NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the global restructuring team at Norton Rose Fulbright

Q1 2025

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To our clients and friends:

Welcome to this year's first issue of the International Restructuring Newswire where our lawyers from around the globe share their insights facing all of us in the restructuring realm.

I expect all will agree that these are unprecedented times with long established trade alliances and international conventions being challenged. As a global firm we strive to reach out to all our clients and friends in all corners of the world to give updated information and advice to help their businesses strive in these challenging times.

In this issue, we look at the latest news and views from both the US and the UK on the hot issues related to liability management transactions, an important decision on business rescue in South Africa, new legislation on the special treatment of perishable fruits and vegetables in Canadian insolvencies, and finally the lessons learnt from the US chapter 11 of Scandinavian Airlines, the first European airline to fly through chapter 11.

We hope you will find these articles useful.

Scott Atkins
Global Head of Restructuring
Sydney

In the news

Meiyen Tan elected as President of the Turnaround Management Association, Southeast Asia

Meiyen Tan (Singapore) recently took over the reins as President of the TMA, Southeast Asia Chapter. The TMA is the most professionally diverse organization in the corporate restructuring, renewal, and corporate health space. The TMA has almost 10,000 members in 54 chapters worldwide, including 34 North American chapters. Members include turnaround practitioners, attorneys, accountants, advisors, liquidators, consultants, as well as academic, government employees, and members of the judiciary.

Prof. Omar Salah inducted as INSOL International Fellow

Prof. Omar Salah (Amsterdam) has been inducted a Fellow in INSOL International's 2023/2024 class. The firm now has seven INSOL International Fellows based in Australia, the US, the UK and the Netherlands, demonstrating the strength and footprint of our Global Restructuring Group and enabling us to advise on some of the world's most high-profile, cross-border restructuring and insolvency matters.

Jennifer Stam joins the board of directors of the ARIL Society

Jennifer Stam (Toronto) joined the board of directors of the ARIL Society. The ARIL Society publishes the Annual Review of Insolvency Law and produces the ARIL Conference annually.

The Annual Review of Insolvency Law is a respected journal that openly solicits papers on relevant topics. Papers selected for publication are juried and subject to rigorous peer review by an editorial board, comprised of over 40 judges, practitioners, and academics from across Canada.

The ARIL Conference features presentations of papers published by the ARIL Society and is Canada's leading multidisciplinary forum for thought leadership open to the entire insolvency and restructuring community.

Book Launch of Prof. Omar Salah and Prof. Bob Wessels

September 2024
The Dutch Restructuring Association (*Nederlandse Vereniging voor Herstructuring*) held their annual meeting in Amsterdam in September. The event brought together professionals in the field of restructuring and insolvency. During the meeting, the new book authored by Prof. Omar Salah and Prof. Bob Wessels was officially handed over to Prof. Frank Verstijlen. The book is focused on the Dutch WHOA (often referred to as the "Dutch Scheme") and forms part of the *Wessels Series on Insolvency Law.*

WHOA Podcast

September 2024
Prof. Omar Salah (Amsterdam) participated in a podcast alongside Prof. Bob Wessels, where they discussed the Dutch WHOA (Wet Homologatie Onderhands Akkoord), offering insights into the legal framework and its implications for corporate restructurings in the Netherlands and abroad.

INSOL Europe Academic Conference

October 2-3, 2024
Prof. Omar Salah (Amsterdam) presented a paper "Parallel Proceedings in Cross-Border Restructurings" as part of a panel on the Cross Border and International Insolvency at INSOL Europe's annual academic conference in Sorrento, Italy.

Howard University School of Law DREAMS Symposium

November 6, 2024
Ryan Manns (Dallas) was a panelist at the 2nd annual Howard DREAMS: Discovering Restructuring Expertise and Mentorship Symposium, presented by the American College of Bankruptcy and the American Bankruptcy Institute. Ryan's panel spoke on "Opportunities in Restructuring."

43rd Annual Jay L. Westbrook Bankruptcy Conference

November 21–22, 2024
Julie Harrison (Houston) was a panelist at the annual Jay L. Westbrook conference in Austin, Texas. The panel discussed the comparisons and contrasts of procedures for complex Chapter 11 cases across the districts.

St. John's University School of Law

December 4, 2024
Francisco Vazquez (New York) was a panelist on a presentation titled "Current Developments in Bankruptcy" hosted by St. John's University School of Law.

ABA Air & Space Law Forum's Aircraft Finance Conference

December 4, 2024
David Rosenzweig (New York) spoke on a panel discussing the SAS cross–border restructuring at the ABA Air & Space Law Forum's Aircraft Finance Conference in New York.

UNCITRAL Working Group V

December 16-20, 2024
Scott Atkins (Sydney) attended the UNCITRAL Working Group V as the official representative of the Australian Government. The Working Group V is the official global body shaping international insolvency and restructuring law, covering areas as diverse as corporate and personal insolvency, cross-border recognition of insolvency proceedings, recognition and enforcement of foreign judgments, group enterprise insolvency, recognition and enforcement of mediated agreements in insolvency, and director's duties and obligations in the insolvency sphere. Scott also holds a standing invitation from The World Bank to attend its (typically) biannual Washington forum where the global standard for insolvency laws is reviewed, adjusted and reset. The World Bank is the officially-designated Standard Setting agency for insolvency law.

International Insolvency Institute – North American Regional Conference

January 15–16, 2025
Francisco Vazquez (New York) was a panelist at the III North American Regional Conference in Chicago. The panel is titled "Novel Issues in Canada Affecting Cross-Border Insolvencies: A Discussion of Reverse Vesting Orders and the Pension Bankruptcy Protection Bill."

Malaysian Cross Border Insolvency Conference

February 25, 2025
Scott Atkins (Sydney) will attend the Malaysian Cross Border Insolvency Conference in Kuala Lumpur hosted by the Malaysian Department of Insolvency (MDI). Scott will be a panelist for a forum titled "Cross-Border Insolvency Barriers: Strategies for Asset Tracing and Reciprocity."

INSOL International

Francisco Vazquez (New York) co-authored the United States chapter in the INSOL epublication*: Insolvency Investigations: Key Search Databases and Contacts for IPs in Foreign Jurisdictions*.

WA Business News

Jeff Black and Kellie Link (Perth) published an article in *WA Business News* discussing challenges and opportunities in the WA market and how our Australian and global restructuring teams are providing strategic support to clients in the region.

US Fifth Circuit Court of Appeals deals a blow to non-*pro rata* LMTs: Now what?

Andrew Shoulder, James Copeland

As *Newswire* readers know, liability management transactions (LMTs) have been a "hot topic" in the distressed-debt community for years, particularly since the onset of the COVID-19 pandemic. Non-*pro rata* "uptiers" have been a preferred LMT throughout, and every indication was that 2025 would be another banner year for uptier-centric LMT structures. But on December 31, with mere hours left in 2024, the US Fifth Circuit Court of Appeals issued a decision that shook the distressed-debt community. The Fifth Circuit reversed the 2023 rulings by the Houston bankruptcy court in the *Serta Simmons* chapter 11 case that, in effect, blessed Serta's non-*pro rata* uptier exchange as a permissible "open market purchase" and dismissed breach claims and other challenges brought by a group of lenders that were "excluded" from participating in the transaction.

As the dust begins to settle on the Fifth Circuit's 54-page decision, this much is clear: it is certain to influence LMT strategies and structures right away. The Fifth Circuit reversed the 2023 rulings by the Houston bankruptcy court in the *Serta Simmons* chapter 11 case that, in effect, blessed Serta's non-*pro rata* uptier exchange as a permissible "open market purchase" and dismissed breach claims and other challenges brought by a group of lenders that were "excluded" from participating in the transaction.

The decision is notable for a number of reasons (including its disposition of some core chapter 11 practice issues not discussed at length in this alert, like equitable mootness, participating-lender indemnities, and equal treatment). First, the decision is binding precedent within the Fifth Circuit, which includes the Houston bankruptcy court, a "go to" venue for complex chapter 11 cases and post-LMT litigation (*e.g.*, pending appeals on LMT-related issues in both the *Robertshaw* and *Incora/Wesco Aircraft* chapter 11 cases). Second, and perhaps more concerning for cash-strapped borrowers, is the unanimous three Judge panel's analysis of the underlying credit agreement's ratable-treatment protections and exceptions.

The Fifth Circuit's analysis conveyed a reading of the relevant documents and seeming skepticism of uptier LMTs that starkly differed from the bankruptcy court's commercial-expectations perspective. The Fifth Circuit speculated in unmistakable terms:

"The 2020 Uptier was the first major uptier. But it was far from the last. And while the loan market has seen an increase in contracts blocking uptiers (so-called 'uptier blockers') since 2020, there are doubtless still many contracts with open market purchase exceptions to ratable treatment. **Though every contract should be taken on its own, today's decision suggests that such exceptions will often not justify an uptier**."

Before taking a closer look at the panel's ruling and potential fallout, we recall Serta's uptier LMT and the Houston bankruptcy court's rulings that set the stage for the Fifth Circuit's decision.

Serta's uptier LMT. In 2020, Serta needed new capital and explored competing proposals from its existing lenders. Serta and a lender group holding majority positions in Serta's first-lien and second-lien credit facilities (or the 'participating lenders') ultimately executed an uptier LMT that created more than US$1 billion in new super-priority debt through two transactions:

- Step one, the participating lenders used their majority-lender status to amend the existing credit agreement to permit them to provide US$200 million in new money in exchange for US$200 million in first-out, super-priority debt; and

- Step two, the participating lenders sought to exploit the "open market purchase" provision in the existing credit agreement to execute a debt-for-debt exchange pursuant to which the participating lenders alone were allowed to trade in US$1.2 billion of their old first-lien and second-lien loans for approximately US$875 million in second-out, superpriority debt.

It was Serta's use of the "open market purchase" provision to justify the non-*pro rata* exchange that excluded lenders argued violated the existing credit agreement's terms.

Bankruptcy Court dismisses excluded lenders' challenges. After Serta filed for chapter 11 relief in Houston, the excluded lenders' claims and challenges to the uptier exchange were quickly teed up through competing summary-judgement motions in the bankruptcy court. The excluded lenders argued that the uptier exchange didn't qualify as an "open market purchase" and otherwise trampled on their sacred rights (*e.g.*, their right to receive a *pro rata* share of payments and recoveries, and their senior lien priority and position in Serta's capital structure). In March 2023, the bankruptcy court ruled in favor of Serta and the participating lenders on the excluded lenders' breach claims, finding that the uptier "clearly" fell within the unambiguous terms of the "open market purchase" exception in the credit agreement.

That decision paved the way for a confirmation trial where the remainder of the excluded lenders' challenges were dismissed. The bankruptcy court confirmed Serta's chapter 11 plan—including a participating-lender indemnity covering losses related to the uptier—disposed of certain other challenges to the uptier transaction and found that all parties (including excluded lenders) knew that Serta's credit agreement was a "'loose document' and understood the implications of that looseness." Because Serta had flexibility built into the agreement, the bankruptcy court found that the excluded lenders received "the bargain they struck—not the one they hoped to get."

Fifth Circuit rejects expansive "open market purchase" exception. The Fifth Circuit ostensibly applied the same law and interpretive tools that the Houston bankruptcy court did (or could have), but reached the opposite conclusion: that Serta's 2020 uptier exchange violated the existing credit agreement's unambiguous exceptions to ratable treatment. The outcome might be rooted, in part, in what seems like a dubious view of LMTs, and non-*pro rata* uptiers in particular, held by the Fifth Circuit. Indeed, the Fifth Circuit devotes the first pages in its opinion to explaining uptiers, their purported costs and benefits, and their impact on the "ratable treatment" of lenders, which he calls "a background norm of corporate finance," and ends by suggesting that exceptions to that norm (or "sacred right") "will often not justify an uptier."

The panel then turned to the text of the existing credit agreement, which generally required *pro rata* sharing among all lenders. The credit agreement contained two exceptions to the ratable-sharing provisions, but only the "open market purchase" exception was relevant. Thus, the panel had to determine whether the 2020 uptier was a permissible "open market purchase" under the 2016 credit agreement.

While the bankruptcy court's analysis was preoccupied with the "[s]ophisticated financial titans" in both lender groups and their commercial expectations, the Fifth Circuit focused on the construction and definition of the phrase "open market purchase." Or better said, the lack of a definition—after all, the linchpin to the participating lenders' argument was the fact that "open market purchase" was not defined—allowing them to propose the broadest possible meaning.

Serta and the participating lenders argued the term "means to acquire something for value in competition among private parties," but that definition, according to the Fifth Circuit, describes only an "open purchase" and therefore "forget[s] the word 'market.'" The panel found that an "open market" means a "**designated market, not merely the background concept of free competition that characterizes much of modern American commerce**." In Serta's case, that meant that "the relevant product is first-lien debt issued under" an existing credit agreement, "and the market for [purchasing] that product is the 'secondary market' for syndicated loans." As a result, Serta "lost the protection of [the 'open market purchase' exception]" by choosing to engage with the participating lenders outside of the designated market.

The panel bolstered its conclusion with an examination of the "Dutch auction" exception, which contemplated an off-market transaction like the one Serta used in the 2020 uptier. The panel reasoned that, "[i]f an open market purchase is merely an acquisition of 'something for value in competition among private parties,' the Dutch auction exception does no work," because "[Serta] could call any arms-length transaction—including a Dutch auction—an open market purchase." The "expansive definitions" favored by Serta and the participating lenders violated interpretive canons that advise against interpretation that "render [contractual provisions] surplusage."

The panel then remanded the excluded lenders' breach claims back to the Houston bankruptcy court, which weren't considered in its initial summary judgment decision. In doing so, the panel observed that the excluded lenders had a "strong case" that Serta and the participating lenders breached the credit agreement. In light of the panel's conclusion, it also reversed the bankruptcy court's approval of, and excised from Serta's chapter 11 plan, certain provisions that required reorganized Serta to indemnify participating lenders for any damages that might be awarded to the excluded lenders on their breach claims.

Read the full text of the decision: *In re Serta Simmons Bedding, LLC*.

Where will the market go from here?

The outcome in *Serta* looks like a rare "sweep" by excluded lenders in LMT litigation. Early industry speculation is that the decision could chill the uptier market. At a minimum, the decision may force distressed companies entrenched in non-*pro rata* LMT litigation to avoid restructuring through Fifth Circuit courts, and in particular the Houston bankruptcy court. Such companies may favor restructuring in jurisdictions unburdened by a circuit-level skepticism of uptier transactions. Although some will argue that *Serta* should be confined to uptiers that rely on "open market purchase" exceptions, if you read between the lines, the Fifth Circuit's decision makes clear that courts should take dim view of LMTs that erode the "sacred right" of ratable treatment.

That said, the LMT marketplace is nothing if not flexible. *Serta* may be a new arrow in the excluded-lender quiver, but **all** market participants and advisors are certain to keep the decision front of mind when drafting their next deal, or drawing up their next LMT playbook. Here are a few things to watch in the next year:

- ***More Fifth Circuit precedent coming?*** Houston's bankruptcy court has been a hotbed of post-LMT litigation in recent years, with borrowers and their participating lenders enjoying more success than their excluded rivals (*e.g.*, until recently in *Serta*, but also in the *Robertshaw* chapter 11). A recent decision by the Houston bankruptcy court in *Incora/ Wesco Aircraft* that preceded the Fifth Circuit's *Serta* decision, however, signaled that the bankruptcy court could invoke an analysis that, like the Fifth Circuit, strengthened excluded lenders' "sacred rights" under existing credit agreements. With plenty more LMT litigation in Houston, 2025 could see the Fifth Circuit re-visit *Serta* issues and provide market participants with more grist for the LMT mill.
- ***When one door closes, another opens.*** While the Fifth Circuit's decision may have pulled out the welcome mat for companies seeking to have their LMT transactions blessed, let's not forget that courts in other jurisdictions outside of the Fifth Circuit have observed, despite the "'all for one, one for all' spirit of a syndicated loan, . . . nothing in the law [ ] requires holders of syndicated debt to behave as Musketeers." Although the *Serta* court applied New York law in its analysis, its ruling does not bind New York courts or federal courts in other jurisdictions. To wit, also on December 31, just a few short hours after the Fifth Circuit revived the Serta excluded lenders' breach claims, a five-judge panel of the New York State Supreme Court's Appellate Division (First Department) paved the way for distressed borrowers and their lenders to structure non-*pro rata* exchanges.
  - The New York Appellate Division unanimously reversed a trial court's December 2023 decision denying motions to dismiss challenges to a 2022 non-*pro rata* uptier exchange. Although that transaction effectively subordinated excluded lenders to US$857 million in new priming debt, the appellate panel found no breach of the underlying credit agreement and deemed the related amendments and new agreements "valid and enforceable contracts."
  - In a short, but unequivocal decision, the New York appellate court was unconcerned with the "violence" allegedly done to excluded lenders' sacred rights. The result, however, can be attributed to a crucial difference in the underlying agreement's ratable-treatment exceptions: the Serta documents allowed for *"open market purchase"* while the documents before the New York panel allowed the company to "*purchase*" loans at any time, *i.e.*, without reference to a "designated market," which was a material consideration for the Fifth Circuit.
  - In light of the unqualified "purchase" exception, the New York appellate court found "no indication in the agreements that a refinancing or exchange cannot include a purchase, nor [ ] any indication that a purchase requires payment in full, upfront, in cash, or that debt cannot constitute payment." Read the full text of the New York Appellate Division opinion.

The New York Appellate Division's decision comes at an interesting moment. If market participants look back in time, they will see that many trailblazing LMTs, that found refuge in federal bankruptcy courts, actually began their journey in litigation filed in New York State Supreme Court. Like *Serta*, many of these companies pivoted to chapter 11 only after a trial court denied motions to dismiss, creating unsustainable uncertainty for them and their participating lenders (*e.g.*, including chapter 11 cases filed after uptiers by Trimark USA, Boardriders, and TPC Group, and cases filed after other LMTs by J. Crew, Neiman Marcus, Revlon, Envision, and others).

Only time will tell whether LMT participants will return to New York, continue to dip their toes in the shores of New Jersey, tempt the Fifth Circuit again, or seek some other "safer" jurisdiction. But has the Fifth Circuit put an end to the non-*pro rata* uptier LMT? Not likely.

- ***Fifth Circuit analyzes bedrock bankruptcy issues.*** As mentioned, the *Serta* decision is also noteworthy for its discussion of other bankruptcy issues. While these rulings won't have the knock-on effects that the Serta LMT ruling might, they provide useful insight for chapter 11 practitioners in the Fifth Circuit and elsewhere.

- "Equitable mootness," a judge-made doctrine that counsels appellate courts to abstain from deciding matters that might alter the outcome in a chapter 11 case, has been questioned by courts in recent years. Although the Fifth Circuit didn't entirely disavow the doctrine, it noted that, "to the extent equitable mootness exists at all, we affirm that it cannot be 'a shield for sharp or unauthorized practices.'" Thus, *Serta* adds to the growing body of law that pushes reviewing courts to avoid dismissing an appeal on equitable grounds and instead consider whether it can fashion appropriate relief without scrambling a confirmed chapter 11 plan.
  - In addition, the Fifth Circuit reversed the bankruptcy court's ruling that an provision in Serta's chapter 11 plan that required the company to indemnify the participating lenders for damages awarded in post-bankruptcy litigation. The panel saw the indemnity as an "end-run" around Bankruptcy Code section 502(e)(1)(B), which disallows contingent prepetition indemnification claims, and rejected Serta's argument that the provision was nevertheless permissible under Bankruptcy Code section 1123(b)(3)(A) as a plan settlement. Accordingly, Debtors cannot use a plan settlement under section 1123 to resurrect a claim that would otherwise be disallowed under other Bankruptcy Code provisions.
  - The Fifth Circuit then considered, "even if the settlement indemnity was justified," whether the indemnity violated the Bankruptcy Code's "equal treatment" requirement. The panel found that it did. While the Bankruptcy Code requires that plans provide the "same treatment for" each claim in a particular class, the Fifth Circuit found that the "differences in the expected value of the indemnity meant that distributions to the members of Classes 3 and 4 were not equal." The panel stopped short of "delimit[ing] the exact scope of [the equal-treatment requirement in Bankruptcy Code section 1123(a)(4)]," but the ruling made plain that the equal-treatment analysis requires courts to look beyond a plan's plain language to evaluate whether "some class members received settlements with higher effective values than their co-class members."

Andrew Schoulder is a partner and James Copeland is senior counsel in our New York office in the firm's global restructuring group.

Navigating distressed liability management transactions: An English perspective

Manhal Zaman, Matthew Thorn, Bernd Bohr, James Dunnett, Helen Coverdale

The new wave of liability management transactions

Higher interest rates, geopolitical uncertainty and other economic headwinds have created significant challenges for some highly leveraged companies in certain industries to obtain new debt and/or refinance upcoming maturities. Companies and their supportive stakeholders are therefore looking for creative (and sometimes aggressive) solutions to manage their capital requirements.

In simple terms, the (relatively) recent wave of distressed liability management transactions (LMTs) fall into three categories, as follows:

1. “**Drop down”:** the use of unrestricted subsidiaries, investment baskets and/or restricted payment baskets to structurally subordinate existing non-participating creditors by moving (or “dropping down”) valuable assets (such as IP or even an entire business unit) to an unrestricted/excluded subsidiary or otherwise out of the existing creditors’ security net so as to allow new debt to be raised in exchange for new security over those (now) unencumbered assets.
2. “**Up-tier”:** the use of requisite lender consent to facilitate the exchange of existing debt of a company for new super senior instruments (typically coupled with an injection of new money) which subordinates the claims of non-participating creditors to the “up-tiered” claims of participating creditors, often leaving the subordinated debt with weaker covenants and lower recovery prospects. In the US, there has been a noted increase in recent years of lien stripping up-tier transactions. These have been less prevalent in Europe but the recent Hunkemoller up-tier could signal a new dawn for these transactions (although this transaction is subject to legal challenge in the US).
3. “**Double dip”:** the use of existing debt, lien, and investment baskets to give creditors a direct and an indirect claim against a debtor, thereby benefitting from a higher proportional return in an insolvency scenario. Often this is done by lending new money to an unrestricted subsidiary with the proceeds being on-lent to the restricted group and guarantees and security being granted for the intercompany loan as well as the original new money (as permitted by the relevant baskets).

There are variations on these themes, but at their core these types of LMTs take advantage of the flexibility in documentation to improve the position of participating creditors to the detriment of non-participating creditors. Utilising flexibility in financial documents to obtain new money at the expense of old money is nothing new, but the proliferation of bond-style covenants in loan markets in recent years has contributed to the increasing popularity of these types of LMTs. But compliance with documentation is not the only legal requirement that needs to be satisfied to successfully implement a distressed LMT. This article is focused on LMTs outside of traditional in-court restructuring procedures, such as schemes of arrangement and restructuring plans in the UK and Chapter 11 proceedings in the US, but it may be that an in-court procedure forms a part of the desired solution.

Directors’ duties

Directors of a company owe duties under the law of the company’s jurisdiction of incorporation and, potentially, the laws of the jurisdiction in which insolvency proceedings are opened. However, given the relatively low jurisdictional thresholds for opening insolvency proceedings in certain jurisdictions, it can be difficult for directors and creditors of large international companies and groups to know for certain where such proceedings will be commenced.

Under English law, directors must comply with statutory and fiduciary duties owed to their company. This includes the duty to avoid conflicts, and to exercise independent skill and judgement. When a company is in financial difficulties, the most relevant duty is often the duty to act in the best interests of the company and act in the way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members (and/or creditors) as a whole. Ordinarily, this duty requires the directors to look to the interests of members (ie shareholders) but if a company is in the zone of insolvency (which is understood to mean bordering on insolvency, where insolvent administration or liquidation is probable, or where a company is insolvent on a cash flow or balance sheet basis) the "creditor duty" is triggered and, from that point, directors are required to consider the interests of creditors, as well as members. The closer a company is to insolvency, the greater weight that should be given to creditors' interests. That balance tips once insolvency is inevitable: at this point the directors' focus should be purely on creditors' interests.

How then should directors act in the context of these distressed LMTs? First, directors need to consider the solvency position of the company. Where the company is solvent (and the creditor duty is not engaged) the duty to promote the success of the company should encourage the directors to pursue a strategy that maximises long term value in the company for the benefit of shareholders, even where that may not be in the interests of the creditors as a whole in the short term. However, if the creditor duty is engaged, the picture becomes more complex. Depending on how likely insolvency is, directors need to weigh the interests of creditors against members, which, in practice, may encourage a more conservative approach on the basis that the directors will want to avoid deepening the insolvency of the company. Directors will need to carefully consider any new money on offer, the terms of that new money and the impact on existing creditors.

Analysis should be carried out as to whether the transaction improves the position of creditors as a whole (and not a subset of creditors) when compared to the alternative of not entering the transaction and/or the company entering into insolvency proceedings (which is likely to leave creditors in a worse position). Offering the benefits of participation in new money to relevant existing creditors (consistent with the approach taken in the context of schemes of arrangement and restructuring plans to ensure compliance with fairness and class requirements) may rebut claims that certain creditors were favoured over others in the same class. Where guarantees are given by subsidiaries for the debts of their parent or sister companies (eg as a part of a double dip transaction) then issues of corporate benefit come to the fore. Directors will also need to be comfortable that there remains a reasonable prospect of avoiding an insolvent administration or liquidation. Directors should ensure that any analysis on the commercial rationale and the reasoning behind their decision making is clearly recorded.

Generally, creditors have no direct cause of action against directors of a debtor for a breach of fiduciary duty. A subsequently appointed administrator or liquidator would have standing to bring a breach of duty claim against the directors (as well as various other actions) but, until their appointment, only the company itself (or potentially shareholders bringing a derivative claim) can bring breach of duty proceedings against board members. If the directors have acted in breach of duty and the benefitting creditor has actual or constructive notice of this fact, the company (eg by a subsequently appointed insolvency practitioner) can avoid the transaction and recover any benefits conferred under it.

Clawback

Should insolvency proceedings be commenced shortly after the implementation of an LMT, there may be grounds on which the transaction can be set aside on application to court by the subsequently appointed administrator or liquidator. As a matter of English insolvency law, there are three principal grounds on which transactions are capable of being set aside:

1. transactions at an undervalue;
2. voidable preferences; and
3. voidable floating charges.

Transactions defrauding creditors may also be set aside, although this is less likely to apply to LMTs in practice.

By way of example, if a company sold IP to a sister company in return for an intercompany receivable and that company raised debt using the IP as collateral, then (depending on the use of proceeds) that transaction may constitute a transaction at an undervalue if the value of the consideration provided to the company (the intercompany receivable, presumably subordinated to the new secured debt) is significantly less than the value of the consideration provided by the company (the IP). If the transaction took place within two years of the commencement of administration or liquidation and the company was insolvent at the time of the transaction (and a good faith and proper purpose defence does not apply) then the transaction is liable to be set aside.

Further, a transaction entered into by a company within six months of administration or liquidation (or two years in the case of connected persons) can be set aside as a preference if the company has done something which has the effect of putting a creditor into a better position than the creditor would have been in if the thing was not done and the company was insolvent at the time of the transaction. The company must have been influenced in giving the preference by a desire to prefer that creditor. An up-tier transaction that prefers the payment of certain creditors over others and/or prioritises certain claims over others may be susceptible to challenge on this basis.

Where a transaction is liable to be set aside on any of the grounds referred to above, this is likely to also constitute a breach of duty by the directors of the debtor company. Where formal in-court restructuring procedures are tilized the risk of a successful challenge is (considerably) lower than in an out of court restructuring, which could mitigate in favour of formal proceedings where any of the risks identified above are substantial.

Oppression of the minority

English common law has developed a protective principle for minority dissenting members of a class which provides that the power given to the majority assenting members must be exercised in good faith for the purpose of benefiting the class as a whole, and not merely individual members.[1]

This principle was further developed in the 2012 case of *Assénagon*[2] where the court held that it is not lawful "for the majority to lend its aid to the coercion of a minority by voting for a resolution which expropriates the minority's rights under their bonds for a nominal consideration".

In *Assénagon,* the debtor company sought to implement an "exit consent" under which it would invite creditors to swap existing bonds for new bonds while amending the terms of the existing bonds so as to substantially destroy the value of the rights arising from those existing bonds which would remain held by the minority bondholders that did not agree to swap their bonds. Finding for the dissenting minority, Briggs J noted that "oppression of a minority is of the essence of exit consents of this kind, and it is precisely that at which the principles restraining the abusive exercise of powers to bind minorities are aimed".

Assénagon was a rather egregious example of minority oppression, and it does not follow from that case that all "up-tier" (or other LMTs) that prefer the majority at the expense of the minority are unlawful. In the context of schemes of arrangement and restructuring plans, it is not unusual to offer (relatively modest) inducements to creditors that agree to vote in favour of the debtor company's proposal and for the rights of non-participating old money to be diluted by reference to the rights afforded to participating new money. *Assénagon* amounted to an effective expropriation of rights, but it is expected that an "up-tier" transaction that leaves some substantial benefit with the dissenting class, is capable of benefitting the class as a whole and is not overly oppressive, will not offend the principles laid down in that case.

Creditor protections: What can creditors do when faced with a potential distressed LMT?

It would be usual for creditors to co-ordinate their response to a distressed debtor by way of traditional co-ordinating (or steering) committees, or more flexible ad hoc committees, usually organised with the consent and support of the debtor. More recently, and in response to risk of the more aggressive LMTs, so called "co-operation agreements" are being used by creditors (independent of the debtor) to seek to avoid the "prisoner's dilemma" inherent in the decision as to whether to accept an LMT proposed by a debtor and take the benefits that come with being a part of the assenting class or hold out for better terms and risk being adversely impacted if the debtor obtains the support of the requisite majority. The aim of these co-operation agreements is to form a blocking stake which means the LMT is not capable of implementation without the support of the co-operating creditors acting together. Creditors may agree between themselves not to trade their debt or negotiate or agree side deals with the debtor or other creditors without the co-operating group and agree to vote in accordance with a specified majority and then only where a transaction treats all signatory creditors equally. Questions have been raised around the efficacy of such agreements, and creditors do need to ensure that any such arrangement is consistent with any duties of confidentiality. Creditors also need to be conscious of any attempts to restrict co-operation in non-disclosure agreements.

Outside of co-operation agreements, if a creditor is not offered a participation in the new money, elevation and/or other benefits (and other legal remedies are not available) they could look to offer the new money to the debtor (eg on more attractive terms). It also remains for non-participating creditors to apply relationship pressure on debtors, sponsors and/or other creditors where possible to seek to avoid the worst consequences of these transactions being imposed on them.

Conclusion

The distressed LMT techniques referred to above are creatures of the US legal market and the English legal risks identified above are not present to the same extent in the US market. The strategies to implement and counter their implementation are therefore likely to play out differently depending on the applicable jurisdictions.

While the risks identified above need to be taken into account, distressed LMT transactions will remain a valuable tool to address financial difficulties of a debtor company with a complex capital structure. Where they are implemented lawfully and in good faith, they can provide the lifeline a company needs to turn its fortunes around and preserve value for the benefit of stakeholders as a whole.

1. *British America Nickel Corporation, Limited and Others v MJ O'Brien, Limited* [1927] AC 369.
2. *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd (formerly Anglo Irish Bank Corporation Ltd)* [2012] EWHC 2090 (Ch).

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Navigating business rescue of state-owned entities in South Africa: Key features, peculiarities and one court's removal of a restructuring practitioner

Widaad Ebrahim-Fakier

Business rescue in South Africa is a legal process designed to facilitate the rehabilitation of financially distressed companies, akin to other corporate rescue / statutory reorganisation mechanisms adopted elsewhere in the world. The process is governed by the South African Companies Act, 2008 (the "Companies Act"). It's not very often that state-owned entities ("SOEs") are the subject of business rescue proceedings, and only a handful have arisen since the inception of the Companies Act. There are, of course, inherent reasons for this – including that SOEs often receive financial support / bailouts from the government, which delay or prevent the need for business rescue. When an SOE commences business rescue proceedings, there are added complexities that in one recent case resulted in the removal of a restructuring practitioner. Although scathing to the practitioner, the Judgment has broader relevance in underscoring the complexities and care needed to manage an SOE through a business rescue in South Africa.

Let's review first the three core features of business rescue under the Companies Act.

1. **Objective of business rescue:** The primary aim of business rescue is to provide a company with temporary relief from its creditors, allowing it to restructure its affairs, business, property, debt, and other liabilities. The goal is to maximize the likelihood of the company continuing on a solvent basis or, if that is not feasible, to achieve a better return for the company's creditors and shareholders than would result from immediate liquidation.
2. **Role of the business rescue practitioner (BRP):** The BRP is pivotal in the business rescue process. Appointed as an officer of the court, the BRP assumes the responsibilities, duties, and liabilities of a director of the company. The BRP is expected to act with the necessary competence, independence, and skill to manage the company's affairs during the business rescue proceedings.
3. **Business rescue plan:** A critical component of the business rescue process is the development and approval of a business rescue plan. This plan outlines the proposed strategy for rescuing the company and must be approved by the creditors (or when shareholder rights are affected by the plan, creditors and shareholders). The Act specifies time periods within which the BRP must execute their duties, including the publication of the business rescue plan within 25 days of their appointment, although it is not uncommon for this period to be extended with approval from creditors (or otherwise allowed by court order).

Peculiarities of business rescue for state-owned entities

Where an SOE is subject to a business rescue proceeding, the restructuring is further complicated due to the interplay with other statutes, the involvement of government bodies, and societal matters.

1. **Compliance with the Public Finance Management Act, 1999 (PFMA):** State-owned entities are subject to the PFMA, South Africa's primary public finance management law. The PFMA imposes specific financial management and reporting obligations on SOEs, which a BRP must navigate. Importantly, the PFMA takes precedence over the Companies Act in the event of any conflict. This means that the BRP must ensure compliance with both the Companies Act and the PFMA, which can complicate the business rescue process for an SOE.
2. **Reporting obligations:** The BRP must regularly report to the executive authority responsible for the SOE, typically the Member of the Executive Council ("MEC") for the relevant government department. This includes providing updates on the financial status of the entity and the progress of the business rescue proceedings.
3. **Governmental oversight and approval:** The involvement of governmental bodies adds a layer of complexity to the business rescue process. For instance, any significant financial decisions, such as securing post-commencement finance ("PCF"), may require approval from the National / Provincial Treasury or other relevant authorities. This oversight is intended to ensure that public funds are managed effectively and transparently, but can lead to delays in procuring the necessary funding.
4. **Prioritization of employees' salaries:** In the case of SOEs, the payment of employees' salaries is a critical issue to ensure continued operations. The Companies Act prioritizes the payment of post-commencement salaries over other creditors. The failure to do so can lead to significant operational disruptions and legal liabilities.
5. **Potential for political and social implications:** The business rescue of SOEs often has broader political and social implications. These entities typically provide essential public services and employment opportunities. The failure of an SOE can have far-reaching consequences for the impacted community and the government. It is accordingly important to maintain transparency and accountability throughout the business rescue process to mitigate these risks.

The above features were emphasised in a recent high court judgment, *MEC for the Department of Community Safety and Transport Management of the North West Provincial Government vs Thomas Hendrick Samons N.O and Others*, dealing with the removal of a BRP in terms of section 139(2) of the Companies Act ("Judgment"). Section 139(2) permits the court's removal of a BRP for (amongst other grounds) incompetence and negligence.

The Judgment

1. The case involves the removal of Thomas Hendrick Samons as the BRP of North-West Transport Investment (SOC) Ltd and its subsidiaries, North-West Star (SOC) Ltd and Atteridgeville Bus Service (SOC) Ltd (the "NTI Companies"). The application for Mr. Samons' removal was initiated by the MEC for the Department of Community Safety and Transport Management of the North-West Provincial Government ("COSATMA").
2. The NTI Companies:
   a. are, in terms of the PFMA, provincial government business enterprises, responsible for bus transport services to commuters in the North West and Gauteng provinces in South Africa,
   b. were placed in business rescue due to severe financial distress and operational challenges, initially identified in an external report, commissioned by the MEC of COSATMA, which highlighted the dire financial state of the companies. The report revealed (amongst other things):
      i. that the NTI Companies were hopelessly insolvent, with a bank balance of ZAR2.5 million and liabilities nearing ZAR250 million,
      ii. that the entities would only survive with considerable financial support, requiring an immediate cash injection of ZAR250 million to settle accumulated liabilities and medium-term working capital support of ZAR15 million per month over a six-month period,
      iii. the NTI Companies had been operating without a board since 2018, and their fleet was in serious disrepair, with over two-thirds of their 612 buses being non-operative, and
      iv. additionally, the companies were in arrears with most suppliers, leading to frequent disruptions in bus services;

recommending that business rescue could be a potential solution, while also recognising that it might not be the ultimate answer, and advising the MEC to seek further legal advice on both business rescue and liquidation options.

3. Following a decision taken in 2022, the NTI Companies were placed under business rescue to address the above challenges to restructure operations, secure necessary funding, and improve governance and accountability to prevent further financial deterioration. Mr. Samons was then appointed as the BRP for the NTI Companies.

4. When later considering the COSATMA's application to remove Mr. Samons, the court's opening remarks about business rescue included its observation that business rescue is only appropriate for entities with reasonable trading prospects, potential for commercial viability, and where creditors would benefit from its success. However, the NTI Companies were the opposite—hopelessly insolvent and reliant on extensive financial assistance to continue operations. It is in this context that the court made the following findings:
   a. that Mr. Samons was incompetent and failed to conduct himself with the proper degree of care in the performance of his functions, contravening various statutory provisions, particularly the Companies Act and the PFMA. Specific instances of incompetence (which the court noted had led to significant financial and operational difficulties) included:
      i. **the failure to publish the business rescue plan timeously.** Specifically – Mr. Samons did not dispute that for over two years he had made various decisions for the NTI Companies, entered into various PCF agreements and attempted to dispose of the assets of the NTI Companies without an approved plan and without the approval of COSATMA under the PFMA;
      ii. **the failure to publish annual financial statements.** The annual financial statements for 2019 to 2024 were neither prepared nor made available. The BRP informed the Auditor-General 18 months after his appointment about his difficulties in compiling these statements, attributing the delays to uncooperative officials. The court was scathing of Mr. Samons' and noted that:
         1. the BRP was expected to manage the process skilfully and independently, not just blame the officials - he failed to inform the MEC of the challenges, nor did he report the entities' affairs to the MEC. He failed to deal with this issue with the degree of urgency and competence required of him.
         2. to make matters worse, the BRP misrepresented the situation to creditors and other affected parties, falsely claiming that financial statements were being finalized at a time when this was plainly untrue. There can be no doubt, the court said, that such misleading statements were prejudicial to the creditors and affected parties.
         3. the BRP did not have current financial records including the management reports, in place (for the duration of the business rescue proceedings), again attributing this to uncooperative officials. He was unable to provide the Provincial Treasury with such information. The BRPs shortcomings not only illustrated his incompetence but his failure to act with a level of skill and case expected of him as a BRP. He did not keep the MEC informed, compromising the financial reporting obligations of the MEC, Provincial Government, and Provincial Treasury under the PFMA.
      iii. **the failure to prioritize employees' salaries**. It was undisputed that employees had not received their salaries monthly. In his defence, the BRP pointed out that to keep the bus operations afloat, he had no option but to pay various suppliers, prioritising payments to creditors, and only paying employees if there were remaining funds. The court found that the BRPs reasoning clearly showed that he failed to appreciate that he had little or no discretion regarding the payment of salaries. It is statutorily prescribed that at post-business rescue stage, salaries are prioritised above creditors. The court found that the BRPs conduct in prioritising payment(s) to creditors was in contravention of the section 144(2) of the Companies Act, which stipulates that employees are preferred unsecured creditors, and pointing out that the rationale of business rescue is to preserve the business coupled with the interest of the employees.
      iv. **the failure to comply with the PFMA and Treasury Regulations.**
         1. The BRP claimed he wasn't required to report to COSATMA or the provincial government, stating he had reported to the Gauteng Provincial Department of Roads and Transport and the Auditor-General. The court emphasised that in business rescue, the BRP assumes the role of the NTI companies' accounting authority and external oversight is conducted through the Auditor-General's office and the provincial legislature. The PFMA, which takes precedence over the Companies Act, mandates that the BRP comply with reporting obligations for state-owned entities. Mr. Samons, however, failed to fulfill his legal duties, not submitting the necessary financial reports to COSATMA, the North West Provincial Treasury, or the Provincial Government. His assertion that he didn't need to report to COSATMA or the provincial government was incorrect.

2. Despite requests for information, “on the current financial operations and management of funds”, Mr. Samons’ response that “he had not prepared any financial reports” was deemed untenable and showed incompetence.
3. The court also found that the BRP had improperly ceded claims and encumbered property without necessary approvals (from at least the Treasury), showing a limited understanding of his statutory duties under the PFMA. His actions demonstrated incompetence and a failure to adhere to legal requirements, imposed under the PFMA.

b. The BRPs actions prejudiced the affected parties, including employees and creditors, with the court noting that Mr. Samon’s conduct resulted in the NTI Companies debt escalating to almost over ZAR1 billion (about US$56 million). The BRP’s failure to comply with statutory reporting obligations under the PFMA undermined the credibility of the business rescue process. The court found that the BRP was ultimately obligated to act impartially and transparently with affected parties, and to advise them that the chances of the entities being successfully rescued were slim. His primary duty was to continuously assess the NTI Companies’ financial prospects and the extent of their distress, a responsibility he failed to fulfill.

   c. Additionally, the BRP did not maintain transparency and accountability in managing the SOE's affairs, failing to report the financial status of the entities and the progress of the business rescue proceedings to the executive authority, leaving the MEC "in the dark regarding the financial circumstances of the very entities which the applicant,… is in control of" under the PFMA.

5. Consequently, the court ordered Mr. Samons' removal as the BRP in terms of section 139(2) of the Companies Act and mandated that the costs of the application be paid by Mr. Samons (in his personal capacity) and Tansnat Coach Lines (Pty) Ltd ("Tansnat") jointly and severally. Tansnat was the main creditor and supplier of buses to the NTI Companies. In the proceedings, Tansnat opposed Mr. Samons' removal as the BRP and joined issue with him.
6. In a counter-application, the respondents (in the main the BRP, supported by Tansnat) sought an order for the payment of ZAR615 million from COSATMA, claiming that an agreement had been reached for this funding to be provided to the NTI Companies. However, the court found that there was no agreement on the funding amount, and the respondents' claim was based on an alleged oral agreement between the legal representatives of the parties. The court determined that no such agreement had been finalized or approved by COSATMA, leading to the dismissal of the counter-application with costs.

The core principles outlined by the Judgment are as follows:

1. **Competence and independence of the BRP:** The BRP must possess the necessary skills and independence to manage the business rescue process effectively (including the proper comprehension and balancing of competing interests of various stakeholders).
2. **Timely development and approval of the business rescue plan:** The BRP must adhere to statutory timelines for developing and publishing the business rescue plan. Delays in this process can jeopardize the success of the business rescue proceedings. Key to this is the BRPs primary duty to continuously assess the entity's financial prospects and distress.
3. **Compliance with statutory reporting obligations:** The BRP must ensure compliance with all relevant statutory reporting obligations, including those under the PFMA. Failure to do so can result in legal challenges and undermine the credibility of the business rescue process.
4. **Transparent and accountable management:** The BRP must maintain transparency and accountability in managing the SOE's affairs. This includes regular reporting to the executive authority and other relevant stakeholders.

Conclusion

The North-West Transport Investment case highlights that the business rescue of SOEs in South Africa is a complex process that requires careful navigation of both the Companies Act and the PFMA. Whilst concerns remain over whether business rescue is suitable for financially distressed SOEs – it can still be a viable option. The outcome of the business rescue process largely hinges on the unique circumstances and challenges faced by the financially distressed SOE, along with the prevailing economic conditions and industry dynamics. Some SOEs also have their own statutes which might impact the business rescue process or even if it can be placed in business rescue.

Given the inherent complexities in an SOE business rescue, the Judgment underscores the importance of competence, transparency, and accountability in managing the business rescue process effectively. By adhering to these principles, BRPs can enhance the prospects of successfully rescuing financially distressed SOEs and ensuring their continued contribution to public service and economic development.

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Canadian insolvency priorities materially enhanced for suppliers of perishable fruits and vegetables – A Canadian version of a PACA trust?

Evan Cobb

Unsecured creditors in Canadian insolvency proceeding, as a general principle, receive *pari passu* treatment, sharing pro rata in recoveries from the insolvent party's assets after secured creditors have recovered from their collateral.

That general principle is subject to a number of historically available statutory exceptions. Not only do those exceptions elevate certain enumerated claims ahead of other unsecured creditors, but also ahead of secured creditors. Typical examples of such statutory exceptions are: unpaid employee source deductions, unpaid wages subject to statutory dollar limits and more recently amounts required to liquidate unfunded pension liabilities or solvency deficiencies.

Another statutory exemption was recently added in Canadian insolvency proceedings, akin to the long-standing Perishable Agricultural Commodities Act (PACA) that applies in US chapter 11 cases. Customers and suppliers who deal in perishable fruits and vegetables, as well as their lenders, must now consider a new statutory amendment that elevates another otherwise unsecured claim into a priority position.

Effective in December 2024, Canada's *Bankruptcy and Insolvency Act* and *Companies' Creditors Arrangement Act* have been amended to provide **statutory priority in an insolvency, restructuring or receivership proceeding to an unpaid seller of perishable fruits or vegetables to a debtor who uses those fruits and vegetables in relation to its business. The unpaid fruits and vegetables and any proceeds thereof (whether segregated or commingled) are deemed held in trust for the unpaid seller** if:

A. the supplier has included in their invoice a notice, or has otherwise given notice within 30 days of the receipt by the purchaser of the perishable fruits or vegetables, in the prescribed form and manner, informing the purchaser of their intention to avail themselves of their right as beneficial owner of the perishable fruits or vegetables and the proceeds of sale in case the purchaser becomes bankrupt or subject to a receivership;

B. the purchaser has 30 days or less to pay the entire balance owing to the supplier; and

C. the supplier is not paid the entire balance owing when it becomes due as provided in the invoice.

Under this new priority provision, 'perishable fruits and vegetables' even extend to items that have been repackaged or transformed by the purchaser to the extent the nature of the fruits or vegetables remains unchanged.

Beyond this general priority protection for suppliers of fruits and vegetables, courts are empowered to make any order that they consider proper in the circumstances upon application of a supplier who believes they have been aggrieved by any act, omission or decision of the purchaser, or the purchaser's trustee or receiver. The types of acts, omissions or decisions targeted by this provision, and why and how they would need to be remedied by the court, are unclear at this time.

These new statutory amendments raise interesting questions about the specific importance of protecting suppliers of these types of goods over other suppliers of perishable goods that may not be fruits or vegetables, or suppliers of services that may not be subject to resale. Other statutory priority rights recognize the unique circumstances of wage earners, pension beneficiaries, and tax authorities. The differentiating circumstances for suppliers of perishable fruits and vegetables relative to those other similar suppliers is less clear.

Various participants in the agricultural and food processing markets must be aware of and account for these provisions. This includes foreign participants dealing with Canadian purchasers.

Suppliers of perishable fruits and vegetables

These amendments are clearly a welcome change to suppliers.

To access the new protections, suppliers will need to comply with the specific procedures established in the legislation.

- Invoices should include the prescribed notice informing the purchaser of the unpaid supplier's intention to avail itself of these new rights as beneficial owner of the fruits and vegetables or proceeds.
- Invoice terms should provide for payment within 30 days
- Fruits and vegetables supplied should be identifiable to ensure they, or their proceeds, can be subject of a trust claim in practice.

Significant suppliers may need to engage in negotiations with the purchaser's lenders on the application of or waiver of these priority rights, notwithstanding the terms of the legislation.

Secured lenders

Secured lenders who rely upon perishable fruit and vegetable collateral to support any portion of their loans will need to carefully consider steps to ensure they adequately account for the risk that they may not have a priority claim to fruit and vegetable inventory that is unpaid.

Those steps may include additional reserves for the value of such unpaid inventory, reporting from borrowers and covenant thresholds on unpaid inventory amounts that could lead to priority claims, and waivers of these priority rights from suppliers in situations where a loan ceases to be viable without clear unimpeded access to this collateral or its proceeds.

These considerations will be most important for the loan management procedures of lenders with existing secured loans that could be materially affected by these new provisions. Those loans would have been entered into at a time in the past when the parties may not have specifically contemplated these new provisions and priorities.

Purchasers

Purchasers of perishable fruits and vegetables who rely upon working capital financing that is dependent upon this inventory collateral may face some of the same challenges as secured lenders, though from the opposite perspective. Lenders' enhanced collateral reporting and compliance procedures may impose additional cost and reporting time on purchasers. Any decisions to impose increased loan reserves to account for the risks of these priority claims would reduce access to working capital funding for these purchasers.

Practical application in insolvency

A number of practical questions remain to be worked out in the application of these priority rights in insolvency.

First, how would this statutory trust claim apply relative to priority "DIP" financing in an insolvency proceeding? If the charge securing such DIP financing can rank ahead of the supplier's statutory trust claim, the value of that statutory trust claim is reduced. The answer to this question will likely depend in part upon the ability to finance the restructuring without access to this collateral for "DIP" financing purposes.

Second, the trust claim in most cases will be limited to proceeds of sale of the goods. Immediate recovery and realization on the perishable goods themselves on any significant scale is likely not practically feasible. Therefore, a mechanism to safeguard and access those proceeds would be needed.

Third, suppliers must also be aware of the limitations of the scope of their priority rights. In many cases, the fruits and vegetables supplied will be processed during an insolvency proceeding, while an insolvency stay of proceedings is operative, such that the nature of the fruits and vegetables is changed. In those cases, any priority rights over the processed inventory is eliminated.

Fourth, revolving loans often implement blocked account or account control arrangements that automatically sweep cash receipts to pay down the facility and create room for further borrowing. Suppose proceeds of perishable fruits and vegetables are received subject to the deemed trust provided for in the legislative amendments, and those proceeds are automatically applied through blocked account or account control arrangements directly to pay down a revolving loan facility. In that case, will the unpaid supplier of those fruits and vegetables, as trust beneficiary, have a trust claim against the revolving lender for return of the swept funds, and will the revolving lender then be required to reverse those repayments even if doing so places the lender in an over-advance position.

We expect these issues will be considered by courts in the future and until such time a conservative approach to each of these issues by lenders, suppliers and purchasers is warranted. Parties may wish to consider the cases and solutions devised in US Chapter 11 cases under PACA as Canada's new law takes effect.

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SAS disembarks safely from Chapter 11: Lessons learned from the Chapter 11 of a European airline

Emily Hong

Scandinavia's leading airline, SAS, is the latest non-US airline and first European airline to find its wings through the US chapter 11 process since COVID-19 related challenges first rocked the aviation industry in 2020. On August 28, 2024, SAS formally exited chapter 11 with a revamped aircraft fleet and a cash injection of US$1.2 billion from new investors Castlelake, L.P., Air France-KLM S.A., Lind Invest ApS, and the Kingdom of Denmark.[1]

"And let me just say," added Judge Michael Wiles at the hearing confirming SAS's plan of reorganization, "that this was a particularly complicated one." As another multinational airline navigating US chapter 11, SAS's case treads familiar territory but also ventures into some uncharted airspace.

Like the other non-US airlines filing chapter 11, SAS harnessed formidable contract rejection tools under the Bankruptcy Code to overhaul its fleet. It also encountered complex jurisdictional issues, and (like other international debtors with respect to their own unique circumstances) implemented a bespoke strategy involving a Swedish reorganization and certain contractual arrangements with key, non-US stakeholders.

We examine these aspects of the SAS bankruptcy case in detail below.

Background: tarmac to trouble

SAS is the flag carrier of Denmark, Norway, and Sweden and was founded by national aircraft companies owned by those governments. In 1951, SAS was reorganized into the "Consortium" (a single entity called Scandinavian Airlines System Denmark–Norway–Sweden), which is SAS's main operating airline entity. The Consortium was owned in its entirety by a holding company incorporated in Sweden, called SAS AB.

When it entered chapter 11, SAS's fleet consisted of 102 aircraft: 22 owned by SAS and 80 leased under different arrangements, on account of which SAS paid around US$33.5 million every month. Its route network included 113 destinations in 34 countries, with around 270 daily scheduled passenger flights.

In 2020, few sectors were more compromised by the spread of COVID-19, and the measures implemented across the globe to control its spread, than air travel. Combinations of travel bans, social distancing policies, and border closings caused SAS's revenue to plummet 56% and 70% in 2020 and 2021, respectively, as compared to 2019. In those years, SAS was forced to lay off around 5,000 employees, and furlough a further 6,000.

Although SAS valiantly pursued various recapitalization and cost-cutting efforts in the immediate wake of the virus' outbreak, these were no match for a confluence of other setbacks, including: low cost carriers expanding into SAS's three main flight hubs; increased operating and jet fuel costs and the closure of Russian airspace due to the February 2022 invasion of Ukraine; and finally, a pilots' strike commencing on July 4, 2022 involving around 900 pilots and the cancellation of 50% of flights. To avert an estimated loss of up to US$12.5 million each day the strike continued, SAS commenced its chapter 11 cases on July 5, 2022.

More mileage with Chapter 11

Why does a Scandinavia-based airline file for bankruptcy in the US? SAS's lead debtor and parent entity (at the time of filing) was incorporated in Sweden. 12 out of 13 of the other debtor affiliates were organized in Sweden, Norway, Denmark, and Ireland, with only one incorporated in the US.

SAS is not the first multinational airline to choose chapter 11 in recent years: Avianca, LATAM, and AeroMexico each filed for chapter 11 protection in 2020, at the height of the COVID-19 pandemic; then followed by Philippine Airlines in September 2021; and GOL in January 2024.

1 Norton Rose Fulbright served as special aircraft finance counsel to SAS in its chapter 11 case.

Of course, chapter 11 is a famously restructuring friendly process. However, let's take a closer look at the aspects that are particularly attractive to an international air carrier:

Fleet Optimization

The keystone of a successful airline restructuring is the successful rightsizing of its fleet and restructuring of its fleet obligations. This involves phasing out older aircraft and introducing modern, more efficient models, as well as amending aircraft leases that are above the market rate. In this regard, these features of chapter 11 are most helpful:

- **Broad rejection powers:** Chapter 11 debtors have extraordinary latitude to "assume" (i.e. continue performing) or "reject" (i.e. get out of) leases and certain other contracts, based on the exercise of their reasonable business judgment. A counterparty's claim for rejection damages is treated as a non-priority "general unsecured claim." In SAS's case, the Bankruptcy Court approved SAS's rejection of leases for eight surplus aircraft and six spare engines.
- **Lease re-negotiation leverage:** Debtors can often leverage the threat of rejection to renegotiate agreements, especially when market conditions are unfavorable to the counterparty. Due to the lingering impact of COVID-19 and other factors in 2022 mentioned above, aircraft lessors may have had limited ability to secure alternative homes for certain aircraft. In this context, SAS renegotiated leases with respect to 59 aircraft with 15 lessors through its chapter 11 process, for annual cost savings of approximately US$98 million.
- **Disregard of lease return conditions:** Courts have held that, when a lease is rejected, debtors need not comply with contractual termination conditions as a priority administrative expense obligation (for example, relating to the state of returned aircraft and the manner of return) as it would "eviscerate" rejection provisions which are designed to assist the debtor to extricate itself from burdensome obligations. Indeed, in SAS, the parties entered into stipulations or the Bankruptcy Court entered orders whereby, upon rejection, SAS only needed to make leased aircraft equipment and related records available to lessors on an "as is, where is" basis. SAS was not required to make representations as to the state of the equipment or its title, nor undertake certifications, audits, or independent verification with respect to the records. Lessors were then obliged to retrieve the equipment within a specified timeframe of a few weeks. The rejection damage and return condition claims were pre-bankruptcy general unsecured claims. Similar stipulations and orders were agreed and entered into in the other recent foreign airline chapter 11 cases.

Foreign debtor friendly

Aviation is by nature a business with creditors and market participants located all around the globe. Chapter 11 is well-suited to such debtors due to the following:

- **Low eligibility threshold:** Subject to limited exceptions, a company may file for chapter 11 if it has ***any*** US asset (including a bank account or a retainer with an attorney or financial advisor). Eligibility was grounded through retainers and fee advance payments provided by SAS to certain professionals, leases for space and an airport lounge, and permits for gates and slots at various US airports, as well as 100% of the equity in a US based subsidiary that was a chapter 11 debtor.
- **Worldwide automatic stay:** Filing a chapter 11 case triggers the automatic stay, which, under US law, operates as an automatic injunction stopping almost all proceedings and acts against a debtor and their property located anywhere in the world.

Crossing borders of Bankruptcy Court jurisdiction

Despite the many advantages of the chapter 11 process, SAS undertook a separate Swedish reorganization to implement its plan with respect to its parent entity, SAS AB. This spotlights the potential parameters of the Bankruptcy Court's power with respect to non-US stakeholders and the types of strategies debtors may employ to nevertheless effect their reorganization.

Jurisdiction over foreign creditors

Chapter 11 is only an effective restructuring mechanism if creditors and other relevant parties are required to comply with orders of the US Bankruptcy Court (i.e. if they are subject to penalties for violating a court order). Generally, this can achieved in one of two ways: (a) if a foreign court recognizes and agrees to enforce the US Bankruptcy Court decision, or (b) if the US court has personal jurisdiction over the foreign creditor (e.g., authority to hold the party in contempt and assess and collect penalties). Overall, US Bankruptcy Courts can have "general" personal jurisdiction over persons with continuous and systematic business affiliations with the US or "specific" personal jurisdiction, if a party "purposefully directs [their] activities at residents of the forum" and the underlying claim arises out of such activities. A party may submit itself to the court's authority for personal jurisdiction in a number of ways, including by participating in the bankruptcy case.

If a debtor intends to bind important creditors in a country where prospects of recognition by the foreign court and the bases for personal jurisdiction (e.g. because the creditors' activities appear remote from the US and they do not voluntarily submit to US jurisdiction) are uncertain, commencing proceedings in the foreign country with respect to such creditors may be a safer option (depending on the insolvency laws of such country).

The commercial hybrid bonds Forbearance Agreement

SAS AB's Swedish reorganization may have been foreshadowed by SAS's entry into a Forbearance Agreement in February 2023, in connection with the commercial hybrid bonds issued by SAS AB in 2020 during the COVID-19 pandemic. Under the Forbearance Agreement, SAS AB agreed to pay certain legal advisor fees incurred by the bondholders' agent, in exchange for the agent's forbearance from taking certain legal actions against SAS. SAS informed the court that the agreement aimed to avoid disputes regarding (among other things) whether the agent was stayed from enforcing the bonds' terms and conditions against SAS in Sweden, and whether the agent was subject to US Bankruptcy Court jurisdiction. The Forbearance Agreement expressly provided that nothing in the agreement "shall be deemed to subject the agent or any bondholder to the jurisdiction of any US Court, including the Bankruptcy Court."

At the hearing approving SAS's entry into the Forbearance Agreement on February 22, 2023, Judge Wiles zeroed in on the key issue: "Are we going to have any issue in Sweden?"

While the Forbearance Agreement represented the parties' desire to avert immediate litigation on the issue, it also revealed that the Swedish commercial hybrid bondholders did not consider themselves bound by the Bankruptcy Court's orders, and were not inclined to voluntarily submit to such jurisdiction. Though it temporarily deferred the fight, the necessity for a Forbearance Agreement created uncertainty as to—as queried by Judge Wiles—whether "whatever I do under a plan of reorganization is going to be recognized?" i.e., how a chapter 11 plan would be enforced as to the Swedish bondholders. SAS responded that many alternatives were under consideration including recognition by the Swedish court, litigation, or a Swedish proceeding.

The Swedish reorganization

In the end, Judge Wiles's question as to the Swedish bondholders was ultimately answered by the Swedish reorganization. SAS's chapter 11 plan provided that the effectiveness of the plan was conditioned upon the successful reorganization of SAS AB under Swedish law. A week after SAS's chapter 11 plan was approved by the US Bankruptcy Court, SAS AB applied for reorganization under the Swedish Company Reorganization Act, on March 27, 2024.

This approach was not risk-free. As SAS cautioned in its chapter 11 plan disclosure statement, the Swedish Company Reorganization Act is not completely compatible with the Bankruptcy Code, including with respect to rules on class composition, voting thresholds, and the meaning of an "allowed claim." Accordingly, the Swedish reorganization may have resulted in outcomes for creditors misaligned with the US chapter 11 plan. In addition, parties not bound by the chapter 11 plan (e.g. the commercial hybrid bondholders, as asserted in the Forbearance Agreement) could challenge the Swedish reorganization of SAS AB or take actions against the other debtors.

Indeed, the agent for the commercial hybrid bondholders did object to the Swedish reorganization on several grounds, including that the bondholders suffered unequal treatment with respect to claims in the same category. Under the Swedish reorganization plan, the commercial hybrid bondholders would receive contingent value notes, while the Danish and Swedish states could expect to recover cash on account of their separately issued hybrid bonds. Fortunately for SAS, the objections were overruled. Not only did the Stockholm District Court clarify that the cash received by the States constituted contribution payments from the investor coalition and not distributions under the restructuring plan (and were therefore, not a reflection of creditor treatment), but it also determined that the agent lacked authority to represent the commercial hybrid bondholders under Swedish law.

On July 19, 2024, SAS AB's Swedish reorganization plan was approved on terms "materially consistent" with the chapter 11 plan, and pursuant to which SAS AB's existing common shares and listed commercial hybrid bonds were redeemed and cancelled, with new unlisted shares issued to the new investors and other creditors of SAS.

Denmark, Sweden and Norway - contractual cooperation

The Swedish bondholders were not SAS's only jurisdictional complication involving foreign parties. In SAS's chapter 11 plan, the Kingdom of Denmark (and one of SAS's new investors) expressed support of the plan, but indicated that it would not ***vote*** in support of the plan because it did not consent to the jurisdiction of the Bankruptcy Court. At the chapter 11 plan confirmation hearing on March 29, 2024, SAS clarified that while the Danish state was technically preserving certain jurisdiction-related rights, it had in fact entered a contract with SAS agreeing to the plan and releasing its rights to challenge it and that Swedish and Norwegian states also were signing similar agreements. At the end of the hearing, Judge Wiles praised the parties for "smoothly" navigating "the overlap of all the other different state authorities and jurisdictional issues."

Takeaways

The SAS chapter 11 case showcases both the main advantages for international airlines seeking US chapter 11 protection, but also limits of that process that must be addressed by the airline and its stakeholders. While the US Bankruptcy Code's contract restructuring tools are always attractive to aviation debtors to restructure their fleet, the effectiveness of those tools and any chapter 11 plan approved by the US Bankruptcy Court is contingent on the complex intersection of relevant parties, jurisdictions, market conditions, and the solutions debtors like SAS can devise to overcome such challenges.

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