The Big Three: the UK Restructuring Plan, the Dutch Scheme and US Chapter 11 Proceedings

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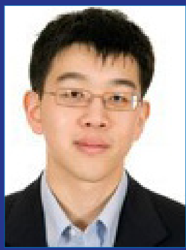

Speed read

This article compares the existing US Chapter 11 process with the new restructuring plan that was introduced into UK law on 26 June 2020 and the new Dutch scheme that is expected to come into force this summer. Clearly the choice of procedure will depend on the particular facts but it will be interesting to see if the "new kids on the block" live up to the tried and tested US restructuring proceeding.

Introduction

Chapter 11 of the US Bankruptcy Code has proved to be a very powerful tool for restructuring the debts of distressed companies. The long-arm reach of the US Bankruptcy Court has meant that this tool can be used for non-US companies; the wide automatic stay provides a breathing space while the plan of reorganisation is put together; and the ability to cram down dissenting classes of creditors in connection with the approval of a plan of reorganisation is a powerful incentive to ensuring that creditors agree to the proposals.

While the UK scheme of arrangement is a very credible alternative in a European context, the absence of a cross-class cram-down mechanism has long been regarded as a limitation of the UK restructuring toolkit. This has led to the successful development of alternative structures, most notably the combination of a scheme and a "pre-packaged" administration to deliver a senior creditor-led restructuring notwithstanding the existence of non-consenting shareholders and/or junior creditors. Such structures add to the cost of any restructuring.

On 26 June 2020, the Corporate Insolvency and Governance Act 2020 came into force in the UK, introducing a new restructuring plan which some refer to as the "super scheme". The restructuring plan is based on the existing scheme of arrangement (and takes effect by way of the introduction of a new Part 26A of the UK Companies Act 2006) but with an additional cross-class cram-down mechanism if certain conditions are met.

In the meantime, the Netherlands has been (for some time) taking steps to legislate for the introduction of a new restructuring tool, with similarities to the English scheme of arrangement and the US Chapter 11 procedure. The Dutch Act on Court Confirmation of Private Restructuring Plans (*Wet homologatie onderhands akkoord* or WHOA to its friends) was adopted by the Dutch house of representatives (*Tweede Kamer*) on 26 May 2020 and is now with the Senate (*Eerste Kamer*). The Senate raised some questions which hopefully can be answered swiftly so that it can be voted on (and come into effect) in short order. Although untested, the Dutch scheme looks like it could provide a credible alternative to the UK and US procedures and, with the implementation of Brexit looming, it might just have a window of opportunity to emerge as the leader of the pack in terms of restructuring measures available among EU member states.

In the table below, we compare some of the features of the UK restructuring plan and the Dutch scheme with the US Chapter 11 process and we have selected four particular features to consider in further detail.

Court involvement

Under the UK restructuring plan and the new Dutch scheme, the court will have a role in overseeing the process and will ultimately be required to confirm or sanction the restructuring plan. Creditors, debtors and shareholders have the opportunity to come before the court seeking judgment on a number of preliminary questions before voting. In the restructuring plan (as with the scheme of arrangement) the forum for many of these arguments is the convening hearing at which the court will order the holding of the relevant creditor or member meetings; under the Dutch scheme, court involvement will not always be necessary at the outset and only the debtor or the restructuring expert can petition the court to have any questions dealt with (which the court will do as quickly as possible to make the scheme an efficient process). This is to be contrasted with the significant court involvement in a typical US Chapter 11 case. A US Chapter 11 case can be filed with the terms of a plan of reorganisation pre-negotiated with, or even pre-approved by, relevant stakeholders, which can expedite the process and minimize the time spent in bankruptcy. However, the majority of US Chapter 11 cases are filed with no plan in place, in which case the operations and assets of the debtor may be subject to the supervision of the US Bankruptcy Court for a prolonged period of time as a plan is developed.

A benefit of the court involvement in all three proceedings is that there is a forum for disgruntled creditors to bring forward their complaints. This allows issues to be dealt with upfront, giving less opportunity to challenge the restructuring later and thus delivering execution certainty. Indeed, under the Dutch scheme, interested parties must have expressed their complaints during the process and are not otherwise allowed to protest at the final confirmation hearing. On the flip-side, where there is a large degree of court involvement (as with Chapter 11), this can lead to extra time, cost and formality. Arguably the English restructuring plan and the Dutch scheme strike just the right balance.

Cross-class cram-down

The UK restructuring plan provides for two ways of imposing a restructuring on creditors and/or shareholders without their consent.

The genuine economic interest test

The restructuring plan enables the compromise of the debt and equity claims of creditors and/or shareholders that the court is satisfied have no "genuine economic interest" in the company. The consent of these creditors or shareholders is not required and they have no right to participate in the restructuring plan approval process. The court has wide discretion as to the assessment of economic interest but is likely to draw on the significant line of scheme of arrangement case precedent in relation to "out of the money" creditors.

The new cross-class cram-down

The restructuring plan also enables the compromise of the debt and equity claims of classes of creditors and/or shareholders that voted against the restructuring plan (a "dissenting class"), provided that:

- the court is satisfied that, if the restructuring plan is sanctioned, no members of the dissenting class(es) would be any worse off than they would be in the event of the "relevant alternative"; and
- at least one class of creditors or members, which would receive a payment or have a genuine economic interest in the company in the event of the relevant alternative, has approved the restructuring plan.

The "relevant alternative" is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned. Again, this gives the court wide discretion as to the benchmark against which to assess the "no worse off" test. However, we anticipate that the starting point will be the appropriate comparator test that the courts use for assessing class composition in schemes of arrangement.

The Dutch scheme also offers a solution to the cross-class cram-down issue. As with Chapter 11, junior creditors and shareholders can be included in the restructuring plan and their rights can be compromised. Even if, as a class, some creditors or shareholders do not consent to the compromise of their rights, provided that the restructuring plan is approved by one or more impaired class, then the Dutch scheme (as with Chapter 11) allows for the rights of classes to be "crammed" (either a cram-down if senior creditors cram down junior creditors or a cram-up if in-the-money junior creditors cram up senior creditors) and thus the restructuring plan can be forced upon them (subject, among other things, to a "no worse off" test and the "absolute priority" rule discussed further below).

Absolute priority rule

Chapter 11 requires a plan of reorganization to be "fair and equitable" with respect to a dissenting class, which includes satisfaction of the so-called "absolute priority rule". In simple terms, this means that a junior class of creditors or shareholders cannot retain or receive any value under a plan unless all dissenting senior classes are paid in full or otherwise receive sufficient value on account of their claims in accordance with the requirements of the Bankruptcy Code. Interestingly, although in the consultation that lead up to the UK restructuring plan, it was contemplated that the UK legislation would introduce a similar concept (with the power for the court to depart from such rule in certain circumstances), the final legislation does not expressly include any such concept. It will be remain to be seen, however, whether the court will consider this principle when exercising its general discretion to sanction the restructuring plan on grounds of fairness.

Although the starting point under the Dutch Scheme where cross-class cram-down is to be used, is the absolute priority rule, a scheme that is rejected by one or more classes and that departs from this principle may still be confirmed by the court provided that: (i) at least one in the money class must have accepted the plan; (ii) there are reasonable grounds for the deviation from the absolute priority rule and the plan is fair and reasonable and not detrimental to the rejecting class (which is the case if the rejecting class has been offered a fair share in the distribution of the reorganisation value regardless of the form in which this distribution is made); (iii) if the rejecting class would have been in the money in a liquidation, they have been offered a cash out option: a distribution equal to what it would have received in a liquidation in cash (this cash out option does not apply to creditors with a right of pledge or mortgage who have provided the debtor with financing in the course of the business); and (iv) SME's with trade claims or tort claims have to be offered (a right representing a value equal to) at least 20% of their claims under the plan (if they are included in the plan which in practice will often be unlikely anyway).

New monies

Where a debtor is desperately in need of cash and the existing creditors are not minded to either provide it or to permit any third party provider to share in their security, Chapter 11 might offer a unique solution for debtors. It is the only one of these proceedings that provides for super-senior interim financing to be approved by the court.

This might appear to be a major disadvantage of the UK and Dutch procedures but, as a matter of practice, if any restructuring is to be successful then a high degree of existing creditor support is required and this generally leads creditors to a pragmatic approach to new financing. They will usually either provide it themselves (albeit sometimes grudgingly) or they will agree to a third party provider sharing their security and ranking either ahead of them or at the very least alongside them. The UK reform proposals consulted on previously considered adopting a more US-style approach to rescue financing but it was ultimately decided that that held more potential problems than it heralded solutions.

Recognition of the procedure

One of the key things that influences a debtor in deciding which proceeding to pursue is whether, if approved, the arrangement would be recognised and given effect to in the jurisdictions that really matter to the debtor, which are primarily those where the debtor has assets. Proceedings that fall under the European Insolvency Regulation will have automatic recognition across all EU Member States which is clearly an advantage where there are assets in Europe.

Given Brexit, the UK restructuring plan will not be listed in the Annexes to the European Insolvency Regulation and so the plan will not benefit from automatic recognition across Europe. That has not necessarily been an issue for the UK scheme of arrangement, though, where other methods of recognition have been sought. Furthermore, thanks to a long-standing common law rule (often referred to as the rule in *Gibbs*[1]), where a debtor is trying to compromise or restructure English law-governed debt, this may need to be done in accordance with the governing law of the debt (i.e. English law), and thus the starting point is that you would need to have an English process to compromise such debt. Here the UK restructuring plan has a trump card that it can continue to play for so long

1 *Antony Gibbs and Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399.

as parties wish to enter into arrangements that are English law-governed.

Once available, the public route of the Dutch scheme will be listed in the Annexes to the European Regulation and so will benefit from automatic recognition. So far so good. However, there is one important exception under the European Insolvency Regulation which means that, for example, notwithstanding that a Dutch scheme has been proposed and has approved a reduction in secured debt from 100 to 80 and there is a stay on enforcement, where a creditor is a secured creditor who has a right *in rem* in respect of an asset in another member state, the opening or conclusion of the Dutch scheme does not affect the rights *in rem* of the secured creditors to enforce their security, and it is arguable such a creditor can enforce the security for its original claim of 100.

The Dutch scheme also has a private version, which will be outside the scope of the European Insolvency Regulation and, as with the English restructuring plan, it is possible that where a Dutch scheme seeks to compromise Dutch law-governed debt, other jurisdictions will recognise such a compromise under principles of private international law and, importantly, such recognition would likely not be subject to the right *in rem* exception under the European Insolvency Regulation as described above.

Conclusions

All in all, the introduction of the UK restructuring plan and the Dutch scheme are welcome additions to the global restructuring landscape. They offer other tools that can be utilised for restructurings, and that must be a good thing. The differences, sometimes subtle and sometimes significant, between the various procedures mean that there might be compelling reasons in a particular case and on a particular fact pattern why, for example, the Dutch scheme might work when Chapter 11 or the UK restructuring plan will not be suitable or vice versa. This might only become apparent once a restructuring starts to take shape and so it will be important for debtors and creditors alike to consider whether their chosen legal advisers have the necessary expertise in each of these jurisdictions.

The "new kids on the block" certainly look promising but they will need to be tested in practice. It will need willing debtors and for the judiciary to be bold and assertive. But, if the new procedures can be used successfully in just a few cases then they may provide credible alternatives (in the right circumstances) to US Chapter 11.

Annex

	US Chapter 11	UK restructuring plan	Dutch scheme
Court involvement	Yes	Yes	Yes
Debtor in possession	Yes (subject to the appointment of a trustee for cause)	Yes	Yes
Eligibility requirements for foreign companies	Available to companies with domicile, place of business or property in the US	Available to companies with "sufficient connection" with the UK	Available to overseas companies with "sufficient connection" with the Netherlands
Can other stakeholders propose?	Yes – debtor has exclusive right to propose reorganisation plan in the first 120 days of the case	Yes – any creditor or member can propose (though in practice likely to be the debtor)	Yes, indirectly – creditors, members and employees through their representatives can request the court to appoint a restructuring expert who can propose
Requirement for financial distress	No express requirement (for debtors commencing case) although the court can dismiss a case "for cause," including if it finds the case was filed in "bad faith"[2]	Yes – debtor must have encountered or be likely to encounter financial difficulties and purpose of plan to eliminate, reduce, prevent or mitigate effect of those financial difficulties	Yes – debtor does not need to face imminent bankruptcy but must foresee that it will not be able to continue to meet its obligations in the long run
Moratorium	Yes: automatic stay	Not as part of plan (but note standalone moratorium proceeding introduced by the Corporate Insolvency and Governance Act 2020)	Not as part of scheme (but can obtain upon court order)
Prohibition on ipso facto termination	Yes (subject to safeharbors)	Yes following convening hearing (subject to safeharbours)	Yes
Priority for new monies	Yes (so long as existing secured lenders are "adequately protected")	Only with consent of existing secured lenders	Yes (over available unencumbered assets)
Amendment of guarantee claims	Not usually (unless guarantor enters Chapter 11)	Yes	Yes
Voting / approval threshold	2/3 in value and more than 50% in number of each class	75% in value of each class (no numerosity test)	2/3 in value of each class (no numerosity test)
Is cross-class cram-down (or cram-up) possible?	Yes if conditions met	Yes if conditions met	Yes if conditions met
Can court decision be appealed?	Yes	Yes	No
International recognition	Private international law principles or UNCITRAL Model Law. Automatic stay purports to have worldwide effect	Private international law principles or UNCITRAL Model Law	Automatic recognition under European Insolvency Regulation if "centre of main interests" in Netherlands. Private international law principles or UNCITRAL Model Law if private procedure
Likely costs	High	Medium	Low-medium
Timetable	Typical Chapter 11 case runs 6 – 12 months but can be shorter or longer depending on circumstances	6 – 8+ weeks from launch	6 – 8+ weeks from launch

2 For example, where the filing does not serve a valid bankruptcy purpose or has been filed to obtain a tactical litigation advantage, in which case lack of financial distress can be evidence of bad faith.