1) the Corporate Insolvency and Governance Act 2020, Schedule 9 paragraph 1.

[10] See section 901A(2) of the Companies Act

[11] See section 901B(2) of the Companies Act

[12] See section 901F of the Companies Act

[13] See section 895 (2) b Companies Act 2006

[14] An "unregistered company" is a company not registered in the UK, which all foreign companies by definition are.

[15] 901(J) of the Companies Act 2006.

15. Part 26A also introduced cross-class cram down which permits the court to approve a restructuring plan even if the dissenting group in a class of creditors or members results in the plan not being agreed by 75% in value of that class[16]. This provision will only apply where the dissenters will be no worse off under the plan in the event of the relevant alternative[17] and where another class of investors that would have "*would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.*[18]"

16. Although under a Part 26A restructuring plan the company is encountering or likely to encounter financial difficulties the directors remain in place and continue to run the business.

17. When exercising its discretion to sanction a scheme or restructuring plan the test has been formulated in various terms. In the case of *Re Rodenstock Gmbh*[19] the Court said that "*the essential question under this heading is whether the Scheme will be effective in practice in binding the opposing creditors into a variation of their rights* "[20], other cases[21] point to utility or the Scheme's ability to serve its purpose.

18. Moreover where the scheme or restructuring plan is of a foreign company in *Re Drax Holdings Ltd*[22], the High Court determined the requirement of sufficient connection applied. While there are many cases considering when a foreign company can be said to have a sufficient connection to the UK common examples include where the core financial documents are governed by English law with a non-exclusive jurisdiction clause in favour of England or where the debtor has moved its centre of main interest (COMI) to the UK.

CHAPTER 11, BANKRUPTCY CODE 1978

19. The reorganisation provisions of the Bankruptcy Code 1978 ("Chapter 11"), "*reflects the primary policy of US Bankruptcy law for corporate debtors: to preserve and protect an ailing business by encouraging a financial restructuring that is binding on all parties*.[23]" and since its enactment it has become a more viable option for companies seeking to restructure their affairs but wishing to avoid insolvency. Central to the

[16] See section 901(G) of the Companies Act 2006

[17] See section 901(G) 3 of the Companies Act 2006

[18] See section 901(G) 5 of the Companies Act 2006

[19] Re Rodenstock GmbH [2011] EWHC 1104 (Ch)

[20] See paragraph 73 of Re Rodenstock GmbH

[21] Re Magyar Telecom BV [2013] EWHC 3800 (Ch), Re Hibu Finance (UK) Ltd [2014] EWHC 370 (Ch)

[22] Re Drax Holdings Ltd [2003] EWHC 2743 (Ch)

[23] Bracewell & Giuliani, Chapter 11 of the United States Bankruptcy Code: Background and Summary 2012

Chapter 11 procedure is the filing of a financial restructuring plan ("the Plan") and unlike a restructuring plan in the UK there is no express requirement that the company be in financial distress.

Chapter 11 Mechanism

20. Unlike a Scheme or Part 26A restructuring plan where the court's sanction is sought once it has been approve by the requisite statutory majority, the Chapter 11 proceeding is commenced by filing a voluntary petition under section 301(a) of the Bankruptcy Code and the mere commencement of the case constitutes an order for relief[24]. This is an important inversion because the steps to relief are far less arduous than in the UK. The bankruptcy estate is created on commencement and comprises of "*Such estate is comprised of all the following property, wherever located and by whomever held*…"[25] The Plan need not be submitted at the time of filing but must be submitted by the debtor within 120 days of filing[26].

21. Under section 109 (a) a foreign company is only eligible for relief under Chapter 11, if they reside, is domicile in, have a place of business, or property in the United States[27] . Section 109(a) has been construed so broadly that in practice, save for the most obvious of cases[28] it is not a difficult jurisdictional threshold to satisfy.

22. In *re Global Ocean Carriers Limited et al Debtors* [29] the Court was being asked to construe the scope of the requirement under section 109 (a) that the person must have property in the US. There the Court confirmed that the present of monies held in escrow on account of legal fees incurred or to be incurred in the very bankruptcy proceedings which were the subject of the jurisdiction challenge was property in the jurisdiction for the purpose of section 109 even if the monies did not belong to the foreign company or was not paid in escrow by the foreign company, the jurisdiction arises once they were able to demonstrate "an interest" in those monies**.**

23. This definition of "property in the United States" and construction of section 109 (2) has been tempered by the Court's discretion inter alia under section 305 of the Code to dismiss, or suspend all proceedings in a case brought under it if "*at any time the interests of creditors and the debtor would be better served by such*

[24] Section 301 (b) , Title 11, Bankruptcy Code 1978

[25] Section 541(a) Title 11, Bankruptcy Code 1978

[26] The Plan can be agreed before Chapter 11 is filed i.e. a pre-pack

[27] Section 109 (a), Title 11, Bankruptcy Code 1978

[28]

[29] No. 00-955 (MFW) TO 00-969 (MFW), 5 July 2000.

dismissal or suspension"[30] .It was an application under section 305[31] that caused the Bankruptcy Court in Delaware to dismiss Chapter 11 proceedings brought by companies incorporated in the Bahamas in In re *Northshore Minland Services, Inc.*, et al., Debtors.[32] That case concerned a dispute about the construction in the Bahamas of the Baha Mar Resort. Prior to the decision of the Bankruptcy Court, the Bahamian court refused to recognise the Chapter 11 proceedings in the Bahamas[33]. The Bankruptcy Court found that although the Debtors had met the eligibility requirements of section 109 (a), the petition ought to be dismissed against the Bahamian entities because they were being treated "fairly and impartially" in the Bahamian proceedings and although the systems were different there was no evidence that the laws of Bahamas contravened the public policy of the US. The Bankruptcy court held that in those circumstances, comity supported an abstention under section 305.

Financial Restructuring Plan (the "Plan")

24. An integral part of filing a Chapter 11 is the approval and formulation of the Financial Restructuring Plan (the "Plan"). Sections 1121-1129 of Chapter 11 governs the Plan. Under section 1123, the debtor is given considerable autonomy to make provisions for the implementation of the plan "*notwithstanding any otherwise applicable nonbankruptcy law*"[34].

25. Broadly, by section 1129 of Chapter 11 the bankruptcy court will only confirm a plan if the plan complies with the Code, the proponent complies with the Code, the plan is proposed in good faith and not otherwise illegal and any payment made under the plan is approved by the court and reasonable[35]. The plan must also "*not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan"* and satisfy the absolute priority rule, meaning in summary that

[30] 305 (a)(1) Title 11, Bankruptcy Code 1978

[31] Referred to as the abstention provision

[32] 537 B.R. 192, 208 (Bankr. Del. September 15, 2015)

[33] See paragraph 63-67 of the Bahamian judgment where Justice Winder found that "…*where (a) the place of incorporation and domicile of the corporations; (b) the center of main interest or principal place of business; (c) the residence or domicile of the bulk of the creditors; and (d) location of the assets, are in The Bahamas there can be no reason to subordinate local proceedings to proceedings in a locale with such limited connection to the subject companies.... The only insolvency proceedings, which can give true effect to the principal of modified universality, would be a unitary insolvency proceedings in The Bahamas*."

[34] those provisions include "*retention by the debtor of all or any part of the property of the estate*", the "*transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan*", the "*sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate*", "*curing or waiving of any default*" or "*modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims*" see 1123 Title 11, Bankruptcy Code 1978

[35] Section 1129 (a) Title 11, Bankruptcy Code 1978

(i) secured creditors must retain their collateral and receive a deferred cash payment or realize their equivalent
(ii) Unsecured creditors must receive or retain property of a value of their claim
(iii) interest holders must receive or retain property of a value to which they are entitled,

26. Chapter 11 also allows for debtor in possession financing[36] which permits the company to seek fresh financing while undergoing a reorganisation.

27. While the bankruptcy court will encourage agreement, if consensus in not forthcoming, it will confirm a plan binding on all creditors and members even if there are dissenters (i.e. the cross-claim cram down). It was this provision that was the inspiration for the UK restructuring plan.

28. Chapter 11 is also known for its automatic stay provisions which operates once a petition has been filed and technically extends worldwide. The statutory moratorium under section 362 (a) is all-encompassing and includes the commencement or continuation of any action, enforcement of a judgment, any act seeking to possess property of the estate, to create or perfect any lien and the setting off of any debt[37].

COMPARING THE KEY CONSIDERATIONS FOR FOREIGN COMPANIES

Availability of a flexible debtor friendly restructuring regime and eligibility for foreign companies

29. While both jurisdictions are available to foreign companies, it appears that it is easier for a foreign company to satisfy the eligibility requirement under section 109 (a) of Chapter 11 than to show that it has a sufficient connection to the UK. In the case of the former a foreign company could quite legitimately contrive circumstances for the purpose of satisfying the test which applies at the time of filing the petition. In the UK it appears that a more substantive connection is required.

The ability to preserve and continue business operations

30. The UK restructuring system does provide for the continuation of a business enterprise under the Court's supervision but the Plan contemplated by the Chapter 11 makes it easier to disregard existing rights and protections for the purpose of implementing the Plan. US debtors are also permitted to raise financing following the commencement of the case. No such rule exists in the UK.

[36] Section 364 Title 11, Bankruptcy Code 1978

[37] See section 362 (1) of Title 11, Bankruptcy Code 1978

Moratorium

31. The US has wide ranging rules on a stay, which will apply once a petition has been filed and the case commenced. There is no such automatic moratorium in the UK, although companies on the brink of insolvency can seek a standalone moratorium under the Insolvency Act.

Recognition and Enforcement of UK and US orders

32. There are three primary routes to the recognition of insolvency related judgments and orders elsewhere they are either under international treaties such as the UNCITRAL Rules on Cross Border Insolvency or the UNCITRAL Model Law on the Recognition and Enforcement of Insolvency Related Judgments, Private International Law including principles of comity and local law related to the Reciprocal Enforcement of Judgments.

33. In so far as it concerns treaties, the UNCITRAL Rules on Cross Border Insolvency only relate to the recognition of a foreign proceeding and foreign representative and not orders or judgments emanating from those proceedings[38]. The UNCITRAL Model Law on the Recognition and Enforcement of Insolvency Related Judgments was adopted in 2018 and while its aim is to create a single harmonised treaty for the recognition of insolvency related judgments is commendable to date it does not appear that it has been adopted in the domestic legislation of either the UK or the US[39]. The jurisdiction to accord recognition of an insolvency related judgments emanating from both the UK and US is therefore typically exercised in accordance with principles of comity, the converse of which was seen in the Baha Mar Resort case above. International comity or assistance, while a somewhat vague concept, is by definition flexible and is a ready anchor for the recognition of judgments and orders or their assistance by their implementation by a foreign court.

34. In addition to the international notion of comity, the UK has bilateral agreement with various countries including the commonwealth and British Overseas Territories; the Administration of Justice Act 1920, the Foreign Judgments (Reciprocal Enforcement) Act 1933 provide for the reciprocal enforcement of judgments by those companies willing to extend reciprocity. It is arguable whether those statutes apply to insolvency related judgments but what is at least clear is that judgments or orders from both the UK and US are in principle enforceable elsewhere. However, whether they will in fact be enforced will be a matter for the enforcing jurisdiction.

[38] Rubin v. Eurofinance *SA* [2012] UKSC 46, [2013] 1 AC 236.

[3939] There currently does not appear to be any signatory to that treaty

CONCLUSION

35. While much of the changes to UK Schemes appear to be inspired by Chapter 11 and are plainly a step in the right direction, those changes have not gone far enough. The Chapter 11 procedure remains on balance, a more attractive system, primarily because of its lower threshold for eligibility for foreign companies, its wide ranging moratorium, and it generous and flexible statutory measures which permit a foreign company to continue to do business and indeed incur additional debt while undergoing a reorganisation. Chapter 11 is a tried and tested restructuring procedure and while the UK has make inroads in the US dominance by the permanent changes under CIGA, Chapter 11 remains the model system for companies seeking support for a reorganisation. Out with the old and in with the new? No, not yet at least.

Tameka Davis

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