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Ready, Willing and Able, but Perhaps Not Always Acceptable: UK Schemes of Arrangement in Europe

ALASTAIR GOLDREIN

The author reviews recent decisions by a variety of European courts involving schemes of arrangement under the English Companies Act.

Schemes of arrangement under the English Companies Act have become an increasingly popular tool in large restructurings. Recently the procedure has aroused the interest of some European companies looking to restructure debt where creditor consent is not unanimous and the local jurisdiction lacks an equivalent procedure.

WHAT IS A SCHEME OF ARRANGEMENT?

A scheme of arrangement is a contractual arrangement entered into between a company and its creditors (or class of creditors) and/or shareholders pursuant to the Companies Act 2006.¹ Whilst the scheme is not a formal insolvency procedure and is not subject to the supervision of an insolvency practitioner, it can be used in conjunction with other insolvency procedures (e.g. administration), or otherwise on a standalone basis (and outside the scope of insolvency).

Alastair Goldrein is an associate in the bankruptcy and financial restructuring practice at Chadbourne & Parke's London office. He is reachable at agoldrein@chadbourne.com.

Advantages

- Schemes are particularly useful in circumstances where there are a large number of creditors and approval for a proposed restructuring is overwhelming, albeit not uniform. Once the scheme has been approved by a majority in number representing three quarters in value of the creditors (or class of creditors), it is binding irrespective of any contractual restrictions (such as requirements in the loan document).²
- A scheme binds not only those known to be within the class, but also unknown creditors who fall within the class.
- A scheme is also flexible; almost any type of compromise or arrangement may be proposed.

Disadvantages

As discussed, a scheme requires the consent of the requisite majority of each class of creditors affected by the scheme.

- Defining the constituents of each class of creditor is an important (and occasionally problematic) feature of the scheme procedure for which responsibility falls to the applicant. A “class” has been defined as constituting “those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.”³ This process can become particularly complex in highly leveraged structures with multiple classes of debt.
- During the period before the scheme is finalised — usually between six to eight weeks — in the event that a scheme is used as a standalone procedure (rather than in conjunction with administration) there is no moratorium in place and the company is vulnerable to enforcement action by creditors, particularly when those creditors are located outside the UK.

Procedure

A company, creditor or shareholder may petition the court to summon

a meeting of creditors and/or shareholders to agree to a compromise or arrangement (a scheme) between the company and its creditors/shareholders. Following the meeting(s), assuming the scheme has achieved the approval threshold, a second hearing is required to obtain the sanction of the court.⁴ Finally, a copy of the court order sanctioning the scheme must be delivered to the Registrar of Companies.

SCHEMES AND OVERSEAS COMPANIES

In certain circumstances, an English scheme of arrangement can be used by an overseas company which does not have a “centre of main interest” (“COMI”) or even an “establishment” in England. An English court may accept jurisdiction to sanction a scheme of arrangement in relation to any company which is capable of being wound up under the Insolvency Act 1986. The English courts will consider a scheme proposed in relation to an overseas company where the company meets the criteria set out in s.221 of the Insolvency Act 1986. This requires that:

- a) there is a sufficient connection with England;
- b) there must be a reasonable possibility of there being benefit to those applying for the scheme to be sanctioned; and
- c) one or more persons interested in the distribution of the assets of the company must be persons over whom the court can exercise a jurisdiction.⁵

ACCEPTANCE AND IMPLEMENTATION OF SCHEMES IN EUROPE

Whilst English legislation allows for overseas companies to make use of schemes, issues have arisen in relation to enforcing the scheme once the company has returned “home” to implement the order.

The EU Insolvency Regulation does not apply to schemes on the basis that they do not constitute restructuring or insolvency measures within the meaning of the Regulation (unless the scheme is part of an administration).

Therefore recognition of a scheme by a non-English court would likely fall under EC Regulation 44/2001, which deals generally with jurisdiction and the recognition and enforcement of judgments in civil and commercial matters between EU states.⁶ Alternatively, private international laws may recognise the validity of the effects of the scheme given that they are valid under English law.

GERMANY: EQUITABLE LIFE

On 8 September 2009, the Higher Regional Court in Celle, Germany declined to recognise a scheme sanctioned by the English High Court.⁷ The case involved Equitable Life, a life insurance company in the United Kingdom and the world's oldest mutual insurer, which was trying to re-structure its policy portfolio including certain contracts it had entered into through its German branch. The German claimant (and Equitable Life policyholder) sued Equitable Life in Germany. The policy was governed by German law and entitled the claimant to 'guaranteed' profits upon maturity. The claimant and other policy holders now stood to receive decreased sums. The scheme that had been sanctioned in the UK had been used as a means to settle claims which had been brought against Equitable Life for breach of its pre-contractual duty of disclosure.

Despite arguments by Equitable Life that the claim in Germany was barred by the scheme, the Higher Regional Court held (upholding the decision at first instance) as follows:

- a) That the scheme was not recognisable as an insolvency or comparable proceeding, in accordance with the Council Regulation No 1346/2000, in so far as it related to policies subject to German law;⁸ and
- b) that the scheme was not a judgment pursuant to Articles 32 and 33 of Council Regulation No 44/2001 in that it lacked the requisite characteristics of a judgment which necessitated a potential or actual dispute between the parties involved. Essentially, the court felt that the sanctioning of the scheme did not resolve a litigious dispute between the parties. Furthermore the German court was of the view that the restructuring plan was first and foremost controlled by the parties rather

than the court whose role was confined to monitoring rather than making decisions.⁹

As will be discussed below in relation to “La Seda,” the judgment must be seen in context and it is unclear whether other cases may be regarded by the German courts as having greater merit in being recognised as schemes.

NETHERLANDS: DAP HOLDING¹¹

In 2005, the English High Court sanctioned schemes of arrangement in respect of 17 Dutch insurers and one Dutch reinsurer, none of which had their centre of main interest or an establishment in England and Wales. The court was satisfied that the formalities in respect of the convening of the creditors’ meetings had been complied with, that the requisite majorities had been achieved, and that the schemes were fair. The only concern was to ensure that it had jurisdiction to sanction the schemes. The judge held that the court’s power to wind up foreign corporations went to the discretionary exercise of the power rather than to the existence of the power itself and accordingly sanctioned the scheme on that basis. In addition, the judge concluded that the relevant EU legislation did not affect the court’s jurisdiction to sanction the scheme for these Dutch companies.

LUXEMBOURG: VITA GROUP

Vita, a Luxembourg-based manufacturer of petro-chemical based products used in the home furnishing and auto sectors, operates worldwide with 5,000 employees in 20 countries. In 2005 the company was purchased by TPG Capital in a leveraged buyout with senior and mezzanine financing.

In December 2008, Vita and TPG approached the senior and mezzanine lenders due to an anticipated breach of financial covenants and an inability to meet year-end interest payments. In 2009 a restructuring was implemented using an English scheme of arrangement. The Vita scheme was completed very quickly with the initial hearing on March 27, 2009 and

the sanctioning of the scheme on April 22, 2009. As a result of the restructuring, debt in excess of €600 million was written down to approximately €100 million in exchange for a 40 percent equity stake in the restructured group and €95 million of new secured debt was provided by new money lenders including TPG Capital which remains the largest shareholder with control of the board. In particular, the entirety of the mezzanine debt was exchanged for 2.5 percent of the equity and warrants, and a chance to participate in the new money facilities.

SPAIN: LA SEDA DE BARCELONA SA (LA SEDA)¹¹

La Seda, a leading manufacturer of packaging, recently completed a successful restructuring of €610m syndicated debt when on 26 May 2010, the English High Court sanctioned a scheme in relation to the liabilities of the Spanish company.

Why did La Seda need to come to England to effect the restructuring? By way of background, Spanish insolvency law does not currently allow the “cramming down”¹² of dissenting creditors outside the realm of a formal insolvency procedure. Restructurings involving Spanish companies have tended to be governed by Spanish law, and success (and frequently the failure) has hinged upon the execution of amendment agreements to the existing loan documentation.¹³

Whilst a significant majority of the lenders who voted at the creditor meeting, voted in favour of the scheme, this would not have been sufficient in Spain where there is no mechanism to “drag” the dissenting minority of lenders. Either the company would have required the unanimous consent of its creditors to revise the loan documentation or it would have had to enter formal insolvency in Spain, a drawn out and onerous process carrying with it the stigma of bankruptcy, and the threat of liquidation.

As La Seda is a Spanish company, the English court had to establish jurisdiction before it could order the meeting of creditors to vote on the scheme. Although the judgment provides little detail on why the court considered itself able to exercise jurisdiction, the issue of sufficient connection was resolved swiftly by the judge. The basis for this conclusion largely rested on the fact that the rights of the lenders concerned were

subject to the jurisdiction of the English court and that many lenders were actually based in the UK¹⁴ and therefore benefitted from the scheme. Additionally, La Seda had subsidiaries and employees based in the UK.

Thus far, those creditors (who voted against the scheme) have not sought to challenge it in the Spanish courts. Unlike in *Equitable Life* where the relevant insurance policies were governed by German law, the loan documentation in La Seda was governed by English law. There were also public policy considerations in that without the scheme, the company faced the prospect of arduous insolvency proceedings.

CONCLUSION

Until the decision in *Equitable Life* becomes settled law, it remains unclear whether German courts can recognise an English scheme. It is conceivable that, with a different factual matrix, and where for example, the policies were governed by English law and the debtor was actually insolvent, a German court might analyse matters rather differently. To a degree this is a hollow consideration: schemes are generally favoured as a means to avoid the stigma, duration and cost of insolvency proceedings.

Consequently, there remains some uncertainty as to whether certain jurisdictions will follow Germany's lead and deny recognition to schemes sanctioned by the English courts. It seems likely that it will often be necessary to prove to the satisfaction of a foreign court that creditors have not been unfairly prejudiced by the scheme and have been granted equal treatment, so as to avoid public policy concerns.

In any case, perhaps the success of La Seda offers a more realistic indication of the success of scheme recognition going forward. It is not difficult to understand how a German court, faced with a German national holding a German-law-governed insurance policy, had concerns about the ability of an English court varying the terms of that policy outside the scope of insolvency. Similarly, it seems likely that a lender holding English-law-governed finance documentation would feel less confident about challenging any variation of rights in the Spanish courts where the alternative might have been the liquidation of the company.

There are also practical steps that can be taken to mitigate the risk of

a challenge. As has been mentioned above in relation to the restructuring of the Vita Group, the lenders accepted an exchange of debt for equity as part of the scheme arrangements. In the context of the securities confirmation form, lenders could be required to agree to be bound by the contractual terms of the scheme irrespective of whether they voted to approve its implementation in order to obtain their shares. It should also be emphasised that many disgruntled lenders would likely be deterred from seeking to enforce pre-scheme claims in local jurisdictions on account of the costs involved.

Whilst some uncertainty lingers on the recognition of English schemes of Arrangement in Germany, the apparent success of the La Seda scheme will continue to encourage European (and international?)¹⁵ companies to consider using a scheme to effect a restructuring; at least until their local jurisdiction legislates to provide a realistic alternative.

NOTES

¹ Ss 895-901.

² This method is referred to as “cram-down.”

³ *Sovereign Life Assurance Company v. Dodd* [1892] 2 QB 573.

⁴ Whilst orders may be given by the court at the initial hearing giving parties a limited period of time to vary or discharge the order, creditors who feel they have been treated unfairly are able to raise objections at this final hearing.

⁵ *Stocznia Gdanska SA v. Latreefers Inc (No. 2)* [1998] EWHC 1203 (Comm) applied in the context of schemes in *Re Drax Holdings Limited* [2003] EWHC 2743 (Ch).

⁶ There is some concern that a scheme might fall outside the scope of 44/2001 which excludes bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings (Article 2).

⁷ We understand that Equitable Life has appealed to the German Federal Supreme Court and that a decision is expected in 2011.

⁸ It should be noted that an English scheme does not satisfy the requirements for an insolvency proceeding under German law in that (unlike in England), the debtor would need to be insolvent, and the proceedings would have to be in the interests of all creditors and include the appointment of an administrator.

⁹ Many legal commentators have disputed this analysis on the basis that that

the creditors have the opportunity to appear at the two court hearings and apply to vary/discharge the scheme on grounds of fairness and procedural deficiencies.

¹⁰ *In the matter of DAP Holding N.V. and others* [2005] EWHC 2092 CH.

¹¹ *Re: La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

¹² *See note 2, supra.*

¹³ Spain provides only one single procedure to facilitate a restructuring or liquidation. There has been a surge in the number of Spanish companies entering bankruptcy with a reported 1500 proceedings in the second quarter of 2010 compared with 263 in 2007 (Instituto Nacional de Estadística).

¹⁴ It has been reported that there was an even split between the Iberian banks and institutional investment funds.

¹⁵ Schemes have long been recognised by the U.S. courts as foreign proceedings under Chapter 15. In Canada, a solvent UK scheme was recognised by the Ontario Court of Appeal in *Cavell Insurance Company Limited (Re)* 23 May 2006, Docket C43657.