CLIFFORD CHANCE

The Clifford Chance Global Restructuring & Insolvency team is led by a core group of 44 partners who regularly advise all types of stakeholders on some of the most complex and high-profile restructuring situations across the globe. The breadth and depth of our practice allows our clients to benefit from restructuring and finance expertise across a full spectrum of products and structures, providing access to specialists in areas which are often pivotal in distressed situations.

Authors Tim Lees, Michelle McGreal and Ellen Choi

Schemes of arrangement and their international effectiveness

KEY POINTS

- Schemes of arrangement have been extensively used to restructure debts governed by both English and New York laws.
- The 'rule in *Gibbs*' means that an effective restructuring of English law debts will often require an English law process. In many cases, that will mean using a scheme.
- Brexit has removed certain arguments in favour of the effectiveness of schemes in the European Union, but Rome I and ordinary principles of private international law continue to provide grounds for recognition.
- Chapter 15 of the US Bankruptcy Code also allows the court to provide both procedural and substantive relief in support of schemes of debt governed by New York law.

Corporate groups will often enter into finance documents governed by the laws of a major financial centre when they borrow money – even when they have little or no other connection with that jurisdiction. New York law and English law are the most commonly chosen governing laws, and they provide all parties with confidence that their agreements will be interpreted in a predictable and commercially rational manner by sophisticated courts should a dispute arise.

When debtors experience financial difficulties, it will often be necessary to make fundamental amendments to their finance documents. Such amendments typically require the consent of 90% or even 100% of creditors to be made contractually. Where that level of consent cannot be obtained, debtors will often make use of a court and/or statutory-based restructuring process that allows amendments to be made with a lower level of consent.

Restructurings are by definition 'bet the company' matters. Any such restructuring process needs to be sufficiently *flexible* to implement the desired commercial arrangement. It is also critically important that any such process is *effective*: it needs to bind all creditors, so that the debtor and supportive creditors have confidence that a dissentient creditor will not receive an enhanced recovery by suing on their pre-restructuring debt, or otherwise upend a successful restructuring.

English law schemes of arrangement are a commonly used process for cross-border restructurings of both English and New York law debt. They are a highly *flexible* tool, allowing companies to implement substantially any financial restructuring with the consent of a majority in number, representing 75% in value, of each affected class of creditors; and the sanction of the court. They permit such arrangements to be entered into outside of insolvency proceedings. They are also generally thought of as *effective* tools for restructuring both English and New York law debts, with a weighty body of precedent to that effect.

However, recent *obiter dicta* from the court in Hong Kong – which has a similar scheme of arrangement regime to England – have cast doubts over the effectiveness of schemes as a tool for restructuring debt governed by foreign laws; and in particular, New York law (*Re Rare Earth Magnesium Technology Group Holdings Ltd* [2022] HKCFI 1686 at [32]). And even for English law debt, the UK's departure from the European Union poses questions as to the effectiveness of schemes in the EU. It is therefore worth revisiting the basis for the international effectiveness of schemes.

INTERNATIONAL RECOGNITION

The effectiveness of a proposed scheme is a critical issue not only to the parties, but also to the court (*Re DTEK Energy BV* [2021] EWHC 1551 (Ch) at [27]). Before sanctioning a scheme, the court will require '*credible evidence that it will not be acting in vain*' (*Re van Gansewinkel Groep BV* [2015] Bus LR 1046 at [71]) which will usually take the form of an expert opinion (or similar) from a leading legal scholar and/or practitioner in each jurisdiction where the debtor group has material assets and/or liabilities.

ENGLISH LAW DEBT AND THE RULE IN *GIBBS*

As a general rule, an English court will think it '*inherently likely*' that an English law scheme of English law debt will be recognised internationally (*Re van Gansewinkel Groep BV* [2015] Bus LR 1046 at [71]). Indeed, a debtor with English law debt may well have no effective alternative owing to the 'rule in *Gibbs*'. In summary, this rule holds that a debt can only be discharged without consent in accordance with its own governing law. In the *Gibbs* case (*Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399), an English law debt was held not to have been discharged by a French liquidation; and more recently the English Court of Appeal has held that an English law debt could not be discharged by an Azerbaijani restructuring process (*In re OJSC International Bank of Azerbaijan Bakhshiyeva v Sberbank of Russia and others* [2018] EWCA Civ 2802). In a recently launched consultation, the UK government has proposed amending the law to recognise judgments handed down in foreign insolvency proceedings in a way that is expressly designed to preserve the rule in *Gibbs* – albeit whilst proposing to consult on *Gibbs* 'in due

Biog box

Tim Lees is a Partner in the Restructuring & Insolvency team at Clifford Chance in London. He specialises in high-value, complex, and cross-border restructurings, insolvencies, and special situations, and advises a wide range of stakeholders, including banks, credit funds, financial sponsors, companies, and directors. Email: Tim.Lees@cliffordchance.com

course' (Insolvency Service, *Open consultation: Implementation of two UNCITRAL Model Laws on Insolvency Consultation* (7 July 2022)).

As a result, companies with debts governed by English law will generally need to use an English law process to restructure. If the company is to avoid insolvency proceedings, that will generally mean using a scheme.

EUROPEAN UNION

Many debtor groups with English law debt have their principal operations in the European Union. Debtors have therefore frequently needed to provide evidence that their scheme will be recognised in relevant EU jurisdictions. It was formerly common for experts to opine that the English court's judgment sanctioning the scheme would be given effect in relevant EU jurisdictions under the Regulation (EU) No 1215/2012 – the 'Judgments Regulation' (article references are to that regulation as recast). Although the question of whether the Judgments Regulation applied to schemes was never settled, on the assumption that it did apply, the court would find that it had jurisdiction under Article 8 (where at least one of the creditors was domiciled in England) and/or Article 27 (where the debt contained an English jurisdiction clause) (see eg *Re Noble Group* [2018] EWHC 3092 (Ch) at [112]). Experts would often opine that the scheme would be recognised and enforced in accordance with Chapter III of the Judgments Regulation.

Following Brexit, the Judgments Regulation no longer applies to English schemes. Evidence as to recognition may now be founded on the Rome I Regulation, which requires EU member states to give effect to the parties' choice of law, as was argued in *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) and *Re Hibu Finance (UK) Ltd* [2014] EWHC 370 (Ch). Experts will also often rely on ordinary principles of private international law, such as have always applied where the debtor group has material operations outside the EU.

NON-ENGLISH LAW DEBT

The position is more complex where debt is governed by the law of another jurisdiction: applying the *Gibbs* principle, the presumption will be that the debt should only be compromised under its own proper governing law. However, the courts have still been willing to sanction schemes where there is evidence that the scheme will be effective. In appropriate cases recognition may result from parallel schemes or scheme-like processes under the laws of other jurisdictions. A scheme may also be effective as part of a wider restructuring implemented in multiple jurisdictions using jurisdiction-specific processes, as was the case in *Re Agrokor DD* [2019] EWHC 2269 (Ch). But this is not always necessary or even possible – for example, where debtors are organised or operate in jurisdictions that do not have their own form of scheme-like procedure.

Formerly, for English schemes where a group's principal operations were in the EU, evidence of recognition might have been founded on the Judgments Regulation. The court would find that it had jurisdiction under Article 8, even if Article 27 did not apply; and it will often have been an expert's view that their domestic courts would have recognised a sanction judgment under Chapter III. That is no longer the case following Brexit, and where the debt is not governed by English law Rome I is of no assistance.

NEW YORK LAW DEBT: CHAPTER 15

Where the debt to be compromised is governed by New York law, experts will commonly opine that the scheme will be recognised and given effect in the United States pursuant to chapter 15 of the US Bankruptcy Code ('Chapter 15'). Indeed, Chapter 15 recognition will typically be a condition to the effectiveness of the scheme, and non-US experts will usually see this as material to recognition in their own jurisdiction. It is therefore worth considering how Chapter 15 operates to give effect to schemes, and the differences in the US bankruptcy courts' approach from that taken in England and other jurisdictions where the *Gibbs* rule is followed.

Under Chapter 15, a scheme (or other non-US insolvency proceeding) may be recognised as either a 'foreign main' or 'foreign nonmain' proceeding. Foreign main proceedings are non-US proceedings pending where a debtor has its 'centre of main interests' or 'COMI'. Foreign nonmain proceedings are non-US proceedings pending where a debtor maintains an 'establishment' (often considered a physical place of operations) – see 11 USC § 1517(b). Upon recognition of a foreign main proceeding, the debtor benefits from an automatic stay, which enjoins all acts of third parties to enforce rights in or against the debtor and its property located within the territorial jurisdiction of the United States (11 USC § 1520(a)). The bankruptcy court may also grant such relief at its discretion for foreign nonmain proceedings.

Recognition of a foreign proceeding under Chapter 15 does not, in itself, give substantive effect to a scheme, and the court in Hong Kong has recently suggested *obiter* that Chapter 15 as a whole provides merely procedural relief (*Re Rare Earth Magnesium Technology Group Holdings Ltd* [2022] HKCFI 1686 at [36].)

However, Chapter 15 provides an avenue for substantive additional relief. Section 1521 provides that: '*Upon recognition of a foreign proceeding, whether main or nonmain, where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief...*'

The Section provides an illustrative list of examples of such relief, including, among other things, suspending the right to transfer, encumber or otherwise dispose of the debtor's assets, examining witnesses, collecting evidence and entrusting the debtor's assets to a foreign representative. The court has held that '*[t]he discretion that is granted is 'exceedingly broad' since a court may grant 'any appropriate relief' that would further the purposes of chapter 15 and protect the debtor's assets and the interests of creditors*' (*In re Agrokor d.d.*, 591 BR 163, 188 (Bankr SDNY 2018) (internal citations omitted)).

Section 1507 furthermore provides that '*the court, if recognition is granted, may provide additional assistance to a foreign representative under [the US Bankruptcy Code] or under other laws of the United States*'. In determining whether to provide additional assistance, US

Biog box

Michelle McGreal is a Partner in the Restructuring & Insolvency team at Clifford Chance in New York. She represents creditors, debtors, agent banks, lenders and other strategic parties in a wide range of corporate restructurings, including traditional bankruptcies, out-of-court workouts and financing transactions. Ellen Choi is an Associate in the Restructuring & Insolvency team at Clifford Chance in New York. Ellen primarily advises financial institutions and other creditors in connection with US and international debt restructurings and insolvency proceedings.

bankruptcy courts shall consider whether such additional assistance, consistent with principles of comity, will reasonably assure, among other things, just treatment of creditors and the protection of US creditors against prejudice and inconvenience in asserting their claims in a foreign proceeding.

The US bankruptcy courts therefore have wide discretion as to the type of relief they may grant for both foreign main and nonmain proceedings, and they routinely use such discretion to recognise and enforce schemes of arrangement sanctioned by non-US courts. In practice it is common for Chapter 15 orders to provide that the scheme and the order sanctioning it '*are recognized, granted comity, and entitled to full force and effect in the United States against all entities* […] *in accordance with their terms*' (*In re Codere Finance 2 (UK) Ltd.*, No. 20-12151, Order Granting Recognition, ¶ 7, ECF No. 12, (Bankr SDNY Oct 9, 2020)), or words to similar effect. Such an order is not merely 'procedural', but has substantive effect. In recognising and enforcing a decision of a foreign court that approves a scheme or plan that modifies or discharges New York law-governed debt, the modification or discharge of such debt is binding and effective under New York state law and US federal law, as one US bankruptcy court has recently affirmed (*In re Modern Land (China) Co., Ltd.*, No. 22-10707, *Memorandum Opinion Granting Motion for Recognition and Related Relief*, 9-10, ECF No. 27 and *Order Granting (I) Recognition of Foreign Main Proceeding, (II) Recognition of Foreign Representative and (III) Related Relief under Chapter 15 of the Bankruptcy Code*, ¶ 5, ECF No. 28, (Bankr SDNY July 18, 2022)).

US bankruptcy courts have been prepared to issue orders of this type because they follow a principle known as 'modified universalism' (*See e.g., In re Agrokor d.d.*, 591 BR 163, 183 (Bankr SDNY 2018)). In contrast with the *Gibbs* rule, this principle holds that, as a general rule, there should be a single global proceeding governing an insolvency or restructuring, so that an equitable distribution can be achieved; and that this proceeding should normally be commenced in the jurisdiction where a debtor has its 'centre of main interests' or 'COMI' – albeit there can be circumstances where another jurisdiction provides a more appropriate forum.

MECHANICS OF NOTEHOLDER SCHEMES

There is also a practical aspect to the effectiveness of schemes, particularly where they compromise notes.

The most common approach in the international capital markets is for notes to be issued in 'global' form. In this structure, one or more 'global' notes representing the entirety of a series will be held by a common depositary, custodian, safekeeper, or nominee (the 'Legal Holder'). The issuer will be expressly entitled to treat the Legal Holder as its sole creditor, albeit the benefit of the covenant to pay may be held by a trustee. The investors who might colloquially be described as 'noteholders' are in fact the holders of ultimate beneficial interests in the global notes (the 'Principals'), often through a chain of custody stretching over a number of intermediaries. There will be circumstances in which 'definitive' notes can be issued to the Principals, and the courts have held that this allows Principals to vote on the scheme as 'contingent creditors', so long as other parties who may have a more direct claim (eg the Legal Holder and the trustee) undertake not to vote (*Re Castle Holdco 4 Ltd* [2009] EWHC 3919 (Ch) at [21]-[24]).

In the ordinary course, instructions from the Principals – for example, with respect to amendments or waivers – are transmitted along the chain of ownership to the Legal Holder, the trustee (if applicable) and other administrative parties, such as the trustee, who are required to take steps to give them effect. As part of the scheme, the Principals will typically issue instructions to the required administrative parties to take the steps necessary to (for example) cancel an existing global note and replace it with new instruments; or amend and restate an existing global note on revised terms. It is common for a scheme to confer a power of attorney on the debtor company to issue the necessary instructions on the Principals' behalf at the appropriate time; and it is equally common for the Legal Holder and other administrative parties to undertake to comply with those instructions, and in fact to do so in the assurance that the steps they are taking are court-approved. As a result, the restructuring is effected not merely by operation of the scheme, but by an interaction between the scheme, the underlying debt documents, and the clearing systems through which the notes are held. A dissentient Principal would likely face real practical difficulties in asserting a continuing claim once a scheme has been given effect.

CONCLUSIONS

Schemes of arrangement are a proven and powerful restructuring tool – they are both *flexible* and *effective*. Indeed, the effect of expressly retaining the rule in *Gibbs*, as the UK government proposes to do, is that only an English law process will be effective to compromise English law debt. For debtors wishing to avoid insolvency proceedings, that will mean using a scheme.

The wide discretion afforded to US bankruptcy courts under Chapter 15, and the supportive manner in which that discretion has been exercised, makes schemes an attractive and effective option for many groups seeking to restructure debts governed by New York law. The court in Hong Kong has suggested that a noteholder with an undisputed debt governed by New York law might be able to sue on their original claim and obtain a winding up order unless their debt is settled, notwithstanding the operation of a scheme and its recognition under Chapter 15 (*Re Rare Earth Magnesium Technology Group Holdings Ltd* [2022] HKCFI 1686 at [37]). But a noteholder will often face considerable challenges in showing that they have a claim that is *not disputed* in light of the way that notes are held and schemes given effect under Chapter 15.

Schemes are not the only effective means of restructuring debt governed by New York law. In particular, companies with significant New York law debt will often consider carefully whether to file for chapter 11 bankruptcy protection. But this will not always be practical or desirable for cost, business, and/or reputational reasons, and schemes remain an important part of the restructuring toolkit. ■