Freshfields Bruckhaus Deringer

Spotlight session

Around Europe with Richard Tett

Richard Tett, 21 November 2017

Agenda

1. The Recast European Insolvency Regulation
2. Update: the Dutch scheme and the UK scheme
3. Brexit
4. EU proposals for a restructuring and second chance directive

The Recast European Insolvency Regulation

Section 1

EU Regulation on Insolvency Proceedings: overview

What is the EU Regulation?

- EU Regulation came into force in 2002 and is directly binding on each member state of the EU (except Denmark)
- EU Regulation had an inbuilt ten-year review process
- In 2015, Recast Regulation came into force with most provisions taking effect from **26 June 2017**

What is the aim of the Regulation?

- Regulation sets out a mechanism to determine who has jurisdiction to open insolvency proceedings for an EU based debtor
- NB. Conflict of laws tool, not a harmonisation tool

EU Regulation on Insolvency Proceedings: overview (*continued*)

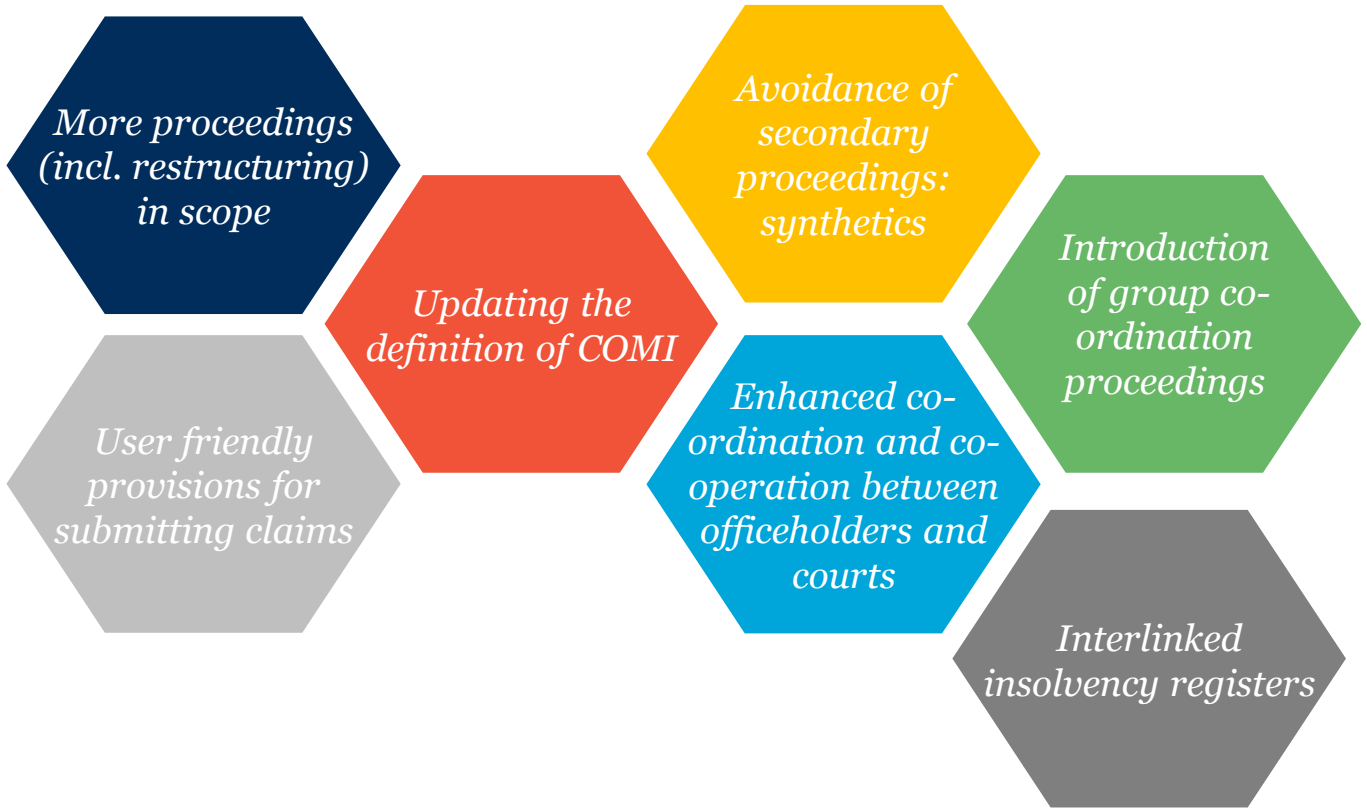
When does the Regulation not apply?

- Regulation does not apply to certain financial or insurance undertakings
- Other pieces of EU law apply here instead

When does the Recast Regulation apply?

- Recast Regulation applies only to proceedings opened **on or after 26 June 2017**
- Original Regulation applies to proceedings opened before
- Potentially (i) main proceedings under original Regulation, but (ii) secondary proceedings under Recast Regulation

EU Recast Regulation – key take aways



Proceedings in scope

More proceedings are in scope of the Recast Regulation

- Recast Regulation increases scope to include rescue and pre-insolvency debtor-in-possession type proceedings
- Recast Regulation abolishes requirement for secondary proceedings to be liquidation proceedings
- In total, 19 new proceedings added to the scope
- UK critical question: are schemes of arrangement in scope?
  - No: Recital 16: ‘proceedings that are based on general company law not designed exclusively for insolvency situations should not be considered to be based on a law relating to insolvency’

Updating the definition of COMI

How does it work?

As before, two types of insolvency proceedings:

Main proceedings	Secondary/territorial proceedings
Where the debtor has its 'centre of main interests' (COMI)	Where the debtor has an establishment, i.e. a *place of operation where the debtor carries out non transitory economic activity with human means and goods*
	Restricted to assets located in the member state where the establishment exists

It is important to know what and where COMI is

Updating the definition of COMI *(continued)*

Updating the definition of COMI

- Recast Regulation introduces a formal definition of 'COMI':
  - COMI is where the debtor conducts the administration of his interests on a regular basis and which is ascertainable by third parties
  - Original Regulation - based on recitals only
- Recast Regulation retains the rebuttable presumption that a debtor's COMI is its registered office
- **New**: where a debtor has shifted its registered office in the 3 months prior to applying for insolvency proceedings, the registered office presumption will not apply
- **New**: courts are tasked to examine whether they have jurisdiction
- **New**: creditor or debtor may challenge the decision to open main proceedings on grounds of jurisdiction

Updating the definition of COMI (*continued*)

What are examples of factors that will determine COMI?

- Location of registered office
- Location and nationality of management
- Accounting and treasury functions
- Location and identity of lenders
- Employees and factories
- Trading address and contact details
- Location of restructuring negotiations and creditor meetings
- Board of directors (less as not public) and place of meetings

Each company has its own COMI – no ‘group COMI’

Time: COMI assessed on date application to open main proceedings is made

Secondary proceedings – timing and synthetics

Relevant time

- Original Regulation: relevant time to determine if an establishment exists is the time of application to open secondary proceedings
- But: in practice, many establishments closed down by main officeholder at that stage
- **New**: relevant time is period of three months prior to the opening of ***main*** proceedings

Criticism of secondary proceedings

- Time consuming
- Distracting for main officeholder
- Potential for value erosion due to time costs

Recast Regulation provides new ways to avoid secondary proceedings

- Undertaking by main officeholder to respect local distribution and priority rules to be approved by qualified majority of known local creditors ('synthetic secondary proceedings')
- Notice to main officeholder of request to open secondary proceedings
- Court may stay opening of secondary proceedings for up to three months

Group co-ordination proceedings

New concept introduced by the Recast Regulation – only for post 26 June 2017 proceedings

Where more than one group company is in insolvency proceedings, an officeholder in any proceedings may apply to court to open group co-ordination proceedings

- Co-ordinator – cannot be an insolvency officeholder appointed over a group member and must not have a conflict of interest
- Co-ordinator must propose a group co-ordination plan
- Group insolvency officeholders to obtain approval either to be party to the group co-ordination proceedings or to object to inclusion
- Local insolvency officeholder not obliged to follow the co-ordinator's recommendations
- Late opt-in to the group co-ordination proceedings possible
- Step into the unknown?

Update: the Dutch scheme and the UK scheme

Section 2

UK schemes of arrangement – an update

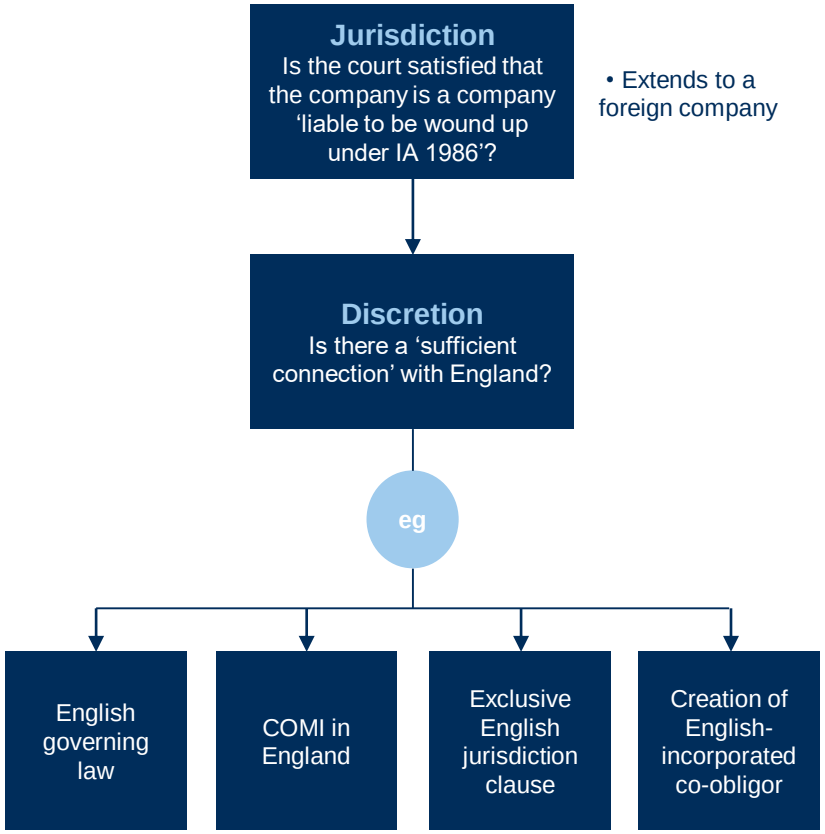
Key points

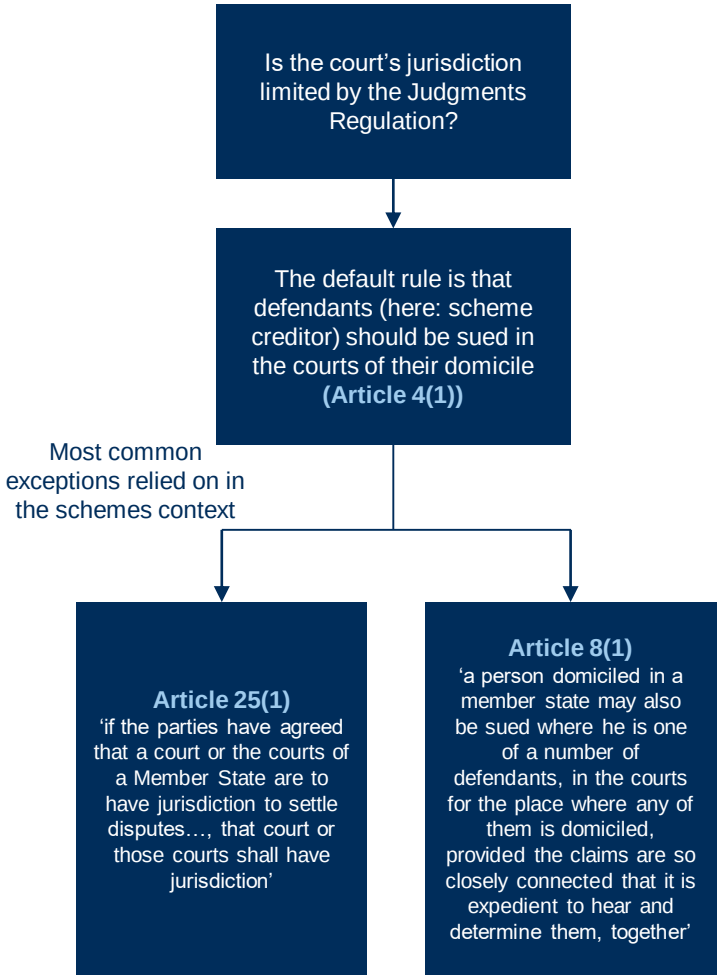
- UK Schemes still dominant for domestic and foreign companies both as option ‘A’ and as option ‘B’
- Continued English court scrutiny for schemes – materially greater than 3-4 years ago
- Forum shopping for schemes ongoing (NB. Court acknowledges ‘good’ forum shopping)
- Pre and post Brexit - when can UK courts can accept jurisdiction for a scheme? Has the threshold been lowered too far?

UK schemes of arrangement

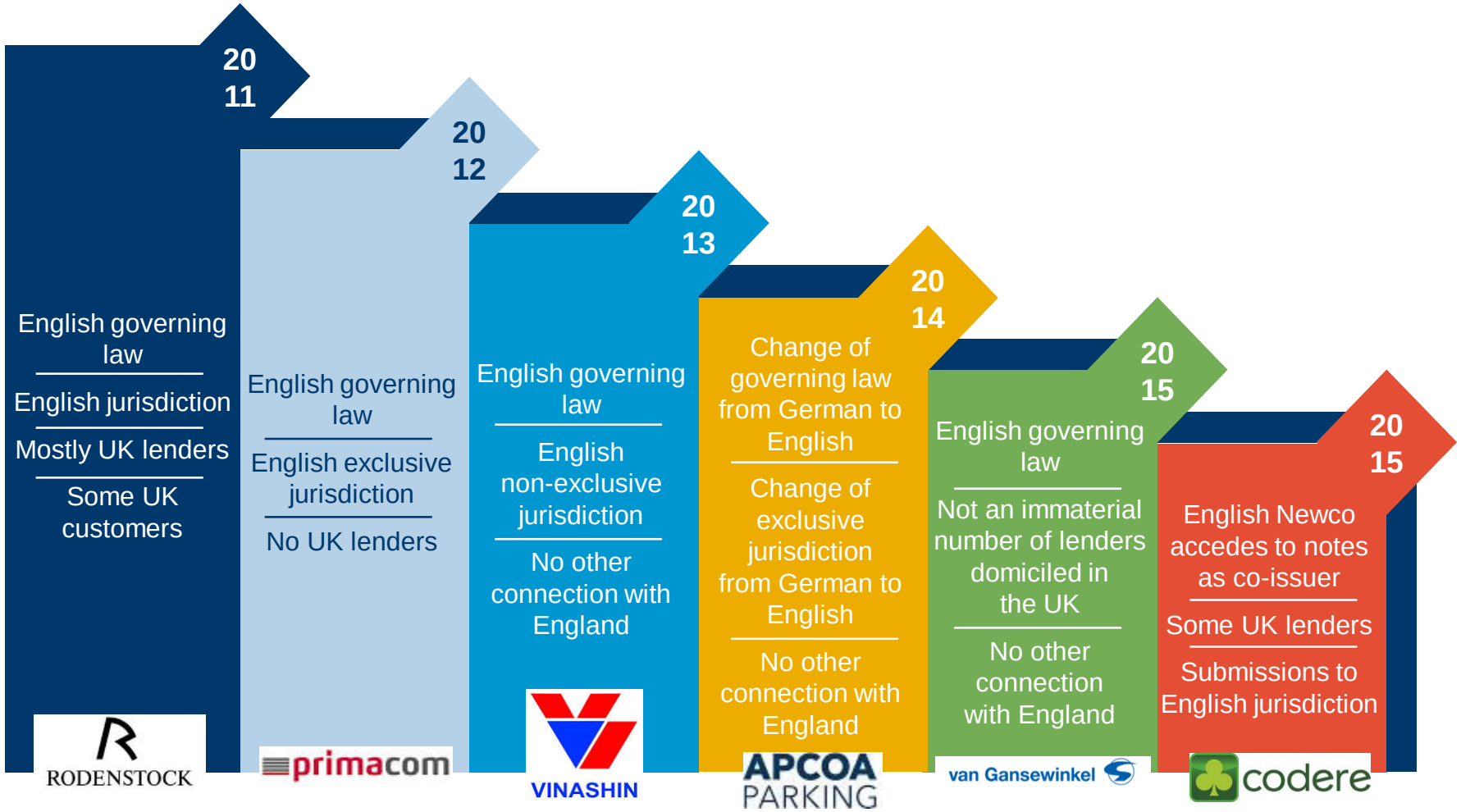
Company	Jurisdiction of incorporation	Jurisdiction of scheme	Date	Sector
Metinvest	Netherlands	England	February 2017	Mining
Algeco Scotsman	Luxembourg	England	June 2017	Service provider
Premier Oil	Scotland	Scotland	July 2017	Energy
Frigoglass	Netherlands	England	August 2017	Services
Boart Longyear	Australia	Australia	August 2017	Drilling
The Co-operative Bank	England	England	August 2017	Financial Services
Ocean Rig	Marshall Islands / Cayman	Cayman	September 2017	Deepwater drilling
FESCO	Russia	England	November 2017	Transportation

UK schemes of arrangement - sanction of scheme for foreign company





Schemes of arrangement – sufficient connection



UK schemes of arrangement – current topics

Current topics

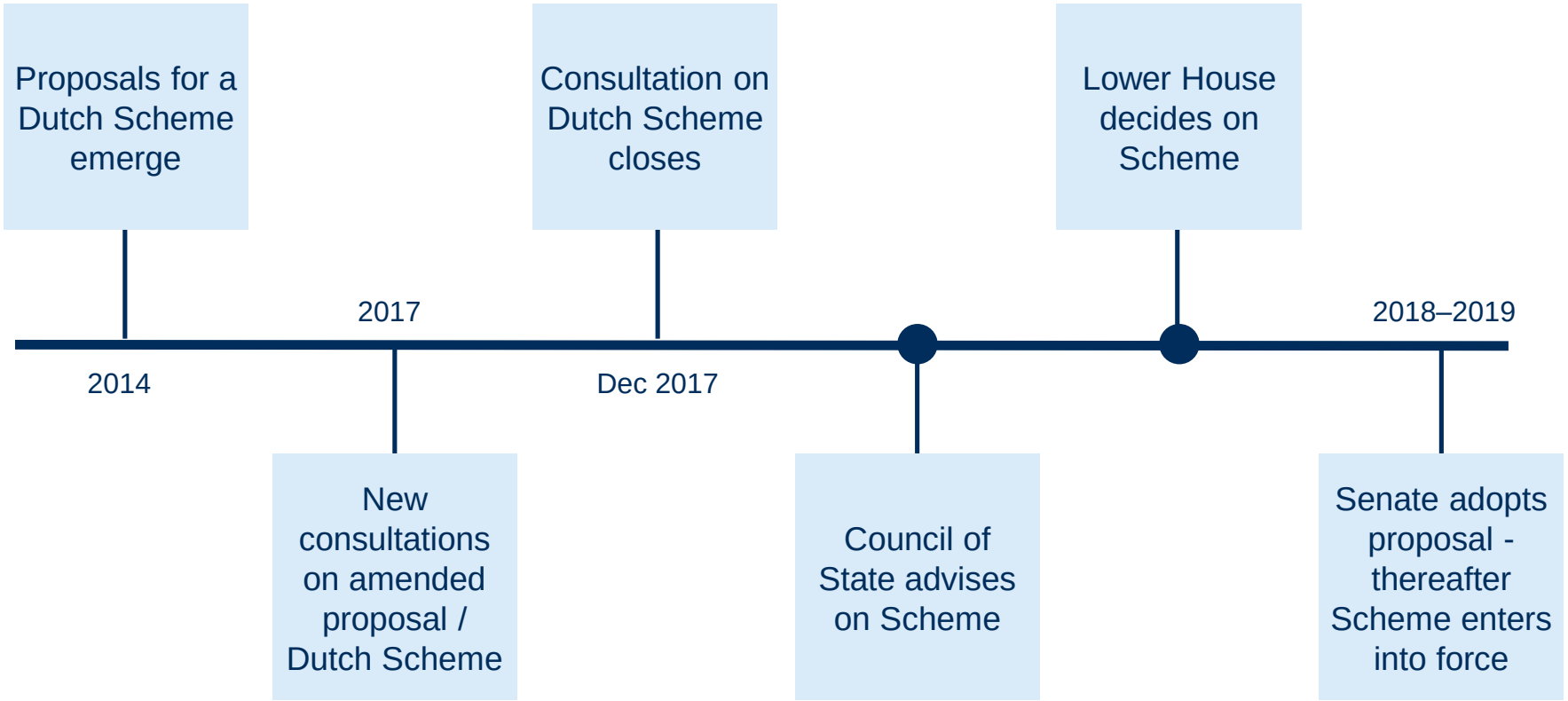
US Chapter 15 required in all cases with a US connection? Recognition through different means, e.g. comity? (*Algeco Scotsman*)

Numerosity (or head count) test and potential leverage for an obstructing minority. Practice of share-splitting (*Dee Valley*) – the court adopted a pragmatic approach to sanction the scheme

Members of a class need to vote in the class's interests - not to promote interests adverse to the class they purport to represent (*British America Nickel, Holders Investment Trust* and reiterated in *Dee Valley*)

Selection of creditors to form part of the scheme is fine. However, selection of creditors with similar rights against the company in / out of a scheme cannot be arbitrary. Needs a rational commercial justification (*Co-operative Bank*)

The Dutch scheme



The Dutch Scheme

Act on court approval of schemes to avoid bankruptcy: Guiding principles for compulsory composition

1. Eliminate nuisance value of out-of-the-money creditors
2. Applicable for both large and small companies
3. Creditor and shareholder rights can be modified → judicial evaluation necessary
4. Economic reality to be the decisive factor

Key features

- Cram down across classes possible

Relevant test: (1) 'No creditor should be worse off' test (i.e. would not have received more in a bankruptcy) and (2) Absolute priority rule (i.e. more junior ranking class does not receive anything until senior ranking classes have been paid in full (unless consenting))

- Wide ability to modify current contractual terms
- Shareholders can be bound (subject to voting as a class)
- Court-sanctioned procedure
- Guiding principle for court to sanction scheme: no dissenting creditor worse off than in a bankruptcy

Schemes comparison

	The Netherlands	England and Wales
Possible changes to the rights of shareholders	• Issuing new shares • Debt for equity swap • Exclusion of preferential rights • Cancelling shares • Reduction in nominal value	• NB. Shareholder consent or shareholder scheme required • Can sometimes separately "leave the shareholders behind", e.g. via pre-pack administration sale
Voting on the plan		
Who can vote?	Creditors whose rights will be compromised	Creditors whose rights will be compromised
How is a class established?	Creditors with claims/shareholders with rights which should reasonably be regarded as similar, are part of the same class	Principles derived from case law. Creditors "whose rights are not so dissimilar as to make it impossible for them to consult together form one class"
Voting per class	• 66⅔% in value voting in each class • NB. No headcount test	• 75% in value voting in each class, and • 50+% in number of voters each class

Schemes comparison (cont'd)

	The Netherlands 	England and Wales 
Cram down and court approval		
When is the composition accepted?	• At least one class approves the plan • All classes approve the plan or the court orders cram down of dissenting class(es)	• Court approves composition • All classes approve the scheme • Court sanctions scheme
Court approval	• Composition is necessary and sufficient to avert imminent liquidation • Catch-all test of reasonableness applied by the court • Court can only approve plan if (i) a dissenting creditor class receives more than in a bankruptcy, and (ii) absolute priority rule is met, and (iii) dissenting creditors in a dissenting class offered cash to exit (at liquidation value)	• Required. Courts consider fairness, class composition and overall jurisdiction of the court
Who can a court-approved composition bind?	Secured, unsecured and preferential creditors and shareholders (where relevant)	Secured, unsecured and preferential creditors and shareholders (where relevant) NB. Each class must approve

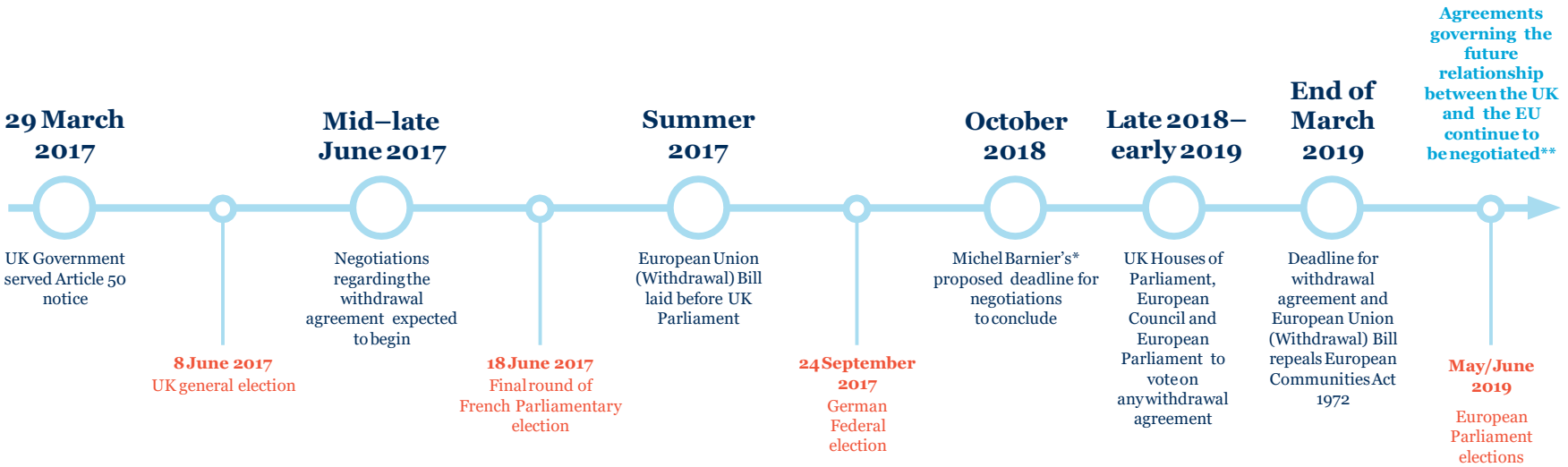
Schemes comparison (cont'd)

	The Netherlands	England and Wales
Insolvency required?	✗	✗
Who proposes the scheme?	Debtor or creditor (debtor should have first opportunity)	Debtor or creditor (although creditor proposal highly unusual)
Does management remain in control?	✓	✓
Moratorium?	No automatic moratorium but debtor can request the court to provide a moratorium	No automatic moratorium but court supportive when scheme advanced
Content of the composition		
Possible changes to debtor's obligations	• Amending maturity date/interest • Debt-for-equity swap • Partial write down • Amending continuing performance contracts	• Same as the Netherlands • Shareholder consent required for debt-for-equity swap, unless coupled with a separate sale to newco, e.g. via a pre-pack admin sale

Brexit

Section 3

Brexit



*Michel Barnier has been appointed as the European Commission's Chief Negotiator.
••The EU has indicated that some discussion on the future relationship between the UK and the EU could begin in the two-year Article 50 process if a sufficient progress is made on particular terms in the withdrawal agreement

Brexit

Recap

- EU Regulation on Insolvency Proceedings is the cornerstone for recognition of insolvency proceedings across EU member states (excl Denmark)
- Big change 31 May 2002, as mentioned restated in 2015
- After Brexit, absent special negotiations, Regulation will cease to be binding on the UK
  - UK insolvency processes would cease to be automatically recognised in an EU member state
  - Instead, look to individual member state domestic law where recognition is sought
  - EU member states insolvency proceedings need to rely on the UK's domestic rules of recognition:
    - s.426 of the Insolvency Act 1986 (Republic of Ireland only – add more to the list?)
    - Cross Border Insolvency Regulations 2006 (UNCITRAL Model Law on Cross Border Insolvency)
    - Common law?

What does Brexit mean for English schemes of arrangement?

- Schemes probably continue, especially where English law debt. Schemes outside Regulation anyway
- Problem is the pre-pack administration if the shareholders do not agree
- Solution to no shareholder cram down was COMI shift and pre-pack
- Can find novel solutions – *Codere* or *ATU*
- Deal certainty, flexibility, quality of Courts, English language and law, London location – still all very attractive

EU proposals for a restructuring and second chance directive

Section 4

Proposals for a restructuring and second chance directive

22 Nov 2016 - the European Commission published a draft directive on a preventive restructuring framework and second chance. Impressive document

What are the Proposals?

- Follows from the 2014 Recommendation on restructuring and second chance
- Aims to reduce barriers to the free flow of capital stemming from differences in member states' restructuring and insolvency laws
- No single insolvency process that all member states must implement
- Key principles as minimum standards – gives member states flexibility to consider national context

What do they mean for EU member states?

- UK: Proposals go further than current UK regime (and reform plans). NB. require cross class cram down and a moratorium
- Germany: Proposals would introduce a pre-insolvency regime that is not currently available, so would transform the landscape
- Netherlands: Dutch scheme fits in well – the first of many?

Summary of the Proposals

Availability of a preventive restructuring framework

Availability of a preventive restructuring framework

- Where there is a *likelihood of insolvency,* the debtor in *financial difficulty* has access to an effective preventive restructuring framework
- Can consist of one or more restructuring measures
- Court involvement to be limited to where necessary and proportionate to safeguard rights of affected parties
- Debtor to apply (creditors only with debtor's approval)

Facilitating negotiations

Debtor retains control

Debtor to remain totally or partially in control of its day-to-day operations. Appointment of an IP only in limited circumstances

Stay

Debtor can apply to court for a temporary stay of enforcement proceedings. The stay can be either *general* – covering all creditors; or *selective* – covering one or more individual creditors. Four months (extendable to 1 year), with safeguards in place to lift the stay

Termination and ipso facto

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Restructuring plan – key principles

Restructuring plan

Who to include

Flexibility on who to include, need not include all creditors

Class votes and threshold

- Affected creditors to vote in classes using 'class formation criteria'
- Sufficiently similar rights to justify 'considering the members of the class as a homogenous group with communality of interests'
- Secured and unsecured creditors as separate classes - workers may be a separate class
- Between 50% and 75% in value in each class

Cross class cram down

- Where relevant majority is not reached in one or more classes, plan may still be approved if it complies with 'cross class cram down requirements', i.e.
  - Dissenting class no worse off in plan than in liquidation
  - Plan is approved by at least one class of affected creditors (excl. shareholders) and any other class which would not receive any payment in a liquidation
  - Plan complies with 'absolute priority rule'
  - Plan provides a reasonable chance of preventing insolvency
  - (cf Dutch Scheme)

Restructuring plan – key principles (*continued*)

Restructuring plan

Court approval

- Required if the plan 'affects the interest of dissenting affected parties' or provides for new financing
- Court must reject plan if it does not satisfy 'best interests of creditors test'

Shareholders

- Shareholders may not unreasonably prevent adoption of restructuring plan
- Shareholders may form a distinct class and can vote on plan but are subject to cross-class cram-down

Valuation

- Liquidation value to be determined by court if allegations of breach of 'best interests of creditor test'
- Enterprise value to be determined by court if cross-class cram-down is applied or there is an alleged breach of the absolute priority rule

New financing – key principles

New financing

Priority

New financing to be adequately encouraged and protected

No claw back

No claw back in a subsequent insolvency

Lender liability

Lenders not to have any civil or criminal liability in a subsequent insolvency (unless new financing granted fraudulently or in bad faith)

The proposals – some thoughts

Will it work?

- Will the envisaged proceedings be too expensive for most companies?
- How will the cram down mechanism work for shareholders and interact with national company law?
- Some concepts are vague (likely insolvency, valuation) – deliberately so to fit in with national frameworks or lowest common denominator on an EU level?
- Is the judiciary adequately equipped in each member state?

The proposals – where next?

Not yet law…

- Delays …
- Draft directive is subject to change before becoming final (co-decision procedure)
- Final text not available before 2018
- Once final, member states will have two years to implement
- Much will depend on how it is implemented in each member state
- Currently: draft report has been issued by the JURI Commission.

Effect on UK

- Timing will overlap with Article 50 notice and eventual Brexit
- UK probably not be required to implement
- UK might implement anyway − or is this one step too far?
- World Bank Ratings may be the ‘non-European’ driver for change in the UK

Biography

Richard Tett

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Richard Tett has a stellar reputation in the market and is praised as an 'outstanding attorney'. In the words of one client, he is 'simply excellent, quite frankly. He always has a creative answer to problems and challenges that come up in restructurings, and is always at the forefront of developing new technology and getting deals done'.

Chambers Global

Practice

Richard leads our restructuring and insolvency practice in London.

About

With more than 20 years of restructuring experience, he has worked extensively on 'in court' and 'out of court' restructurings/ refinancings, intercreditor agreement disputes, formal insolvency appointments, high-yield bond and CMBS bond restructurings, distressed M&A, English schemes of arrangement, US Chapter 11s and s363 sales, pension deficits, insurance workouts, telecoms, and insolvency aspects of structured finance.

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Richard has acted across the capital structure for all the key stakeholders including corporates, lenders, bondholder/lender formal and ad hoc committees, creditors, shareholders, private equity sponsors, distressed debt investors and asset purchasers, directors, security trustees, administrators and liquidators.

Richard has particular cross border restructuring experience involving the UK, Europe, the US and across the globe.

Thank you