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Clients&FriendsMemo

European Restructuring and Distressed: 2022 in Review

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Market overview

Few could have predicted the unexpected twists and turns 2022 would provide. A year in which the spectre of war came home to haunt Europe. It sent energy prices spiralling out of control and the world economy facing a triple whammy of rising interest rates, double-digit inflation and a reversal of the forces of globalisation that had been the predominant trend in the world economy since the end of the Cold War. And, of course, 2022 was also the year we lost Meatloaf...

The European restructuring landscape continued to evolve in 2022, with the UK retaining its position at the top of the forum shopping league tables, but against a backdrop of more serious competition from some of its continental European neighbours as the implementation of the EU Restructuring Framework Directive introduced novel ideas of shareholder cramdown to a number of new jurisdictions. While we have yet to see a wave of companies heading to a new jurisdiction to implement their restructuring, we have certainly moved into a new era in which the UK won't be the only destination.

The market for corporate debt looks set to continue to cleave into two camps: quality assets that have access to financing albeit at a reset price on the one hand, and corporates that are unable to access funding – at least in public markets – on the other. As with primary issuance in 2022, we expect to see more private capital finding its way into stressed and distressed corporates in 2023 as companies seek to buttress balance sheets battered by inflation and rising floating rates.

Commercial real estate will continue to feel the pressure in 2023 as a combination of rising rates and demand compression put downward pressure on yields and prices. All eyes will be on Adler, the German real estate behemoth, which announced a deal with creditors late in 2022 but which needs to fold a number of series of bonds forming part of its jumbo capital structure into the deal and (at least publicly) was facing the prospect of challenges from rival groups of bondholders.

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Scheme and restructuring plan round-up

Starting the year in style was the ***Smile Telecoms***[1] restructuring plan. In *Smile*, the company successfully applied under section 901C of the Companies Act 2006 to exclude a creditor class from voting that was proven to *be out of the money* (i.e., it did not have a 'genuine economic interest' in the outcome of the restructuring plan). This was the first time this route to cross-class cram down had been utilised. The Court was satisfied (based on evidence which included valuations, comparator reports, and admissions from creditors that they were out-of-the-money) to grant the company's application and order a meeting convened by only a single class of the in-the-money creditors. The Court set out the following principles for such applications (affirming the comments made in the ***Virgin Active*** restructuring plan).[2]

1) When considering whether a creditor has a 'genuine economic interest', the Court will assess the position by reference to the relevant alternative insolvency procedure which is likely to be implemented if the plan is not sanctioned.
2) The civil standard of balance of probabilities should be applied when determining whether a class actually has an economic interest in a real (as opposed to a theoretical or merely fanciful) sense.
3) It is open for the Court to conclude at the convening hearing that there is insufficient evidence to determine that a class should be excluded from voting on the basis that it does not have a genuine economic interest.

At the sanction hearing, the Court addressed objections from a creditor who opposed the Court's decision (made at the convening hearing) to exclude the out of the money class, and convene a single class meeting. The creditor filed evidence challenging the decision, but did not attend the sanction hearing. At the sanction hearing, Snowden J refused to re-open the issue, and gave a warning that creditors who wanted to oppose a plan (or a scheme) must stop "*shouting from the spectators' seats and step up to the plate*". They must adduce evidence, attend the hearing and make compelling submissions.

In another first, *Smile* was a foreign company seeking to compromise its shareholders' interests in the equity of the company. The Court was careful to hear detailed evidence of the effectiveness of the plan in Mauritius (where the company is incorporated) on the company's shareholders. Ultimately it was satisfied with the local law expert evidence that the necessary amendments to the constitution and share capital would be validly effected pursuant to the power of attorney given to the scheme company, and that the Court was not exercising exorbitant jurisdiction.

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[1] *Re Smile Telecoms Holdings Ltd* [2022] EWHC 387 (Ch) (convening hearing); *Re Smile Telecoms Holdings* [2022] EWHC 740 (Ch) (sanction hearing).

[2] *Re Virgin Active Holdings Ltd and ors* [2021] EWHC 1246 (Ch) (sanction hearing).

The second attempt of the ***Amigo***[3] scheme of arrangement was sanctioned in 2022 (the first having been attempted in 2021 in which the subprime guarantor lender proposed a scheme which was resisted by the Financial Conduct Authority ("**FCA**") on fairness grounds and ultimately sanction was refused)[4]. In 2022, now with the blessing of the FCA, the company proposed a scheme that sought to compromise consumer redress claims (amongst other liabilities), and also provided two solutions to address the company's position, demonstrating the flexibility of the scheme of arrangement. The first solution assumed the FCA would allow *Amigo* to resume lending. However, if the FCA did not allow lending to resume then the scheme proposed an orderly wind-down of the *Amigo* business. The decision contains useful guidance for schemes involving consumer liabilities, including ensuring there are suitable processes in place to consult with consumers.

Hot on *Amigo's* heels came ***Haya Real Estate***, a Spanish real estate company.[5] The company took well-trodden steps to create the required jurisdictional nexus with the UK: it incorporated a UK SPV that acceded as a co-issuer of its high-yield bonds, thus becoming jointly and severally liable for the obligations under the bonds. It also amended the governing law and jurisdiction clauses of the bond indenture to change the governing law to English law and that the Courts of England had jurisdiction in the event of proceedings in connection with the bonds. Local law advice confirmed the variation of the company's obligations under the scheme would be recognised and effective in Spain – olé!

Next - ***ED & F Man***.[6] This had a complicated capital structured and proposed a five class restructuring plan that was the first to amend a plan company's articles of association without the need for a shareholders meeting and resolutions. In considering the relevant alternative, the Court should require a good reason to depart from the company's valuation where their "evidence appears on its face to reflect a rational and considered view of the board". Trower J had some interesting comments on the distribution of the restructuring surplus and the relative entitlement of creditors to share in it; in considering whether the restructuring was being distributed equitably he said: "*In my view it is also relevant that the members of the dissenting class are very nearly out of the money even on a high case return. It follows that to the extent they have an interest in the restructuring surplus, it can fairly be described as one that is minimal. The closer the members of*

[3] *Re ALL Scheme Ltd* [2022] EWHC 549 (Ch) (convening hearing); *Re ALL Scheme Ltd* [2022] EWHC 1318 (Ch) (sanction hearing).

[4] *Re ALL Scheme Ltd* [2021] EWHC 1401 (Ch).

[5] *Re Haya Holco 2 PLC* [2022] EWHC 1079 (Ch) (convening hearing); *Re Haya Holco 2 PLC* [2022] 6 WLUK 66 (sanction hearing).

[6] *Re ED & F Man Holdings Ltd* [2022] EWHC 433 (Ch) (convening hearing); *Re ED & F Man Holdings Ltd* [2022] EWHC 687 (Ch) (sanction hearing).

the dissenting class are to being out of the money, the less clearly it can be seen that they might have an entitlement to an enhanced share."

We also saw the first restructuring plan sanctioned for a mid-market company. ***Houst***[7], was a significant decision, not only because it demonstrated to the restructuring profession that the restructuring plan could be effectively used in the mid-market, but it was also the first time a restructuring plan had been used to cram-up a debt due to HM Revenue & Customs ("**HMRC**"). HMRC was the only class that did not approve the proposed plan, and the Court was asked to sanction the plan using the cross-class cram down provisions under sections 901G of the Companies Act. The Court accepted (based on evidence) that HMRC was likely to receive a greater dividend under the proposed plan than it would in the event of the relevant alternative. Indeed, HMRC's objection to the plan was because they refused to give up their status as a preferential creditor (which had been reinstated in 2020).

Post *Houst,* it will be interesting to see how the restructuring plan develops as a mid-market implementation tool. It had been considered that the restructuring plan procedure was simply too expensive to be used by smaller and medium-sized companies. This is in part due to the detailed valuation evidence required, legal fees, and the execution risk if multiple jurisdictions are involved and / or there are challenges to the plan. In the latter part of the year, the Insolvency Service issued a report including suggestions to make the plan more attractive for smaller companies[8]. At the time of writing there has not been any legislative change to implement such measures. Given the macro economic outlook for 2023 there may be increased pressure on the Government to consider such changes.

Hong Kong Airlines[9] proposed a restructuring plan that sought to compromise certain aircraft lease liabilities. In a similar way to the ***MAB Leasing Ltd*** scheme case from 2021,[10] the Court side-stepped the vexed question of whether a restructuring plan was an "insolvency related event" such that it would be precluded from assuming jurisdiction and instead assumed the Cape Town Convention would apply, and considered whether affected lessors had consented. Although a group of creditors raised objections to their treatment at the convening hearing, they formally withdrew their objections by the time of the sanction hearing – mindful of Snowden J's guidance in *Smile* (as to which, see our comments above).

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7 *Re Houst Limited* [2022] EWHC 1941 (Ch) (sanction hearing).

8 https://www.gov.uk/government/publications/corporate-insolvency-and-governance-act-2020-evaluation-reports

9 *Re Hong Kong Airlines Ltd* [2022] EWHC 3210 (Ch) (sanction hearing).

10 *Re Mab Leasing Ltd* [2021] EWHC 379 (Ch) (sanction hearing).

Lastly, the decision of ***Oceanfill***[11] is a timely reminder to practitioners on the importance of not overlooking the rights of third parties, specifically guarantors. In *Oceanfill* the High Court granted summary judgment in favour of a landlord's claim for rent due from the guarantors of a lease. The lease had been compromised by the *Virgin Active* restructuring plan, sanctioned in 2021.[12] While the restructuring plan provided that the sums payable by the *tenant* to the landlord were reduced to zero, the plan did not address the liability of the *guarantors* under the lease. The Court concluded that the restructuring plan released the *company* from future liabilities under the lease, but it did not release the guarantors. As such the guarantors were liable for the rent that, but for the plan, would have been payable by the tenant.

Sequana – where does this leave directors?

In October, the Supreme Court delivered its long-awaited decision in ***BTI 2014 LLC v Sequana***[13], a significant judgment for the law of directors' duties. We reported on the decision in depth in our Clients & Friends alert. For the first time the Supreme Court considered the circumstances in which directors can be found liable for failing to take into account the interests of company creditors. In upholding the 2019 Court of Appeal decision[14], the Supreme Court affirmed a line of cases requiring directors to prioritise creditors' interests over those of the shareholders when an insolvency is more likely than not.

Sequana confirmed that directors have a duty to consider the interests of creditors at the point in time when directors know, or ought to know, that the company is insolvent or bordering on insolvency (and insolvency here includes cash-flow or balance-sheet insolvency). In addition, when an insolvent liquidation or administration is inevitable, then the directors must treat the interests of creditors as paramount. While the decision produced helpful commentary about the creditor duty, not much has changed in terms of practical guidance for directors of distressed companies. Our earlier alert includes further guidance for directors.

Enforcement considerations

There were also some important decisions in 2022 for secured lenders. In May we reported on the decision of ***Lombard North Central Plc v. European Skyjets***[15]. The Court ruled that the secured lender was entitled to terminate the loan agreement and enforce its security on the basis of misrepresentation and material adverse change events of default, despite the acceleration notice

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[11] *Oceanfill Limited v Nuffield Wellbeing Limited and anor* [2022] ESHC 2178 (Ch).

[12] *Virgin Active Holdings Ltd and ors* [2021] EWHC 1246 (Ch) (sanction hearing).

[13] *BTI 2014 LLC v Sequana SA* [2022] UKSC 25.

[14] *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112.

[15] *Lombard North Central Plc v. European Skyjets* [2022] EWHC 728.

the secured lender issued only citing a non-payment event of default. The decision is also an important reminder to lenders about the operation of no waiver clauses and reservation of rights letters (see our alert here for further information).

The role of valuation evidence was examined in the matter of ***Swiss Cottage Properties Limited (in liquidation)***.[16] In brief, administrators had been appointed and worked towards selling two "iceberg" properties. After selling the properties it was alleged that the administrators had breached their duties by, in part, failing to adequately market the properties. The Court disagreed. One important takeaway from this decision for administrators is that it was not necessary to obtain a "red book valuation" when the value of the property had been tested through an extensive (albeit, pre-administration) marketing campaign.

Lastly in this space is the decision of ***ABT Auto Investments Limited v. Aapico Investment Pte Ltd and Ors***[17]. Here the Court considered for the first time the meaning of the term "commercially reasonable manner" in Regulation 18 of The Financial Collateral Arrangements (No. 2) Regulations 2003 ("**Regulations**"). The Regulations allow a secured lender to exercise the remedy of appropriation, letting the secured party take ownership of the financial collateral. Regulation 18 requires the secured party to value the financial collateral, (i) in accordance with the terms of the security document; and (ii) in any event, in a commercially reasonably matter. The Court ruled that what is commercially reasonable will turn on the facts of each case, but, importantly, the Regulations do not require a secured party to act in good faith, nor do they impose any equitable duties. The requirement set out in the Regulations in exercising the appropriation remedy is for the valuation to be made in accordance with the terms of the arrangement and in a commercially reasonably manner – "no more, no less".

Cross-border developments

A longstanding feature of English law is the *Rule in Gibbs.* The rule provides that an English Court will not recognise a foreign law discharge of an English law debt, unless the creditor had submitted to the foreign proceeding in question, or a treaty existed authorising such discharge. However in 2022, the UK Insolvency Service launched a consultation around whether it should adopt a modification to the UNCITRAL Model Law on Cross-Border Insolvency, through a provision known as Article X. Article X would enable the recognition and enforcement of insolvency-related foreign judgments by English Courts. It is not proposed that foreign law judgments compromising English law debt would be recognised. Thus, while the *Rule in Gibbs* remains in place for now, it will be

[16] *Swiss Cottage Properties Limited* (in liquidation) [2022] EWHC 1495 (Ch).

[17] *ABT Auto Investments Limited v. Aapico Investment Pte Ltd and ors* [2022] EWHC 2839 (Comm).

interesting to see what is borne out in the results of the consultation, which are expected to be published later this year.

October saw another chapter added to the long running ***Galapagos*** saga. Following various litigious manoeuvrings, which culminated in a decision by the European Court of Justice ("**CJEU**") that the English Courts retained exclusive jurisdiction to open "main proceedings", a group of creditors of Galapagos applied to the English High Court for an order that the company be wound-up. Previously Galapagos had opened proceedings in Germany seeking relief and a Düsseldorf Court had designated these proceedings as main proceedings. However with the benefit of the CJEU decision, the English High Court determined that the German proceedings had not been validly opened and that Galapagos' centre of main interests ("**COMI**") was in England at the time the winding-up application was made. As such, the Court had jurisdiction to make the winding-up order (and did so!).[18]

Also this year, the Court of Appeal re-affirmed the importance of the presumption in the EU's Recast Insolvency Regulation that a company's COMI was the jurisdiction of its registered office, unless that presumption could be displaced through sufficient evidence of actual administration of the company's interests in any other place. In ***East-West Logistics LLP v Melars Group Ltd***[19], a winding-up petition was issued in respect of a company with its registered office in Malta, but which operated in other jurisdictions, including in England. At first instance, the Court found the company's establishment in Malta to be "illusory"- being only a "letterbox" with no real operations in the jurisdiction – and had landed on the company's COMI being England, based upon (among other factors) certain contracts having been entered into by the company being governed by English law and having English dispute resolution clauses.

However, the Court of Appeal re-iterated that the presumption in Article 3(1) of the Recast Insolvency Regulation remains in place and could not be disregarded, absent proof to the contrary: it was not enough for there to be a lack of evidence that the debtor actually carried out any activities at the place of its registered office. Further, when considering whether the question of where the company administered its interests on a regular basis "ascertainable by third parties", facts ascertained by an individual creditor from their dealings with the company should be admissible as evidence as to the location of COMI, but the Court would need to consider the proper weight which should be attached to such facts.

Whilst the case was determined under the EU's Recast Insolvency Regulation, which only has effect in the UK where main proceedings were opened before the end of the Brexit transition

[18] *See Re Galapagos SA* [2022] EWHC 1633 (Ch).

[19] [2022] EWCA Civ 1419.

period, the guidance on COMI from East-West is likely to assist in the interpretation of the equivalent UK provisions in the Retained Insolvency Regulation.

As noted above, we think it is a question of "when" rather than "if" we will see companies forum shop outside the United Kingdom. After the introduction of the Dutch (*Wet Homologatie Onderhands Akkoord*), German (*StaRUG*) and French (*Accelerated Safeguard*) restructuring procedures we also saw new procedures introduced in Italy and Spain – with the latter seeing its first test case in the shape of troubled Barcelona-based steel business, Celsa Group.

Priming: asset dropdowns and uptiering

The role of priming transactions and other "creditor-on-creditor violence" was never far from the minds of credit investors in 2022. Spurred by some aggressive transaction structures in the US market, uptier priming financing transactions (or uptiering) is worth a special mention. In these transactions the debtor makes an agreement with a subset of its lenders to make amendments to the credit documentation to permit the incurrence of a new super-priority facility that, on enforcement, has priority over the proceeds of the security and permits participants in the new facility to exchange their existing senior debt into new super-priority debt. To date, this has been more of a feature in the US lending market and has not yet been commonly used in Europe. In the US these transactions have been the subject of litigation (see for example, the *Serta Simmons* and *TriMark* litigation). That said, as the capital structures of European companies come under renewed strain we expect sponsors and their advisors to give such financing more serious consideration although we also see potential vulnerabilities in a European context.

Tax developments

Finally, there were some notable tax developments which restructuring advisors should keep in mind. Firstly, as we reported over the summer, the UK's First-tier Tribunal held that the payment of interest received by an Irish company was not to be denied the benefits of the relief afforded under the interest article of the UK-Ireland double tax treaty (see our previous report here). Also, the introduction in April 2022 of the Qualifying Asset Holding ("**QAHC**") regime seeks to enhance the UK's competitiveness in the fund sector. The benefits introduced by the QAHC, which include an exemption from UK tax on gains from the disposal of qualifying shares and overseas property (amongst other changes), have been welcomed widely in the investment management and restructuring sectors, particularly by managers and funds who may have been concerned about recent anti-tax avoidance initiatives in the EU.

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